Decision No. 37167

ORIGINAL

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CALIFORNIA STREET CABLE RAILROAD COMPANY for an order of the Railroad Commission of the State of California authorizing increases in fares.

Application No. 24486
Second Supplemental

ORRICK, DAHLQUIST, NEFF & HERRINGTON, by HILLYER BROWN, for Applicant

JOHN J. O'TOOLE, City Attorney, DION R. HOLM, Assistant City Attorney, PAUL BECK, Valuation Engineer, for the City and County of San Francisco

IVORES R. DAINS, for Market Street Railway Company, interested party.

SACHSE and CLARK, COMMISSIONERS:

FOURTH SUPPLEMENTAL OPINION AND ORDER

The Commission made four prior decisions and orders in this matter.(1) In Decision No. 35753 we authorized applicant to increase its basic fare from five to seven cents and school tickets from 20 for fifty cents to 16 for fifty cents, subject to the establishment of a universal transfer between applicant's lines and those of the Municipal Railway of San Francisco and the Market Street Railway. The decision said (supra, p. 11):

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(1) No. 35753 (Interim Opinion and Order) dated September 5, 1942;
No. 35798 (First Supplemental Order) dated September 23, 1942;
No. 35987 (Second Supplemental Opinion and Order) dated November 27, 1942; and
No. 36507 (Supplemental Opinion and Order) dated July 27, 1943.

"In reaching our conclusions in this matter we must give consideration to the value of service to the patrons of applicant. The average length of haul on the California Street Cable line is 1.03 miles, as compared to the average haul of 2.51 miles on the Municipal Railway and slightly over 3 miles on the Market Street Railway. However, at the hearing on June 22, 1942 applicant stated it was willing to put into effect a universal transfer between the Municipal and Market Street lines. With the universal transfer the value of service is materially increased. Our order will be conditioned upon applicant placing in effect a universal transfer."

Applicant was unable to put the universal transfer plan into effect and proposed a changed and less extensive transfer arrangement. This transfer plan reduced the service available to applicant's patrons below that contemplated in Decision No. 35753. In Decision No. 35987 the Commission modified its original interim order, authorized the lesser transfer privilege and permitted an increase in the basic fare from five to six cents. This fare and transfer service were put into effect on December 1, 1942.

On May 28, 1943 applicant filed its supplemental petition asking that the transfer privileges be further curtailed so as to conform to those in effect prior to December 1, 1942 under the five-cent fare. The program of a complete or partial universal transfer was abandoned. The application was granted by the Commission in Decision No. 36507 and the basic six-cent fare was left unchanged. This decision was placed into effect on August 9, 1943. The Commission said:

"The Commission in its Second Supplemental Opinion and Order, Decision No. 35987, permitted the adoption of the modified transfer plan, together with a basic 6-cent fare. If now we allow a further curtailment of the transfer privilege the result will be, on the one hand, a further lessening of this street railway's usefulness as a link in San Francisco's over-all local transportation system (which should be accessible through transfer to all riders, irrespective of originating line), together with a further reduction in its very short average haul per revenue rider and, on

> the other hand, some increase in applicant's gross and net revenue (perhaps as much as $500 per month net), together with some improvement in the service and the convenience to the regular revenue riders of the Cable line. Weighing these pros and cons, we conclude that the supplemental application should be granted pending further efforts to secure for San Francisco what is so urgently needed at this time; viz., a unified and city-wide mass transportation system with a uniform fare structure embracing all of the Municipal, the Market Street and applicant's lines."

Applicant, on October 30, 1943 filed its second supplemental application requesting authority to increase its basic fare from six cents to seven cents without any extension of transfer privileges or service. Applicant contends that in spite of being relieved of the burden of the original and the modified transfer plan and in spite of economical operation of its railway it is unable to pay its operating expenses and secure a fair return on its investment at the six-cent fare and that, therefore, the six-cent fare is unreasonable and inequitable.

Public hearings were held in San Francisco on February 25, March 13 and March 15, 1944, when further testimony was introduced by applicant and by the Commission's staff.(2) The matter was submitted and is now ready for decision.

The question to be decided is whether a further fare increase from six to seven cents is necessary, equitable and reasonable in view of the character, extent and quality of the service rendered the public and in view of applicant's financial condition and requirements. With reference to applicant's financial situation we shall

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(2) The principal staff exhibits were exhibit 39 "Report on California Street Cable Railway Company" by C. W. Mors, transportation research engineer, and T. J. Canty, associate transportation engineer, and exhibit 43 "Memorandum" by G. F. Conroy, assistant transportation engineer, on service and maintenance of California Street Cable Railway Company.

give consideration, on the basis of the record, to operating revenue and expenses, net revenue, traffic, past and present earnings, the type and condition of its transportation equipment and operation, the competing streetcar systems in San Francisco and the need of a reasonable forecast of what applicant's situation will be in the near future.

Revenue, Expenses and Traffic:

The financial results of applicant's operations, as shown on its books, for the last ten years are shown in detail in exhibits 11 and 39, from which the following figures are taken:

Year	Operating Revenue	Operating Expenses*	Taxes	Total Operating Expenses and Taxes	Non-Operating Income**	Net Income
1934	$351,306	$334,513	$18,971	$353,484	$ 9,030	$ 6,852
1935	368,968	358,975	16,862	375,837	10,592	3,723
1936	393,785	364,574	23,332	387,906	9,410	15,289
1937	405,992	385,566	21,132	406,698	9,265	8,559
1938	439,253	396,581	23,455	420,036	9,206	28,423
1939	496,725	419,296	26,241	445,537	10,038	61,226
1940	469,657	455,250	27,788	483,038	10,500	(2,881)
1941	451,007	444,997	23,425	468,422	9,332	(8,083)
1942	490,275	477,854	20,823	498,677	4,743	(3,659)
1943	520,432	506,521	20,501	527,022	6,558	(32)

(____) Red Figure

* Includes depreciation.
** Includes income from bonds, rents of restaurant and cigar stand and miscellaneous items.

