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ORIGINAL

Decision No. 86222

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of FALCON CHARTER SERVICE, INC., a California Corporation, for authority, on a trial and experimental basis, during calendar year 1976, for Falcon's management to establish rate increases of up to forty percent of the present rate, subject to a retroactive review by the Commission in 1977, for commuter service between Foster City and San Francisco, --or in the alternative-- for authority to abandon its certificated commuter service between Foster City and San Francisco on or before June 30, 1976.	Application No. 56141 (Filed December 23, 1975)

Eldon M. Johnson, Attorney at Law, for applicant.
Kenneth H. Broomhead, for Foster City Transportation Committee, interested party.
James Squeri, Attorney at Law, R. E. Douglas, and A. L. Gieleghem, for the Commission staff.

O P I N I O N

Applicant operates a scheduled passenger stage operation which provides a commuter service five days a week between Foster City and San Francisco.

Applicant seeks authority to set its own fares to achieve the 90.9 percent operating ratio adopted in applicant's last general rate proceeding (D.83451 in A.54439 effective October 21, 1974). The sought authority would allow increases up to 40 percent above present fare levels. Under applicant's proposal, the authority would be

granted immediately with a subsequent "ground rules" hearing which would fix a formula for allocations and other ratemaking issues. At the beginning of the next calendar year, applicant would reduce its rates to offset any sums collected in excess of the target ratio as determined by the formula. It should be emphasized that applicant seeks to be made whole for the entire calendar year 1976 by collecting in June through December enough revenue to achieve the target ratio not only in the future, but for January to December.

In the event this relief is denied, applicant seeks authority to discontinue the passenger stage service, although it expressly concedes that the service it provides is required by the public convenience and necessity. It has, at least tacitly, conceded that the difficulties it assertedly encounters under double digit inflation and regulatory lag do not amount to confiscation of its investment or a denial of due process.

Staff moved to dismiss primarily on the grounds that the proposed procedure would violate both Section 454, Public Utilities Code (which calls for a showing and a finding that a rate increase is justified), and the rule against retroactive ratemaking (PT&T v PUC (1965) 62 Cal 2d 634). The motion was set for oral argument in San Francisco on February 22, 1976 before Examiner Gilman, presiding, Commissioner Robert Batinovich in attendance and participating.

Arguments

Applicant asserts that the Commission, as long as it relies on present techniques of fixing rates, is incapable of allowing applicant sufficient revenues to achieve the operating ratio found reasonable by the Commission. It alleges that the Commission procedures result in a mismatch of costs and rates, with cost allowances, determined during a rate case, always lagging behind those actually encountered while the rates are in effect. It argues that it is therefore unjust to deny it relief for past periods in which the revenues were insufficient to produce the target operating ratio.

Applicant points out that, unlike other commute carriers, it has no source of funds to subsidize its Foster City operations, since its other principal source of revenue is in the highly competitive charter field.

It claims that public policy now requires the encouragement of new private commuter carriers and that a policy of limiting fares so that they cover only costs and a fair return will drive away prospective entrepreneurs. It concludes that aggressive rate regulation is thus adverse to both environmental improvement and to fuel conservation. It urges the Commission to abandon its tradition of cost-based ratemaking and instead permit commuter rates to increase to whatever levels the market will bear. It contends that intermodal competition from car pools and private autos will prevent any commuter carrier from charging excessive rates.

If permitted to institute its novel system, applicant is willing to surrender the protection against competition now afforded by Section 1032 and states that it will consent to the refund of any excess revenues collected, either by a rate freeze or by a rate reduction. (It indicated in oral argument that it is opposed to direct refunds to consumers who overpaid.)

Staff argues that applicant's criticism of present procedures is not supported by comprehensive and logically related data, and that the lack of factual information in the application creates further unnecessary delay. The staff points out that the data accompanying the application lumps common carrier and charter service together, without providing any method for comparing the cost estimates underlying the established rates with actually experienced costs.

Staff claims that Falcon should easily be able to delineate those items of expense likely to vary and to project the impact on operating ratio so as to support a conventional request for offset rate relief. It argues further that if issues are disputed, the problem of delay for litigation can be mitigated by interim relief.

By way of summary, the staff asserts that the fundamental thrust of applicant's argument is not to streamline, but rather to abandon, rate regulation.

The representative of Foster City and its transportation committee opposed both the form and the amount of the proposed increase. He pointed out that the application provided no assurance that applicant was not in fact experiencing earnings sufficient to meet or even exceed the target operating ratio. He also challenged the cost allocation method used in the prior offset rate proceeding (D.84824 in A.55391 dated August 26, 1975) and asserted that applicant had not provided the quality of service promised in prior applications.