Applicant's estimate of operating revenue for 1944, under the six-cent fare, is $503,969 (Exh. 36) and a similar estimate by our staff is $521,457. The operating revenue of a street railway at a given rate of fare depends, of course, on the number of revenue passengers carried, and that number in turn is dependent in large measure on the extent and quantity of service available as expressed in terms of number of cars operated, car miles and car hours. If, in this time of increasing demand for service, fewer cars are operated and the number of car hours and car miles declines, the result is, on the one hand, greater congestion and poorer service and, on the other hand, an increasing loss in passengers and in revenue. The next tabulation reflects these conditions on applicant's line during the last six years:

Operating Data-1938 to 1943

Period	Revenue Passengers	Car Miles	Car Hours	Passenger Revenue
1938	8,797,118	1,145,143	159,190	$438,157
1939	9,956,753	1,145,143	159,190	495,518
1940	9,423,788	1,148,280	159,627	468,896
1941	9,033,596	929,596	146,232	449,667
1942	9,611,590	814,206	130,726	487,165
1943	8,667,985	656,745	104,129	518,624

There are in evidence in Exhibit 39 and in the transcript the corresponding monthly figures for 1942 and 1943 and for January and February, 1944.(3) The figures show that the highest number of revenue

(3) Exhibit 39 shows revenue passengers and passenger revenue, by months, from October, 1942 (month of highest number of revenue passengers) to January and February, 1944, as follows:

Year & Month	Revenue Passengers	Passenger Revenues
1942		
Oct.	893,982	$ 44,557.95
Nov.	813,578	40,535.60
Dec.	836,917	50,015.47
1943		
Jan.	784,897	$ 46,954.92
Feb.	746,080	44,601.92
Mar.	715,496*	42,778.59
Apr.	736,228	44,036.15
May	694,273	41,497.36
June	707,944	42,340.39
July	698,898	41,807.33
Aug.	700,867	41,954.81
Sept.	701,227	42,120.50
Oct.	738,604	44,165.52
Nov.	717,410	42,936.31
Dec.	726,061	43,430.13
1944		
Jan.	697,934	$ 41,730.56
Feb.	686,269 (Tr.411)	not in record

* Walkout of employees on March 8 and 9; cars did not operate.

passengers (893,982) was carried in October, 1942, producing in that month passenger revenue in the amount of $44,558. After the fare increase authorized in Decision No. 35987 took effect on December 1, 1942, there were only three months when the receipts of passenger revenue exceeded the five-cent fare receipts of October, 1942 (in December, 1942 the receipts were $50,015; in January, 1943 they were $46,955; and in February, 1943 they were $44,602). There followed a gradual, though not uniform, decline in the revenue passengers which reduced the number of 893,982 of October, 1942, before the rate increase, to 697,934 in January and 686,269 in February, 1944. This represents a decline of more than 200,000 revenue passengers per month, or approximately 23 per cent. The rate increase, notwithstanding the increasing demand for wartime service, did not bring the desired result. Instead of increasing the passenger revenue, the receipts actually declined and in January, 1944, amounted to $41,731 compared with $44,558 in October, 1942 under the five-cent fare.

The dollar, traffic and operating figures above referred to are deserving of careful study and analysis. They are conclusive in their refutation of the oversimplified argument that the sole remedy for unsatisfactory revenues and profits is higher fares. In this case the higher fare is producing a smaller income than would be received from the lower five-cent fare. This is apparent when the loss of passengers subsequent to the charging of higher rates is taken into consideration. In addition, the higher fare, contrary to the claims and expectations presented to the Commission in these proceedings, has not benefited applicant's patrons by improved service, but has been accompanied by reduced and poorer transportation and by greater congestion and increased inconvenience of the car-riders. The record leaves no doubt on these points, as will be shown below under the reference to service.

Applicant urges that increasing operating costs can only be met by a further increase in the fare, regardless of adequacy, extent and quality of the service rendered by its cable railway. Operating expenses, including cable renewals, but exclusive of depreciation and taxes, applicant points out, have increased from $428,036 in 1941 to $489,942 in 1943 and are expected to increase further in 1944, under the six-cent fare, to $500,375. The latter figure includes an estimated prospective wage increase, subject to War Labor Board approval, of $24,400 per year. Applicant's estimate of 1944 operating costs, (Exh. 36) is subject to comment and revision and exception was taken by the Commission's engineers to a number of operating expense items. The items in question and their disposition are shown in the margin.(4) Summarizing by groups of accounts, the 1944 operating expense claims of applicant

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(4) The operating expense items are designated by their account classifications.

1. Rail Fastenings and Joints. Applicant's estimate for this item for 1944 is $1,678, compared with a recorded expense for 1943 of $1,378. The record shows that the actual expenses for this item in the four years prior to 1943 were: 1939, $370; 1940, $490; 1941, $257; 1942, $237. Corresponding figures for the five-year period prior to 1939 show that the highest expense for this item (in 1936) was $730 and the lowest (in 1937) was $227. Applicant's witness testified that the marked increase in expense subsequent to 1942 was due to a program of rail corrugation elimination. The corrugation has accumulated over a period of prior years. It does not appear reasonable to combine this expense in a short operating period and during a period of extreme labor shortage. Neither is it certain that this work will be continued at the 1943 rate or at an increased rate. At the time of the last hearing in this proceeding and several months prior thereto no such work had been carried on. The Commission's engineer's testimony was that an estimate of $1,000 would be reasonable for 1944 and such an allowance will be made.

2. Underground Construction. Applicant's 1944 estimate for this item is $6,681, the same amount as in 1943. According to the testimony of the Commission's witness the pulley

and the allowances made by us compare as follows:

Expense Group	Company	Commission
Way and Structures	$ 39,657	$ 27,493
Equipment	38,270	33,646
Power	62,179	62,797
Conducting Transportation	256,414*	251,523*
General and Miscellaneous	79,455	65,238
Total	$475,975*	$440,697*

* Not including $24,400 prospective wage increases, on annual basis.

(Footnote 4 cont'd)

installation, principally represented by this expenditure, is nearing completion and the estimated expense for this item made by the Commission's engineer of $5,000 will be allowed. It should be noted that this expense item in the four years 1939, 1940, 1941 and 1942 was, respectively, $1,684, $1,227, $2,168, and $7,179.

3. Track and Roadway Labor is estimated, in accordance with the testimony of the Commission's witness, in an amount corresponding to the recorded expenses for 1943, namely, $10,229, less $2,040 for an accounting reclassification, or $8,189.

4. Paving. Applicant includes in its 1944 estimate $6,000 for this item and a similar amount is shown in the recorded expenses for 1943. It appears from the testimony that these amounts do not represent actual expenditures but are intended to be considered as a paving reserve. A comparison of this theoretical expense with the actual cash expenditures for this expense item during the last five years is significant. The actual expenditures were: 1939, $214; 1940, $171; 1941, $638; 1942, $79; and 1943, $435. In the five-year period prior to 1939 the highest expense per year (in 1934) was $443. Our 1944 estimate for this item will be taken at the 1943 actual expense figure in the amount of $435.

5. Passenger and Combination Cars. Applicant's estimate of $34,624 for 1944 corresponds to the amount of the recorded expense for this item in 1943. The record shows that there will be fewer cars painted this year than were painted last year. In addition, it is in evidence that out of a total of 31 cars classed as operative, only 20 cars were in service as of the date of the last hearing. The record shows further that the operating expense for this item in the four years 1939 to 1942, inclusive, was $21,034 (1939), $19,337 (1940), $23,444 (1941), and $32,856 (1942). In the five-year period prior to 1939 this expense averaged less than $18,000 per year. In the 1944 estimate $30,000 will be included for this item.

6. Cable Expense. Applicant's 1944 estimate includes $32,760 for "replacement of cables" under this account. This amount is similar to the recorded expense in 1943. Cable is a large item of total plant investment and one of the largest of all of the operating expense accounts. Applicant employs a practice of "cable adjustment", i.e., averaging the total cost of all cable as an operating expense over a short indeterminate period of time, so that the total cable investment on December 31, 1943 appears on the books in the disproportionately small amount of $8,217. The actual investment, or depreciated investment, of all cable in operation

Depreciation

We are here concerned with depreciation as an operating expense and the amount to be included in the 1944 estimate. Much

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(Footnote 4 cont'd)

on that date is unquestionably much larger. If the "adjustment" is spread over a longer period, the average annual operating expense charge will be correspondingly smaller. A more reasonable average annual expense for this item appears to be the adjustment figure used by applicant prior to 1940, in the neighborhood of $25,000. Recognizing the present increased cost of cable and its short service life we shall allow cable expense in the amount of $30,000 in the 1944 estimate. The same amount would have been a proper charge in 1943. This adjustment increases applicant's net revenue in 1943 and 1944 annually by $2,760.

7. Power Purchased. This is shown by applicant in the 1944 estimate at $17,473, corresponding to the 1943 recorded expense. The record shows that service has been curtailed and less power will be used in 1944 than in 1943. The estimated expense for this item has accordingly been adjusted to the amount of $16,711. Increased service may increase this expense, but would also result in greater revenue.

8. Conductors and Gripmen. This item is estimated by applicant for 1944 in the amount of $205,271, as compared with the recorded expense of $216,583 for 1943. The reduction is accounted for by the reduced service being rendered and it is questionable whether full allowance for service reduction is reflected in applicant's figure. Applicant's estimate will be left unchanged. We have, in addition, allowed the sum of $24,400 for proposed wage increases.

9. Miscellaneous Car Service Expenses. This item appears in the 1944 company estimate in the amount of $5,859 corresponding to a similar amount in 1943. The expense chargeable to the item in 1939 is $701, in 1940 $755, in 1941 $1,123, and in 1942 $1,920. The disproportionate increase in 1943 and 1944 is due largely to overtime payments and to advertising for help expenses. The record indicates that as a consequence of increased wages and a more favorable employment situation, the expenses in this account will be reduced and overtime payments will be lessened. Having these considerations in mind, the estimate for 1944 for this item will be taken at the average of the annual figures for 1941, 1942, and 1943 in an amount of $2,968.

10. Carhouse Employees. In accordance with the testimony of the Commission's witness, there is allowed $16,724, corresponding to a similar amount in 1943.