Discussion

This is the second time that applicant and its counsel have asserted that this Commission should ignore those statutory provisions and precedents which forbid retroactive ratemaking. In applicant's last offset rate proceeding (D.84824, supra) it persisted in attempting to recover, in future rates, extra revenue expressly labelled as a recovery of past losses. That proposal was, of course, rejected; no review was sought. In this proceeding applicant seeks enough extra revenue in the months between the date of decision and the end of the year 1976 to achieve the target ratio for the whole year 1976. This has the same defect as the proposal rejected in D.84824; it should likewise be rejected. Even after the books were closed on calendar year 1976, applicant's proposal would continue to require retroactive ratemaking in future periods. For example, if carrier-established rates produced an operating ratio of 93 percent

in 1977, 1978's customers would apparently be expected to make up the difference through rates set to achieve a 89 percent ratio. Similarly, if there were an overcollection in 1976, the next year's customers would enjoy lower rates.

The basic principle of prospective ratemaking is that over- or undercollections in any past period are dead issues. The rates effective in any particular period must be fixed before the period begins based on estimates of costs and revenues to be experienced during the period. A subsequent discovery that the estimates were too optimistic or pessimistic, while useful for the next round of ratemaking, cannot be the basis for a post-facto revision of the rates.[1/] Applicant's proposal for 1976 and its proposal for the indefinite future are both in conflict with this principle (PT&T v PUC (1972) 62 Cal 2d 634).

Where carriers are involved, the basis for the retroactivity doctrine is derived from the California Constitution, Article XII, Section 4 provides:

> "A transportation company may not raise a rate or incidental charge except after a showing to and a decision by the commission that the increase is justified..." (Emphasis added.)

Thus, even the legislature would have no power to establish a system of ratemaking in which today's transportation rates are adjusted to offset yesterday's over- or undercollection.[2/]

1/ The only exception to this basic principle lies in this Commission's power to grant reparations to consumers. (California Constitution, Article XII, Section 4.) However, no reparations can be granted on the grounds of unreasonableness if the rates were established with a formal finding that they would be reasonable. (Section 734 of the Public Utilities Code.)

2/ Since for a carrier the rule is based on the Constitution, there is no need to determine the statutory arguments raised by applicant or staff, except to remark that Conclusions 1-5 could be based either on Sections 454 and 728 or on the cited constitutional provisions.

Applicant suggests that certain statements from the opinion in Los Angeles v PUC (1975) 15 Cal 3d 610 support its view. The Court in that proceeding stated that:

> "The insertion of numbers derived from an accounting system adopted at one hearing, into a formula approved at another hearing, does not deny due process; the Fourteenth Amendment to the United States Constitution does not prohibit arithmetic.
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> * * *
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> "Norfolk[3/] thus stands for the proposition that due process requires adequate hearings at the significant point of the adoption of the adjustment clause, rather than at the relatively unimportant occasions of its application. Measured by this standard, the system of annual adjustments proposed by the hearing examiner and the commission staff would offend no tenet of due process." (At p. 700.)

We are not refusing to design or adopt a sliding scale of rates.[4/] The Supreme Court's opinion plainly covers prospective formula ratemaking. There is nothing in that opinion which would warrant our establishing an increased rate based solely on the hope that an acceptable formula for refunds can subsequently be worked out. On the contrary, the opinion can only be interpreted as requiring hearings before the formula is placed in operation. Hearings would be meaningless without at least a statement of the applicant's proposed formula and a reasonably detailed exposition of how it would operate in practice. Since applicant has not furnished such a showing nor provided a reason why our staff should be required to assume that responsibility, its proposal is not supported by the citation.

3/ Norfolk v Virginia Electric, etc. (1975) 197 Va 505, 90 SE 2d 140.

4/ It is interesting to note that the legislature has expressly authorized the use of a formula approach for utilities but not for transportation companies (Section 457 Public Utilities Code) describing the product as a "sliding scale of rates". It would seem that our constitutional power to establish transportation rates is broad enough and flexible enough to justify the use of similar techniques without specific statutory authorization.