11. Pensions and Gratuities. Applicant includes this item in the 1944 estimate in the amount of $9,000. In the year 1943 there was a charge to this account of $9,352. The allowance for 1943 and the estimate for 1944 are not intended to reflect actual payments in pensions and gratuities to the company's employees, but are transfers into an "Employees' Benefit Fund" established by the company in 1942. Applicant's board of directors, on February 2,

testimony is in the record on this subject. The depreciation, amortization and obsolescence problem presents itself in this cable

(Footnote 4 cont'd)

1942, authorized "the payment of the sum of Five Hundred Dollars ($500.00) from the funds of this corporation......to the trustees hereinafter appointed, to be held and applied by said trustees for the benefit, relief and assistance of the employees and individuals described in the 'Agreement of Trust' hereinafter in these resolutions set forth." By a further resolution of the board a monthly payment of $500, commencing with March, 1942, was authorized to be made into the benefit fund and the monthly contribution was increased to $750 in October, 1942. The record shows that applicant assumes no obligation for specific pensions or benefits to any of its employees and that all benefit payments are discretionary with the benefit committee both as to amount and duration. The actual payments of pensions and gratuities, and charged to the appropriate Account No. 88 in the past, were as follows: in 1934, $600; in 1935, $125. No expenditures were made in 1936, 1937, 1938, and 1939. In 1940 an actual cost of $900 is shown against this account. The cost for 1941 was $4,102, including a payment to the former president of $3,400.

In view of the character and language of the agreement under which applicant's benefit fund operates, and in view of the company's past practices in the matter of pensions and gratuities to its employees, we are of the opinion that the Commission should make full allowance in operating expenses for such pensions, gratuities and benefits as the company is actually paying to its employees. We believe that such actual expenses are not an unreasonable or unfair charge to be assessed against applicant's patrons and to be borne as a reasonable and justifiable operating expense by the car-riders.

It is to be noted that although the company has in past years been extremely successful financially and has been able out of operating revenues to repay in its entirety the total investment in its property and all of its debt, pay continuous dividends on its stock, and, in addition, accumulate a substantial surplus, applicant has not seen fit to make any contribution, out of its net earnings or out of its surplus, to any pension or other fund operating for the benefit of its employees. The small gratuities that have been paid in the past were all charged to operating expenses and were paid, consequently, not by the owners of the company but by the car-riders. Under the terms of the agreement (Exh. 37) it is contemplated that the car-riders continue to meet all contributions to be made to the fund without any aid by applicant out of its net earnings or out of its surplus.

We are unable, in view of this company's history and in view of its uncertain and unsatisfactory prospects for the future, and having in mind the provisions contained in exhibit 37, to recommend that the Commission at this time estimate and allow a charge to operating expenses greatly in excess of any pension or gratuities payments the company has made at any time in the past, is making at the present time, and is likely to make in the discernible future. We desire to go on record stating that we, in accord with the established policy of the Commission, are in favor of genuine pension or benefit systems designed to operate with certainty to the advantage and benefit of utility employees. It is our belief, however, that, having in mind the specific conditions and circumstances of each utility, the total burden of contributions to a proper pension or railroad in several aspects. The first question is, should the Commission require from the rate payers a continuing payment for depreciation expense, as a part of applicant's operating costs and distinguished from net earnings and rate of return, when this company has been fully reimbursed for its total investment in its

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(Footnote 4 cont'd)

benefit fund should not be borne exclusively by the rate payers but that such burden should be fairly distributed between the beneficiaries, including the utility, its owners and stockholders, the utility employees and the rate paying public.

The record here shows that the actual prospective pension and gratuities expenditures for 1944 will amount to $972, consisting of three items, namely, pensions $420, compensation insurance adjustments $352, and gratuities $200. We shall include in the 1944 estimate for this account the sum of $1,000 which, according to the record, is an amount in excess of the actual annual payments made to company beneficiaries at this time.

12. Injuries, Damages, and Insurance. These two operating expense accounts should be considered together. Applicant's estimate for 1944 is $33,953 for injuries and damages and $9,831 for insurance, a total of $43,784. There has been a very large increase in these expense items since 1939. In the next four years these expenses increased as follows:

Year	Injuries and Damages-Personal	Insurance
1939	$10,132	$3,392
1940	28,203	3,386
1941	30,190	5,342
1942	28,796	9,449
1943	39,109	9,831

In 1941 applicant made a change in its insurance coverage for personal injuries which accounts for the increased insurance expense in subsequent years. Although the present expenses under this item must be considered abnormal (also because of several severe and costly recent accidents) and might properly be spread over a reasonable number of years, allowance will be made in the 1944 estimate for this item in the amount of $37,567, consisting of the following items: $26,767 in injuries and damages-personal (average of 1940 to 1943 period under present insurance policy); injuries and damages-property, $969 (average 1940 to 1943, inclusive); insurance, $9,831 (as in 1943).

depreciable property and in addition has received net profits at a fair rate of return, or higher?

The expense of depreciation, in addition to ordinary maintenance and repair expenses, is an operating cost. This cost is prior to and must be differentiated from net earnings (profits) available for fixed charges, dividends and surplus. The United States Supreme Court has so held in numerous decisions; commissions have uniformly followed the rulings of the courts in this respect, and the prescribed utility accounting systems uniformly classify depreciation as one of the costs of operation. Actual net earnings can correctly be computed only after allowance for the expense of depreciation is included in the operating costs. See C.R.C. Decision No. 36909, Vallejo Electric Light and Power Company.

A large part of this cable railroad is more than fifty years old. At the present time the entire physical property is unquestionably obsolete.(5) A modern motor coach or trolley

(5) In Decision No. 35753 the Commission said:

> "Although the record affords no enlightenment upon the subject, other than a statement by applicant's witness that in his estimation increasing fares was the only solution to the company's problem, it appears obvious from the records filed currently with this Commission that the type of operation performed by this carrier is extremely costly; especially when compared with a similar or improved standard of service that might be realized through substitution of the conventional type of internal combustion motor coach or the electrically propelled rubber-tired trolley coach."

And further:

> "Under average operating conditions the cost per vehicle mile, including depreciation and taxes, ranges from 20 cents to 25 cents, whereas the cost per car mile of cable operation as shown above, was slightly in excess of 42 cents for the year 1940. By comparison it would appear that a motor coach or electric trolley coach operation could be substituted for the present cable lines and, with the present fare structure, produce an ample return upon the required investment."

operation, with greatly reduced operating costs, could have been installed before the war but must now await the time when such equipment is again available.