Much of applicant's argument is related in one way or another to its complaints that it is conducting today's operations with cost figures based on observations conducted in a past period. This apparently reflects a fundamental misunderstanding of test year ratemaking, in which rates are based on estimates of costs as they are expected to be during the period when the rates are in effect. The elementary principles of the Commission's test year methods are set forth with exceptional clarity in PT&T v PUC (1965) 62 Cal 2d 634 at 644, 645.5/ While transportation ratemaking focuses less on rate base than on operating ratio, the principle of a future-oriented results of operation is applied in both fields. Our review of applicant's past rate decisions shows that principle to have been observed; applicant has cited no specific examples of a violation.

5/ "[1] It appears that in telephone rate proceedings in California the general approach employed by the commission, and followed in the present case, is to determine with respect to a "test period" (1) the rate base of the utility, i.e., value of the property devoted to public use, (2) gross operating revenues, and (3) costs and expenses allowed for ratemaking purposes, resulting in (4) net revenues produced, sometimes termed "results of operations." [2] Then, by determining the fair and reasonable rate of return to be fixed or allowed the utility upon its rate base, and comparing the net revenue which would be achieved at that rate with the net revenue of the test period, the commission determines whether and how much the utility's rates and charges should be raised or lowered. The commission here followed its long-established principle of determining rate base by taking original cost of the property devoted to public service, and deducting depreciation therefrom. [3] The test period is chosen with the objective that it present as nearly as possible the operating conditions of the utility which are known or expected to obtain during the future months or years for which the commission proposes to fix rates. The test-period results are "adjusted" to allow for the effect of various known or reasonably anticipated changes in gross revenues, expenses or other conditions, which did not obtain throughout the test period but which are reasonably expected to prevail during the future period for which rates are to be fixed, so that the test-period results of operations as determined by the commission will be as nearly representative of future conditions as possible."

It may be that applicant's statements on this point are nothing more than a unique way of voicing the universal claim of the regulated that our staff projections are unrealistic. If that complaint were justified, applicant would find it quite easy to give convincing comparisons since it is still in the middle of the last test period. For example, the current rates are intended to cover fuel at 42¢ per gallon. If that estimate were sufficiently in error to require an upward fare adjustment of, say, 10¢ per trip, this fact could be demonstrated without any sophisticated techniques.

We can only assume that applicant cannot demonstrate any material difference between estimated and actual costs, and that the claimed injury does not exist.

Since submission of this proceeding we have issued D.85731 in C.9886, the fuel clause adjustment investigation. A significant feature of that opinion is a new analysis of the retroactive ratemaking problem. We determined that it was necessary to shift from an estimated, to a recorded data, basis for determining the incremental charges to be assessed by energy utilities in recouping fluctuating fuel costs.

The gist of the retroactive ratemaking problem was stated thus:

> "...when we are changing to a new procedure based on actual energy costs from one based on average year experience in the middle of a weather cycle when the utilities have had the benefit of a series of wet years (with lower than average fuel costs), should we adopt a conversion adjustment of some type to prevent the utilities from experiencing windfalls by avoiding the adverse results of the dry side of the cycle[?]"

We went on to say:

"In our view, it is fair and reasonable that under- and overcollections be eliminated so that the fca effect shall be as originally intended--to reimburse the utilities for increased fossil fuel expenses. The only objection raised to any implementation of this view is the argument that it would constitute retroactive ratemaking, which is barred by Public Utilities Code Section 728 and various California Supreme Court cases interpreting it, primarily PT&T v PUC (1965) 62 Cal 2d 634. The Court there said '...we have concluded that the Legislature has not undertaken to bestow on the Commission the power to rollback general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a Commission decision ordering a general rate reduction.' (P. 651.) The Court also stated on page 652: 'This Court has also declared the principle that "The fixing of a rate in the first instance is prospective in its application and legislative in its character. Likewise the reducing of that rate would be prospective in its application and legislative in its character."' (Citations omitted.) This language clearly bars the reducing or refunding of revenues under rates which were lawfully and finally effective.

"We intend to do neither. However, we see no proscription in the cases discussing retroactive ratemaking (and contrariwise we see authority) for reducing rates prospectively even though that reduction may be appropriate in part because of past performance."

We emphasized that the adjustment clause rates were the product of a special proceeding rather than a general rate proceeding, after citing PT&T v PUC (1965) 62 Cal 2d 634:

"We think this is a valid distinction. All the parties agree that the purpose and intent of the fuel clause is to match increased fuel costs with increased revenues on a dollar-for-dollar basis. There is no intent to provide either the utilities or the ratepayers with a windfall. Had the amount of overcollection occurring to date been an equal amount of undercollection, we believe the utilities would have been before this Commission forthwith with applications for rate relief to assist them in keeping their operations viable. Now it is of academic interest since the shoe is on the other foot; we think the shoes on both feet should match. We believe the public interest requires this Commission to balance these interests. Therefore, we hold that the distinction between general rate revenues and fca revenues is so clear that there is a corresponding clear distinction between fca increases and general rate increases."

We described the method of resolving this problem as follows:

"Thus, we shall compute the specific amount of over- and undercollection for each of the respondents under their respective existing fuel clauses as of the latest date available and amortize that amount, adjusted as appropriate, initially over a period not to exceed 36 months* and order a commensurate reduction in rates, subject to revision. Interest will be included on this balance..." (Footnote omitted.)

We found:

"1. The rates fixed as a result of fca are not general rates, but specialized extraordinary rates not created by or in a general rate proceeding.

"2. The amount of over- or undercollection of fuel clause revenues compared to increased fuel costs should realistically be determined on an actual recorded basis from the birth of the fuel clauses through the latest available date...

"3. Any difference in revenues and expenses, as computed under Finding 2, should be amortized in rates over a period not to exceed 36 prospective months, on an interim basis. Thirty-six months is a fair and reasonable initial time period over which to amortize such difference, without unduly burdening either the utility or the ratepayer, and the Fuel Collection Balance as of April 1, 1976 shall bear interest at the rate of 7 percent per annum.

"4. In ordering a future reduction or increase of rates due to an over- or undercollection of revenues compared to increased fuel costs, on a recorded basis, under the fca, we are setting future rates because of existing financial inequities due to past performance."

We also found that the three principal utility respondents had overcollected and that another (Sierra Pacific Power Co.), serving a relatively small number of consumers, had undercollected. We postponed a finding of the actual amounts until after filing of the data required in Finding 2.

We concluded that:

"4. The setting of future rates to reflect past over- or undercollection is not retroactive ratemaking.

"5. The future reduction of fuel clause adjustment rates is not retroactive ratemaking."

At first glance it would appear that applicant's situation is precisely the same as that of the Sierra Pacific Power Co. and that Conclusion 4 should be adopted herein. Upon more careful attention it can be seen that applicant unlike Sierra Pacific Power Co. would not be inequitably prejudiced by being caught in mid-cycle during a change from one form of ratemaking to another. The shoe that fits Sierra is too small for Falcon.

As to Conclusion 5 we have already indicated our opinion that there must be a meaningful opportunity for hearing before a sliding scale of rates is adopted. Such a hearing was held in the Fuel Clause case; here applicant has proposed that it be postponed until after the rates are in effect. That proposal constitutes a basic defect in applicant's requested relief for future cost fluctuations. Another is the lack of factual showing that applicant really needs any form of adjustment clause.

Discontinuance

Applicant seeks authorization to discontinue commuter service if its new rate-setting procedures are not adopted.

Applicant has not, however, alleged that its total regulated carrier operations are incapable of earning a return on equity (cf. Lyon & Hoag v R.R. Comm. (1920) 183 Cal 145, Southern Pacific Co. (1963) 61 CPUC 113). It has not alleged that its commuter operations are not able to earn at least enough to cover the incremental cost of performing that service (Golden West Airlines (Riverside Discontinuance) D.81791, A.51216 (1973), reh. den. D.82154 (1973)). Nor has it alleged that the commuter service is no longer required by the public interest.

Applicant has therefore failed to give any of the traditional reasons why it should be relieved of its obligations as a public utility. Absent such justification, applicant's patrons have an enforceable right to continued service, and this portion of the application should be dismissed.

Summary

It is conceivable that we could reconstruct applicant's proposal so that the relief does not exceed the limits of our authority. However, this would necessarily involve such major surgery that the end result might well be disowned by its original proponent. In any case, applicant appears interested in finding a wider audience for its ultimate theory, i.e., that effective commuter fare regulation is adverse to the public interest.

It would therefore seem unadvisable to deny or defer a final decision on the issues thus far presented. The dismissal ordered below is, of course, without prejudice to applicant's right to file a new application seeking whatever prospective rate relief it can support by a proper showing.

Even though there is no specific evidence that applicant intends to unilaterally reduce or eliminate service as a result of this order, we have taken the precaution of adopting a restraining order, so that there can be no possible misunderstanding by applicant as to what we believe its obligations to be, nor as to our determination that consumers are not to be involved as guinea pigs in a test case.

We have made the order effective immediately since it merely requires continuation of the status quo.