The first section of the cable railroad was built in 1878 and the present company was organized in 1884. A large part of the property was destroyed by fire in 1906 and thereafter rebuilt. The interesting history of the road is reviewed by witness Jenkins, transportation research engineer of the Commission, in exhibit 11. Applicant could have no cause for complaint if all of its investment in depreciable property were repaid and returned to the owners, as part of operating expenses, and if after such complete reimbursement no further depreciation allowance were included in the cost of operation. (C.R.C. Decision 36909, supra)(6) See also Federal Power Commission v. Hope Natural Gas Company, 88 L. ed. 276, 285, and Lindheimer v. Illinois Bell Telephone Company, 292 U.S. 150, 166-169, which cases hold that one full depreciation is all that a utility is entitled to.

Exhibits 11 and 39 show that prior to 1911 the company made no provision for depreciation and had no depreciation reserve. Obviously, however, depreciation was a fact then as now and was actively consuming applicant's property prior to that year in the

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(6) The Commission in Decision 36909 said:

"Commissions and courts have clearly distinguished in this respect between operating expenses and net income (the fair return), the latter representing profit and depending upon the rate of return. The cost of future depreciation on the portion of the plant remaining to be depreciated must be paid by present and future consumers and allowance for that cost will be made in the rates. But when the total plant or a portion of the plant has fully depreciated, and payment has been made by the rate payers in operating expenses for such depreciation, the law does not require the setting up of a second or third depreciation reserve for the same items of property. When the cost, or investment, is returned in full to the owner, surely no further contribution for depreciation should be exacted from the rate payers. The Public Utilities Act places the duty on this Commission to make certain that this practice does not obtain in utilities operating in California (Sections 13 and 49 of the Public Utilities Act)."

same manner as it would subsequently, regardless of whether or not the accounting records recognized the fact. In the early years of operation and subsequently, including the period to 1925, during which period, according to witness Jenkins (Exh. 11), "the earnings of this company were phenomenal," there is no question whatever that all operating costs, including the full cost of depreciation, were earned and, in addition, a high rate of return on the investment. Exhibit 11 shows that (p. 83):

> "From 1884 up to and including the year 1941, dividends in total amount of $3,373,000 were paid to the stockholders of this company. On the basis of an annually reducing investment balance, $2,974,673 of that amount represents the excess paid to stockholders over and above a six per cent return on remaining investment. On the basis of a non-reducing balance, $1,313,300 was paid in excess of six per cent return over the entire period of years."

There is doubt, because of the property's long history and the absence of reliable accounting records in the first twenty-five or thirty years of operation, of the actual cash investment and the amount of depreciable property against which annual depreciation allowances should have been accumulated. The maximum amount is the total of the existing depreciable property at the time of the hearings in this application. This amount is shown in exhibit 39, table 8-2, exclusive of fully depreciated property,[7] as "company book cost" in the sum of $1,469,949, as of December 31, 1943. A smaller and different investment figure is shown in exhibit 11, viz. "The total investment of stockholders in the property amounts to only $600,000. There is no bonded indebtedness at the present time. The $900,000 issue of January 1, 1890, has been redeemed

(7) It is to be noted that applicant here recognizes the impropriety of continuing depreciation charges against "fully depreciated property."

through earnings of the property." Applicant's depreciation reserve on December 31, 1943 is shown on its books at $630,941.

Whether the larger or the smaller figure be taken as the base figure of applicant's depreciable property, the record is convincing that the total amount has long since been returned to the owners in cash and, in addition, there was earned a fair return on the owners' investment (Tables 1 and 1A, Exh. 11). Witness Jenkins, in exhibit 11, says:

> "Since 1884 dividends have been paid to stockholders each year, except 1907, aggregating up to and including 1941 a total amount of $3,373,000, representing an average annual payment of $58,743 and an average rate of 9.8 per cent on the stockholders' investment. Assuming the excess of dividend payments over 6 per cent on the investment balance to be applied as a return to the stockholder of his investment, the entire $600,000 item was returned out of dividends by 1903, and subsequent to that time $2,196,000 of additional dividends have been paid."

Witness Canty, associate engineer of the Commission, at the March, 1944 hearings, produced a theoretical depreciation estimate in exhibit 39 (Table 8-2). This estimate takes as its base applicant's book cost as of December 31, 1943 and ignores the property's actual depreciation experience. Instead, the estimate assumes various lives for the several classes of property, resulting in a composite estimated life of fifty-four years. Witness Canty says:

> "Based upon the assumption that this company's operations will be converted to motor coach or trolley coach service at the end of five years, the present accrued depreciation has been developed in Table 8-2. Applying straight-line depreciation rates consistent with this assumption to the book investment in each depreciable property account as of December 31, 1943, yields an estimated depreciation expense of $30,803 for the year 1944."

The witness's assumption as to the remaining life of this property is, of course, altogether speculative. It may be that in five years this obsolete cable railroad will have been abandoned and a modern, economical method of transportation substituted. Its remaining life may also be longer. We need not, however, resort to speculation in this instance and prefer to base this decision, wherever possible, on fact rather than assumption.

The status of this cable railroad with reference to depreciation, retirements and replacements is unusual. Practically no retirements and replacements affecting the depreciation reserve are being made. The total amount of property retired and charged against the reserve in the eighteen years from 1926 to 1943, inclusive, was $9,062.83. During the same period the depreciation reserve increased from $209,739 to $630,941. The total of additions and betterments to the property from 1924 to 1943, inclusive, was $12,968.26. The largest depreciation item, Cable Expense, Account 47-A, is not treated by applicant as a depreciation expense but as a direct operating expense item and proper allowance is made by us for this cost in the operating expense estimate.

The facts relating to past depreciation are sufficiently available and reliable. Adhering to the established policy of this Commission of not requiring further depreciation contributions from rate payers when the cost of investment in depreciable property has been returned in full, as part of operating expenses, to utility owners, we find that such reimbursement has been made to applicant for a large portion of its property and it is our conclusion that on the basis of this record no additional allowance for depreciation should be included in applicant's operating expense accounts for such fully reimbursed investment at this time. A depreciation allowance for investment not fully repaid to the owners will be made. A small portion of depreciable investment, in an amount not to exceed $65,000, may be considered as remaining subject to depreciation at an annual allowance of not more than $2,500, and such allowance will be included in the 1944 operating expense estimate. Any new and additional capital investment applicant may make in the future for depreciable operative property will be, of course, also subject to depreciation and a proper reserve may be set up against such property.

In declining to allow further depreciation expenses for property fully depreciated in the past, we desire to point out that we are here not dealing with the question of the return on such property. That matter will have consideration subsequently.

Estimated Operating Results for 1944 and Actual Results for 1943

Our conclusion as to operating results to be expected in 1944 under a six-cent fare is as follows:

Operating Revenue		$521,457
Operating Expenses	$440,697	
Allowance for Wage Increases	24,400	
Depreciation	2,500	
Taxes	27,560	
Total Operating Expenses		495,157
Net Operating Income		$ 26,300

The allowance for wage increases is made on the basis of the testimony of applicant's president, Mr. Coleman, that the company had agreed with its platform employees on the main points of a new contract providing for increase in wages and improvement in working conditions. He stated that the pending increase had yet to be approved by the War Labor Board. Witness Canty testified that if applicant would employ twelve additional full-time platform men, thus providing for necessary additional service, there would be a probable annual increase in net operating income, before Federal income taxes, of $8,700.

The corrections and adjustments made by us in applicant's 1944 operating expense estimate apply to a certain extent also to the 1943 expenses as shown in exhibit 36 and on the company's books. Applicant's 1943 annual report to the Commission lists net operating revenue before taxes as $15,538.93; operating income after taxes as $4,962.55 (deficit), and gross income, after inclusion of $4,540 income from securities and accounts, as $422.55 (deficit). On applicant's exhibit 36 is shown a 1943 operating loss of $6,680.55.

The company's records do not indicate the true results of the 1943 operation for the reason that the actual operating expenses are overstated and certain revenue from rent of operating property has not been included in operating revenue. The net operating revenue is correspondingly understated. A comparison of the amounts actually expended for paving and pensions and gratuities with the amounts shown on the books, and the effect of the differences, together with the adjustments in cable expense and operating revenue, upon net operating revenue is as follows:

Account	Actually Expended	Shown On Books	Difference
Paving	$ 435	$ 6,000*	
Pensions and Gratuities	2,510#	9,352	
	$2,945	$15,352	$12,407
Add: Reduction in cable expense			2,760
Adjustment of operating revenue			1,710
Increase in net operating revenue			$16,877

* Considered by applicant as "paving reserve."
\# Includes a nonrecurring payment of $1,650.

Revising applicant's income statement for 1943 (Exh. 36) as adjusted above and without any other operating expense adjustments, produces the following operating results:

Item	Applicant's Statement	Revised Statement
Total Revenue from Operations	$520,431.51	$522,141.51
Operating Expenses		
Way and Structures	51,816.72	46,251.72
Equipment	38,513.26	38,513.26
Power	62,873.89	60,113.89
Conducting Transportation	265,726.59	265,726.59
General & Miscellaneous	46,551.19	39,708.73
Injuries and Damages	41,128.93	41,128.93
Total Operating Expenses	506,610.58	491,443.12
Taxes	20,501.48	20,501.48*
Total Expenses	527,112.06	511,944.60
Net Operating Revenue	$ (6,680.55)	$ 10,196.91

( ) Loss

* This amount includes no income taxes. If the operating expenses had been recorded on the company's books as here adjusted it is probable that a small income tax would have resulted.

Rate Base and Rate of Return

The Commission in a proceeding of this nature is not required to use a specific formula in determining just, fair and reasonable rates. The United States Supreme Court in Federal Power Commission v. Hope Natural Gas Company says:

> "We held in Federal Power Commission v. Natural Gas Pipeline Co., supra, that the Commission was not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' Id., p. 586. And when the Commission's order is challenged in the courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Id., p. 586. Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. Cf. Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U.S. 287, 304-305, 314; West Ohio Gas Co. v. Commission (No. 1) 294 U.S. 63, 70; West v. Chesapeake & Potomac Tel. Co. 295 U.S. 662, 692-693 (dissenting opinion). It is not theory but the impact of the rate order which counts.

<u>If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.</u> The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences. Cf. <u>Railroad Commission</u> v. <u>Cumberland Tel. & T. Co</u>., 212 U.S. 414; <u>Lindheimer v. Illinois Tel. Co</u>., <u>supra</u>, pp. 164, 169; <u>Railroad Commission</u> v. <u>Pacific Gas & E. Co</u>., 302 U.S. 388, 401." (Emphasis supplied.)

We desire, however, to state clearly the basis upon which our decision rests and what factors were given consideration in reaching our conclusion. Reference is made in Decision No. 35753 to applicant's investment, according to its books, and to its financial structure. The minimum rate base claimed by applicant in the hearing on the supplemental petition (Tr. 600) is $600,000. Witness Jenkins (Exhibit 11) says:

"Gauging the reasonable rate of return of a utility upon the historical reproduction cost of physical properties, with sinking fund depreciation allowed in operating expenses, may be equitable when applied to certain types of utilities, but with respect to this company application of that theory cannot be justified. Such procedure requires that depreciation annuities be either invested in interest-bearing securities or be reinvested in the plant so that at the end of the service life of the property the accumulated depreciation reserve plus accumulated compound interest thereon will have built up to a sufficient fund to either rebuild the property for continued operation or return to the investor his equity. There has been practically no expansion of this cable railway system since it was rebuilt after the fire of 1906 and, furthermore as pointed out above, after allowing a six per cent return on the entire stockholders' investment even on a non-reducing balance the entire $600,000 was returned by 1906. There are no outstanding bonds against the property."

And further:

"When considering this property in the light of the impressive financial advantage of modernization through substitution of motor coaches or electric trolley coaches, it is already obsolete and its remaining service life should be considered as no longer than the time required to obtain adequate equipment and facilities to make the conversion. These elements should be given due consideration in a determination of the financial requirements of this property."

Witness Canty, in exhibits 39 and 40, on his assumption that the present cable railroad service would be discontinued in five years and bus or trolley coach service substituted, estimates the depreciated book cost as of December 31, 1943, with land included at present market value, in the sum of $226,000, and uses this figure as a rate base.

There is also in evidence the valuation for tax purposes of the State Board of Equalization for the year 1943, as follows:

Land		
Hyde and California Street property	$33,600	$
Hyde and Beach Street property	190	33,790
Main Track*	71,200	
Office Building	1,400	
Shops and Carhouse	11,740	
Convenience Station (Hyde and Beach)	70	
Power Plant Machinery	7,160	91,570
Shop Equipment	100	
All Track#	1,570	
Rolling Stock	18,060	19,750
Grand Total		$145,000

* Includes engineering, grading, special work, underground construction, track and roadway labor, paving, etc.

\# Rails, rail fastenings, and joints

The record contains, therefore, a wide range of investment, valuation and rate base figures. Applicant's financial history must also be given consideration, including the fact of dividends having been paid up to and including 1943 in the total amount of $3,418,000. The entire cost of all depreciable property has been returned to the owners as part of operating costs as an expense of depreciation. In addition, a $900,000 bond issue has been retired out of earnings. The owners have received over the entire period of operation a high average rate of return on their total undepreciated cash investment.

While we may not ignore this past record, we must recognize the fact that applicant's railroad in its depreciated and obsolete condition is still in existence and furnishing service of its character, extent and quality. We think applicant is entitled to just compensation, through the charging of a just and reasonable rate, for the use of its present property even though a better and modern substitute could for a number of years past have given a much superior service at a much lower cost and applicant was aware of that fact. Our estimate of 1944 operating results produces a net revenue of $26,300, equivalent to a rate of return of five per cent on a rate base of $526,000. We make no finding of such a rate base believing the figure to be greatly in excess of the present fair market value of this property. The earning value of the property is not a proper measure of a rate base and earnings here are only partly dependent upon the rate to be fixed. The estimated net return is clearly sufficient, however, to meet applicant's needs and to enable the continuance of a service better than the present service and with the six-cent fare remaining in effect.

Regarded from the viewpoint of applicant's financial requirements the 1943 profit and loss statement in the annual report shows the following conditions:

Profit Balance at beginning of year 1943	$	$531,325.43
Miscellaneous credits and debits	798.79	
Dividends paid on common stock	21,000.00	21,798.79
Profit Balance on December 31, 1943		$509,526.64

Applicant has no funded or unfunded indebtedness and there are no interest charges. A dividend of $2.10 per share was paid on the total issued and outstanding common stock of 10,000 shares. At the end of 1943 the total profit balance was $509,526.64. This is a static utility; no expansion has taken place since 1891 and practically no additions or betterments have been or are being made. The total additions for the period from 1924 to 1943, as previously mentioned, amounted to only $12,968. Total retirements during the same period were $9,063.[8] No new capital is required. Abandonment of the present obsolete and expensive operation and substitution of a modern transportation plant could be so profitable that it could be financed out of operating savings and increased earnings in the space of a few years (Exhs. 11 and 39).

Service

Applicant takes issue with the conclusion of the Commission that the value of the service to the car-riders must have consideration in fixing the rate. Counsel for applicant filed a "Memorandum on Value of the Service as a Factor in Rates" and concludes as follows:

> "It thus appears to be definitely established that value of the service cannot prevail over cost of service in fixing rates. Furthermore, both authority and common sense demonstrate that when a mass of consumers is willing to pay a certain price to ride on the street car, no one can say that the value of the service is less than this price. The attempt to use the value of the service theory in establishing a rate which is below cost (including a reasonable return) and also below what the consumer will pay must fail both because it would result in the illegal confiscation of the utilities property and because no reasonable standard to measure the value of service is available."

We are not in accord with this view. The argument that the value of a utility service should have no bearing on the price paid for such service is contradicted not only in the Public Utilities Act and the decisions of the courts, but also by the every-day realities of rate making and rate paying. A longer ride is worth more than a shorter ride and usually costs more, and rates are made on that basis. This principle is not lost sight of even when rates are blanketed throughout a uniform rate area. The rate payer in the same category of service must pay more for a larger quantity of electricity or gas than for a smaller, and this Commission has fixed different rates for gas

(8) There were also "cleared" from road and equipment account in 1933 certain "fully depreciated" items totaling $67,175.18.

of a lower as compared with a higher heating value. The point need not be labored.

When in this case we speak of value of the service, we mean the extent, character and quality of the transportation furnished by applicant's cable railroad as compared with the transportation service furnished by other comparable agencies in San Francisco and elsewhere. The very limited extent of applicant's operations, expressed in track mileage, average length of haul and number of cars operated, as contrasted with Municipal Railway and Market Street Railway, has already been referred to. The average length of ride, with the curtailed transfer arrangement, is one mile or slightly less and the cost per mile is six cents, undoubtedly one of the highest rates of street railway or bus fare in the country. The cable system is incapable of expansion and definitely limited in performance; only through an adequate transfer exchange with the connecting street railways can its service be broadened and made of greater value to the passenger.

Applicant's present service is inferior to the service of past years under the five-cent fare. The record shows that many riders, in order to find room on applicant's cars, first travel in the direction opposite to their destination and pay a double fare.

The factor of service has another important aspect. The gross and net revenue of a transportation utility, such as applicant's, is determined to a large extent by its management. If service is reduced below a necessary or reasonable standard, if a disproportionate percentage of available equipment is kept out of service and an excessive number of schedules fails to operate, the result must be a loss of passengers and a decline in revenue. The public interest will not be served if higher fares are fixed to overcome the consequences of poorer service. Applicant's income would increase if its service were maintained even at the approximate level obtaining when the five-cent fare was in effect. The record shows the number of platform men was 112 in October, 1941. By January, 1942, the number had declined to 102 and by May, 1943, to 68. Since May of last year the number has remained approximately constant to January, 1944, with a slight upturn during February and March. Service, instead of improving, has decreased greatly since departure from the five-cent fare. The following tabulation shows the extent of the decline between January, 1942, and May, 1943:

	Number of Platform Men	Actual Car-Miles Operated	Number of Cars Scheduled
January, 1942	102	71,184	31
May, 1943	68	51,796	20

The record also shows that in May, 1943, 18.8 per cent of the scheduled car-miles were not operated. Traffic checks made by the Commission's staff on February 25 and March 1, 1944, indicate that many people waiting for applicant's service and unable to board the cars because of over-crowding, used automobiles or taxicabs, and this notwithstanding the fact that applicant has sufficient service equipment to operate at least thirty cars. If the available equipment is operated to the required extent and as it was operated in January, 1942, and previously under the five-cent fare, not only will the company's earnings increase but it will also be possible to reduce overtime penalty costs which for platform men alone in 1943 exceeded by $12,990 similar payments in 1940. Other operating costs, such as overtime for shop employees, student pay, and other extras, could also be reduced.

We have mentioned the outmoded and obsolete type of vehicle and the high cost of operation at a time when better and more economical facilities were available and applicant was financially well able to effect the change, with obvious advantage to its future operating and financial position. None of these facts, applicant contends, should have a bearing on the fixing of a fair and reasonable rate. According to applicant, cost of operation alone, and that means the abnormal and excessive costs of operation of an obsolete cable railroad, must be controlling. We are unable to accept this viewpoint. The rate must be just, fair, and reasonable not only to the utility but also to the rate payer. Applicant's service does not justify a rate higher than six cents per ride.

We find no justification, on the basis of the record, for a fare increase from six to seven cents and recommend that the supplemental petition be denied. We append the following form of order.

<u>O R D E R</u>

California Street Cable Railroad having filed its supplemental petition for increase in street railway fares from six cents to seven cents, public hearings having been held, the Commission being apprised of the facts, and the matter being under submission and ready for decision,

IT IS HEREBY ORDERED that the supplemental petition in Application No. 24486 be and it hereby is denied.

The effective date of this order shall be twenty (20) days from the date hereof.

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 28th day of June, 1944.

Richard Sachse

Franck R. Havenner

Justus F. Craemer

Commissioners

I dissent from the foregoing opinion and order. Instead of a fair consideration of the present financial needs of the California Street Cable Railroad Company, the Commission, by a process of retroactive rate making covering a period of more than half a century, has arrived at the conclusion that the company is entitled to practically no earnings today. This is done in spite of the fact that not until two years ago did the Commission concern itself with the rates and operations of this company. I cannot agree with the value of the service theory propounded, nor with a depreciation theory which reduces the utility's rate base to a mere fifteen percent of the investment in its useful properties and at the same time denies an adequate depreciation expense allowance. No engineering witness testified to the results arrived at. Moreover, it is only an assumption that there will be an early junking of this street railway property and the substitution of busses. The city must first give its consent to such a proposal, and there is no evidence reflecting the public approval of a bus operation over routes having such extreme grades.

Commissioner.

I join in the foregoing dissent by Commissioner Rowell.

Justus F. Craemer

Commissioner.

After reading the dissent of Commissioners Rowell and Craemer I desire to call attention to their apparent misunderstanding of part of the majority decision.

The financial needs of applicant have had careful consideration in the opinion and order. It is estimated that the 1944 operating result will produce a net operating income, after all operating expenses and taxes, of $26,300. Such net income is equivalent to a rate of return of five per cent on a capital base of $526,000. How, in view of this factual finding, my dissenting fellow Commissioners can say that we have reduced "the utility's rate base to a mere fifteen percent of the investment in its useful properties" is impossible for me to understand. Applicant's own rate base claim is $600,000. If the $526,000 base constitutes, in the minority's opinion, a mere fifteen per cent of the investment in useful properties, then such investment would have to be more than $3,500,000. No such figure is in the record and applicant has not claimed or suggested such a rate base.

Adequate depreciation is allowed on all property for which complete reimbursement has not been made to applicant in the past as part of operating expenses.

The majority decision, contrary to the assumption of the dissenting Commissioners, does not assume "an early junking" of this cable railroad. Such an assumption was made by one of the Commission's engineers (witness Canty) but was not accepted by the majority as a proper basis of rate making.

Richard Sachse
Commissioner