Findings

We take official notice of our own files to show:

1. That applicant's last rate proceeding (A.55391, supra) required litigation because of a factual issue, allocation methods, and a legal issue, retroactivity.

a. The matter was disposed of as follows:

Application filed	12/18/74
Staff report furnished to applicant's attorney	3/18/75
Prehearing conference (Applicant to file amended application, including updated wage and fuel costs.)	4/28/75
Amended application filed	5/14/75
Staff report amended to recommend a 12.5 percent, instead of a 6 percent, increase	5/14/75
Hearing held	6/2/75

Examiner's draft decision circulated internally	7/2/75
Decision issued	8/26/75

b. The rates established therein were based on costs and revenues figures estimated to be incurred during the period August 1, 1975 to August 1, 1976, and were found justified.

c. Applicant has not alleged that any of said estimates were or are erroneous.

2. Applicant's only general rate proceeding required litigation because it was the first general review of applicant's operation and because of a material dispute over allocation methods.

a. The matter was disposed of as follows:

Application filed	10/8/73
Original hearing set for	4/19/74
Amendment filed	4/22/74
Hearing held	5/14, 15/74
Submitted	5/24/74
Test period begins	6/30/74
Examiner's draft	7/10/74
Decision issued	9/17/74

3. We find that both proceedings were disposed of without prejudicial or injurious delay.

4. If we accepted each factual allegation of this application as true and drew all permissible inferences therefrom, we could not support a finding that applicant's results of operation are less favorable than those estimated to be experienced during a period which will include the effective date of this order.

5. Applicant should be restrained from using an unauthorized discontinuance as a means of testing the lawfulness of Conclusion 9 below.

Conclusions

1. Applicant cannot raise its rates for common carrier service without the approval of the Commission.

2. The Commission can:

   a. Grant a final rate increase to a specified level.

   b. Establish a formula under which rates will fluctuate automatically in proportion to objectively verifiable changes in costs.

   c. Grant an interim increase subject to refund only after a showing and finding that the rates to be charged will be justified by the results of operations estimated to be experienced during the period in which they will be effective.

3. The Commission cannot revise common carrier rates charged in a past period. It can give refunds or reparations on the ground of unreasonableness only if the rates were established subject to refund or without a finding of reasonableness.

4. The Commission cannot establish a rate regulating system in which common carriers unilaterally determine the timing and amount of rate increases and in which consumers must rely solely on refunds for protection against excessive rates.

5. This Commission has no power to fix transportation rates for a future period at levels higher than justified by estimated results for that period in order to compensate for past operations at less-than-reasonable rates.

6. Any statute purporting to authorize retroactive ratemaking for common carriers would be ineffective as inconsistent with Article XII, Section 4, California Constitution.

7. The application for a rate increase should be dismissed for failure to state grounds for relief.

8. Applicant has not alleged:

a. That its common carrier service is no longer necessary.

b. That its continued operation under reasonable rates will not cover out-of-pocket costs.

c. That its continued operation under reasonable rates would generate losses sufficient to erode its investment, so that requiring continued operation would constitute a taking of property.

9. Applicant has not demonstrated that the Commission's ratemaking procedures or its ability to allow timely rate relief are such that it will be denied due process.

10. Applicant's request to be relieved of its common carrier obligations should be denied for failure to state grounds for relief.

11. Applicant's present fares were established on the assumption that existing equipment would be utilized and existing service standards maintained. Any deterioration below these standards will be considered in future proceedings.

A.56141 kw *

O R D E R

IT IS ORDERED that:

1. This proceeding is dismissed.

2. Applicant shall not, without specific authorization by Commission order, discontinue or fail to operate any schedule or schedules provided in its Timetable No. 27.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 10th day of AUGUST, 1976.

I will file a concurring opinion
William Symons Jr

President

Commissioners

Commissioner D. W. Holmes, being necessarily absent, did not participate in the disposition of this proceeding.

Commissioner Robert Batinovich, being necessarily absent, did not participate in the disposition of this proceeding.

A. 56141 - D. 86222

COMMISSIONER WILLIAM SYMONS, JR., Concurring

The prohibition on retroactive ratemaking makes applicant's request illegal. I concur in the ordering paragraphs.

However, I cannot agree with the rationale set forth in the discussion which strains like a gnat swallowing an elephant. Of course it has to: it has the Herculean task of reconciling this denial with the Commission's 3 - 2 Decision No. 85731, rendered in April in the fuel clause adjustment investigation Case No. 9886, which was an obvious illegal venture into retroactive ratemaking.

San Francisco, California
August 10, 1976

William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner