

**REPUBLIC OF THE PHILIPPINES, PETITIONER, VS. HON. ENRIQUE MEDINA, HON. GREGORIO PANGANIBAN, HON. JOSUE L. CADIAO, HON. FILOMENO KINTANAR, HON. PAZ VETO PLANAS, AS ASSOCIATE COMM...**

*G.R. No. L-32068. October 04, 1971*

Ponente: REYES, J.B.L., J.

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**REYES, J.B.L., J.:**

On 7 May 1970, Manila Electric Company (hereinafter termed MERALCO) filed an application with the Public Service Commission seeking approval of revised rate schedules, with increased charges, claiming that the floating exchange rate and economic conditions resulting therefrom increased its operating and maintenance expenses by more than 40%, and likewise increased the peso cost of servicing its foreign debts, causing it to incur an operational deficit and net loss of over one million pesos a month. The proposed new rates, applicant contended, would give it a reasonable return of below 12% of the present value of its properties devoted to the public service, and implicated no additional burden to small consumers (of 100 KWH or less per month) constituting around 52% of petitioner's customers.

Embodied in the aforementioned application was a motion "for immediate provisional approval of proposed rates", which, over the opposition of the petitioner Republic and others (Villegas, Mutuc, Gonzalez and Baro), was granted by the respondent Commission in an order dated 20 May 1970, "at the risk of the applicant," subject to return of the sums collected if, "after hearing on the merits, the application was not found meritorious." A motion for reconsideration of said order authorizing the provisional increase in rate charges was filed by the oppositors before the Commission en banc but was denied in its order dated 3 June 1970. The oppositors filed petition for certiorari and prohibition with preliminary injunction to annul and set aside the two orders aforementioned, which were given due course (G.R. No. L-32068, L-32083, L-32155, and L-32464).

In the meanwhile, on 18 May 1970, the Republic and other oppositors filed an opposition to respondent MERALCO's main application for increase in rate charges on the ground that the floating rate of exchange notwithstanding, the applicant's sound financial condition is still capable of maintaining efficient service and meeting due payments on its obligations, with a reasonable rate of return on its investment; that the applicant's cash reserves accumulated and realized from its huge net annual profits over the past years is capable of sustaining itself without resorting to borrowings, despite the alleged increase in operating expenses; that the proper basis of rate fixing is the fair value of its property useful and being used in the service of the public, without regard to encumbrance or indebtedness; that the increase in rate sought is excessive and unreasonable and will bring about greater hardship to the people, as well as directly cause increase in the cost of production which will have to be unduly borne by the consuming public; and that the rate of increase prayed for cannot be supported by the evidence to be presented in justification thereof, apart from other grounds that may become apparent in the course of the proceedings.

On 27 May 1970, the respondent Commission, through Commissioner Enrique Medina, issued an order directing the Auditor General to conduct an examination of respondent MERALCO's books of accounts pursuant to Commonwealth Act No. 325 and to submit a report thereof within fifteen days (Annex C, petition for review, L-32374),

On 9 June 1970, the Office of the Auditor General, by letter, requested the respondent Commission to allow it sufficient time until 30 June 1970 to submit its report. On 16 June 1970, the Commissioner replied that in view of his impending retirement on 2 July 1970, the report be submitted on or before 20 June 1970 (Annex D, petition for review, L-32374).

On 19 June 1970, the Office of the Auditor General, by return indorsement, informed the Commissioner that although the examination could be finished that day, yet it would take about a week or so to prepare and write the report (Annex E).

On 24 June 1970, the Office of the Auditor General submitted its report to the respondent Commission, without the supporting documents mentioned therein and, for lack of material time, without being able to delve "into as much detail as would ordinarily be done in a rate audit, considering the magnitude of the utility's operations, so that only the bit items were test-checked." Neither was it able to verify the reasonableness of the valuation for lack of material time and the voluminous nature of the appraisal report (Annex F, petition for review). The annexes in support of the General Auditing Office were filed a few days later.

After hearing on the merits of the petition, during which respondent MERALCO adduced its evidence (morning and afternoon, 27 May, 1, 2, 3 [morning only], 15, 16 [morning only], 17, 18, 19 and 22 June and the oppositors on 23, 24, and 25 June 1970), on 30 June 1970, respondent Commission, through the Honorable Commissioner Enrique Medina, Presiding, and the Honorable Associate Commissioners Gregorio C. Panganiban and Josue L. Cadiao, Members, promulgated a decision finding the proposed rates reasonable and justified with minor adjustments, and the dispositive part of which is as follows:

"IN VIEW OF ALL THE FOREGOING, the Public Service Commission hereby AUTHORIZES and APPROVES the proposed rate schedules of Meralco attached as Annexes 'A', 'A-1', and 'A-2', and are made part of this decision except that the following shall be exempted from any increase:

'(1) All government-owned hospitals certified by the Bureau of Hospitals as such;

(2) Street lightings for public streets and public plazas.'

"The Commission is approving a rate adjustment of 36.5% over the old rate based on a P2.10 or 54% increase in the exchange rate from P3.90 to P6.00 to U.S. \$1.00 considering that 70% of Meralco's cost is affected by the exchange rate. In view of the above, there should be an adjustment of 3.8% in the billings under the revised rates for every thirty (30) centavos change in the exchange rate from P6.00. In fairness, such adjustment should be upward as well as downward, depending on whether the exchange rate goes up or down.

"The following currency exchange rate adjustment shall, therefore, apply but using only 3.0% instead of 3.8%.

"When the average of the daily U.S. Dollar selling rate of the Philippine National Bank during a calendar quarter is less or more than 6.00 pesos to one (1) U.S. dollar, a corresponding adjustment shall be made on all billings for the succeeding calendar quarter as computed under the Residential Meter (RM-5), the General Service (GS-4) and the General Power (GP-4) rate schedules. Such adjustment shall be a reduction or an increase at the rate of 3.0 per cent for each full 0.30 peso increase above 6.00 pesos to one (1) U.S. dollar of the abovementioned average of the daily selling rate of the U.S. dollar.

"Residential and commercial customers consuming up to but not more than 120 kilowatt hours and 90 kilowatt hours, respectively, who do not receive any rate increase under the revised rates shall also receive the benefit of a downward adjustment in their rates should the exchange rate go down below P6.00 as specified above but shall, however, be exempted from any upward adjustment should the exchange rate go above P6.00 to U.S. \$1.00.

"For the purpose of insuring that the above adjustment shall be carried out properly, the Secretary of the Commission is hereby ordered to obtain from the Philippine National Bank the necessary information as to said bank's daily U.S. dollar selling rates; compile such information; compute the average of such daily rate during a calendar quarter; and within five (5) days after the end of such quarter, issue a certification of the results of his computation.

"In line with one of the conditions stated in the Order of this Commission dated 21 May 1970, the Commission hereby orders the Meralco to reimburse to or credit to the accounts of all its 477,814 residential consumers whatever amounts or sums of money it has collected or received from said consumers under the provisional authority in excess of the residential rates approved and authorized in this decision and attached hereto as Annex 'A'.

"The increase hereinabove APPROVED and AUTHORIZED shall be effective from the date of this decision and Annexes 'A', 'A-1', 'A-2' cancel and supersede all previously authorized rate schedules." (Annex G, petition for review, L-32374)

On 1 July 1970, respondent Commission, through the same Presiding Commissioner and Associate Commissioners, issued an order clarifying and supplementing its decision that in case the decision should be appealed the provisional rates should apply in the meantime (Annex H, petition, L-32374).

On 20 July 1970, the Republic filed a motion for reconsideration of the decision (Annex G) and order (Annex H) with the Commission en banc, requesting the Secretary to include it in the calendar of the Commission en banc on 6 August 1970 (Annex I, petition for review, L-32374).

On 10 August 1970, the oppositors below filed with the respondent Commission a notice of appeal from the decision dated 30 June 1970 and supplementary order dated 1 July 1970 (Annex J, Ibid).

For lack of quorum to enable the respondent Commission to sit en banc, owing to the retirement from the service of Commissioner Enrique Medina on 2 July 1970, the existence of a vacancy among the five Associate Commissioners, thereby leaving only four incumbent Associate Commissioners, namely, Hon. Gregorio C. Panganiban, Josue L. Cadiao, Filomeno C. Kintanar and Paz Veto Planas, and it being the provision in Section 3 of the Public Service Act that five Commissioners shall constitute a quorum for sessions en banc, the petitioner's motion for reconsideration could not be heard and resolved by the respondent Commission. For this reason, the Republic filed a petition for review (L-32374) without awaiting the resolution of the respondent Commission on the petitioner's motion for reconsideration, the filing of which notwithstanding is not a condition precedent to enable the petitioner to appeal from said decision of the respondent Commission (*Mirasol Transportation Co. vs. Negros Trevelways Corp.*, 64 Phil. 317; *Mondia vs. Public Service Commission*, 65 Phil. 708). Oppositors Mutuc and Gonzalez likewise appealed, and were allowed to intervene in the case.

Meralco in turn filed a motion for reconsideration praying that the dispositive portion of the Public Service Commission decision providing for a rate adjustment of 3% in the billings for every thirty centavos (P0.30) change in the exchange rate (up or down) of P6.00 to every dollar be modified to a more flexible schedule, by allowing a change of 1-1/4% for every P0.10 increase or decrease in the exchange rate. Its motion for reconsideration being unacted upon, for lack of a quorum, Meralco resorted to this Court (G.R. No. L-32402).

The appellant Republic of the Philippines assigned six alleged errors committed by the respondent Commission, while appellant Gonzalez in turn assigned ten errors. These assignments of error raise in fact three issues:

- 1) The validity of the order of 20 May 1970 authorizing the provisional rates;
- 2) That the oppositors-appellants were denied due process by curtailing their evidence;
- 3) That the rates authorized are not warranted, and that a different method in fixing the rate base should have been adopted.

It having been agreed that the evidence submitted in connection with, or in support of, the provisional rates should be taken as evidence submitted on the merits of the petition, and a decision on the merits having been rendered by the Commission, after consideration of all the evidence submitted by the parties, the review of the Public Service Commission order of 20 May 1970 (authorizing the provisional rates) would serve no practical purpose, since the decision on the merits superseded said order, and the moneys collected thereunder by Meralco would have to be returned or credited to customers in so far as they exceeded the rates authorized by the ultimate decision. Anyway, the brief of petitioner Gonzalez in the Case L-32464 discusses the propriety of the authorization of provisional rates.

It is contended by petitioner Gonzalez, however, that the provisional rate proceedings were void for want of jurisdiction, because the notice of hearing was first published in two newspapers of general circulation beginning 9 May 1970, and continued for 10 consecutive days until 19 May 1970; that the hearings on the provisional rates actually started 14 May, and said rates were approved on 20 May 1970.

We do not find this contention meritorious, considering that when the hearings were begun the notice had already been published six days in succession, and moreover, Section 16(c) of the Public Service Act (Commonwealth Act No. 146), in its first proviso, expressly prescribes -

"That the Commission may, in its discretion, approve rates proposed by public services provisionally and without necessity of any hearing; but it shall call a hearing thereon within 30 days thereafter, upon publication and notice to the concerns operating in the territory affected ....." (Italics supplied).

If the Commission is empowered to approve provisional rates even without a hearing, a fortiori it may act on such rates upon a six-day notice to persons concerned. In fact, when the provisional rates were approved on 20 May, the full 10 days notice had been published. To be sure petitioner Gonzalez argues that the proviso quoted applies only to initial, not revised, rates. The Public Service Act, however, makes no distinction; it speaks of rates proposed by public services; and whether initial or revised, these rates are necessarily proposed merely, until the Commission approves them. The Public Service Commission practice, moreover, is to hear and approve revised rates without published notices or hearing. The reason is easily discerned: The provisional rates are by their nature temporary and subject to adjustment in conformity with the definitive rates approved, and in the case at bar, the Public Service Commission order of 20 May 1970 expressly so provided.

Oppositor Villegas contends that the Public Service Commission could not act on the petition for provisional rates because it expressed no cause of action, there being in it no statement of the value of the properties devoted to the service to be used as base rate. Suffice it to say that the base rate assets of applicant's properties were established as of 1965, in this Court's decision in *Manila Electric Co. vs. Public Service Commission* (L-24762, 14 November 1966), 18 SCRA 651; and subsequent additions thereto appeared in the annual reports filed in the Public Service Commission by MERALCO, as required by law [Commonwealth Act No. 146, Section 17, paragraph (h)], and of which the Commission could take judicial notice, being part of its own records.

Reliance upon our decision in *PLDT vs. Medina*, L-24340, 18 July 1967, 20 SCRA 659, is misplaced. That case

involved a petition for reconsideration by Araneta University to reduce the PLDT rates fixed in a decision of the Public Service Commission that had become final one year previously, and which Araneta University filed in the finished proceedings. Naturally, it was ruled that the petition was improper, since the cases had been definitely closed, and that to modify the rates established required a new proceeding with proper or reasonable notice to interested parties. No question of provisional rates were at all involved.

The second basic issue raised by oppositors-appellants is that they were allegedly denied due process. It is averred that the hearings on the merits were conducted with improper haste, because of the avowed desire of Commissioner Medina (to whom the hearing had been entrusted by the Commission en banc) to finish the case before his impending retirement on 1 July 1970; and that to attain this purpose, hearings were conducted morning and afternoon; that cross examinations were curtailed, and oppositor Gonzalez was denied presentation of witnesses; that oppositors were not given adequate time to examine the documents exhibited and even the General Auditing Office was compelled to submit an incomplete report of its examination of the MERALCO books of account.

These are serious charges, but are not substantiated by the record before us. While the initial hearing of the application had been set for 11 May 1970, hearing was deferred and started on 14 May at the request of the Solicitor General, representing oppositor Republic of the Philippines. Thereafter, hearings were intermittently held for a total of 42 days, from 14 May to 25 June, and the case finally decided on 30 June. While the case could have proceeded at a more leisurely pace, the time employed does not sustain the charge that the case was "railroaded."

Undoubtedly, the impending retirement of Commissioner Medina did play a role in his being strict in granting continuances; but in the absence of any evidence of improper motivation (and none was produced), or of proof that oppositors were denied adequate opportunity (of which more anon), such conduct does not constitute irregularity warranting reversal. An analogous situation obtained in *Manila Yellow Taxicab vs. Barredo*, 58 Phil. 385, 388, where Judge Vicente de Vera, being temporarily assigned to the Public Service Commission, had to return to his district, and for this reason the Commission decided the case even before the expiration of the period allotted for the filing of counsel's memoranda. This Court ruled that the irregularity did not warrant modification or reversal of the Public Service Commission decision. Indeed, it would have been more anomalous to speed up the proceedings if Commissioner Medina's retirement from the service had not been impending at all.

It is well to note here that the trial and hearings were not continuous, and intervals of several days, sometimes of a week or more, took place. The main outlines of the case for respondent Meralco (the adverse effect of the floating rate on the cost of operation) appeared from the testimony in chief of applicant's witness Antonio Ozaeta, whose cross examination was lengthy, occupying over 130 pages of the transcript. Hearings were held morning and afternoon, but only once did they proceed beyond 5 p.m., and most afternoon sessions starting at 2:00 p.m. ended at 4 or earlier. No undue restrictions were placed on oppositors until the Public Service Commission, apparently realizing that its policy to allow even individual consumers to cross examine independently applicant's witnesses was unworkable and would lead only to confusion, decided to limit the number of cross examiners. This lay within the trier's discretion and should not be interfered with in the absence of abuse, which is not here shown. As pointed out by Francisco (Rules of Court) in his commentary on Rule 132, Section 8, "it is undesirable for more than one attorney to cross examine the same witnesses, and the right may be denied where the interests of the co-defendants are identical."

Oppositors-appellants insist that the Public Service Commission gave the General Auditing Office (GAO) only fifteen days to submit its report on its examination of Meralco's books of account and that the examination was incomplete. This is not accurate. On 27 May 1970, GAO was given 15 days to make its report, and did not protest

that the period fixed was insufficient. Neither did it complain, when subsequently it asked for an extension and was given up to 20 June 1970 (Petition, Case G.R. No. L-32374, Annexes C and D). In fact, GAO finished the audit on 19 June 1970, according to the testimony of Pablo S. Bumanglag, head of the auditing team (t.s.n., 25 June 1970, page 4), and submitted its written report on 25 June 1970. Nowhere did he claim that the period allotted was insufficient. Nor was it likely to be such, since Auditor Bumanglag admitted he was familiar with the Meralco books of account (t.s.n., page 35), that had been audited in 1964. Moreover, the subsequent yearly reports of said company were also audited by GAO conformably to the Public Services Act. True, the supporting schedules were not attached to the report until a few days afterward, but it is not shown that they contradicted the Report of 25 June 1970 in any way.

Finally, some of the oppositors appear to have gone to unreasonable lengths in their effort to delay the hearings, insisting on continuances to present witnesses who were not identified nor subpoenaed and whose names were not given; and, when rebuffed in such attempt, have resorted to filing graft charges against some of the commissioners, with the clear purpose of forcing their withdrawal from the case and thus delay the proceedings further. Such tactics must be condemned. At any rate, no statement or offer of proof was made for the record of what the oppositor expected to prove by the witnesses as should have been done,<sup>[1]</sup> in order that on appeal the superior Court may appraise whether the proposed testimony could change the result and thus warrant a remand for rehearing.

The Commission's resolve to avoid unnecessary delay in this particular case appears justified in view of the unwholesome situation that could arise were the hearing Commissioner to withdraw at the middle of the trial, since a newcomer would not be able to proceed without first acquainting himself with what had previously transpired; and also because the evidence indicated that serious losses would be incurred by the applicant public utility were it to continue serving at the rates previously approved. While it is the Commission's duty to protect the public, i.e., the persons who are to use and pay for the service, still -

"Such service does not necessarily mean reduced rates. It could be quite the contrary. So it is, that, at bottom, a just rate must be founded upon conditions which are fair and reasonable both to the public utility and the public itself." (Phil. Long Distance Telephone Co. vs. Medina, L-24340, 18 July 1967, 20 SCRA 659, 676, per Sanchez, J.)

It is finally urged that only five days elapsed between the time the case was submitted for decision and the rendition of the judgment. For itself, this datum is inadequate to support oppositor's conclusion of bias. The evidence was mainly documentary, and the Meralco books of account had been reliably audited by reputable private accountants as well as by the GAO and the latter's conclusions were embodied in its report. Not only this, but the case was in fact only an updating of the rate base examined and passed upon by the Commission in 1965 and affirmed by the Supreme Court (v. 18 SCRA 651). The difference consisted in the effect of a notorious and well-known fact, the floating rate of the peso vis-a-vis the U.S. dollar, with the consequent increase in the cost of imported materials. That in the decision on the merits Meralco was required to reimburse or credit to residential consumers the difference between the rates provisionally approved and those finally authorized is evidence that the Commission acted not blindly but with discernment in judging the case.

We conclude that the claim of denial of due process is unfounded and must be overruled.

The foregoing considerations should not, however, be understood as an approval of the practice of unnecessarily curtailing the opportunities of parties litigant, barring exceptional circumstances. Otherwise, suspicion is aroused, and the public confidence eroded, to the detriment of the administration of justice. It is the duty of tribunals, judicial or quasi-judicial, not only to be just but to appear to be actually so. It is equally their task to sedulously avoid giving rise to speculation, rumours and gossip by hasty or ill-considered action.

The Commission found from the evidence that, taking as a basis the audited operation figures for 1968 as a test year (because the 1969 figures were not yet audited when the hearings were held in the Public Service Commission), the net value of MERALCO's properties devoted to public service, expressed in terms of present cost after deducting depreciation, was P913,447,085.00. Adding thereto a working capital of two months operating expenses, equivalent to P29,666,878.00 (i.e. 1/6 of total operating expenses for the year in the sum of P162,759,661), the Commission found the rate base (upon which to compute the percentage of reasonable return) to be P943,113,963. Dividing the operating income of P87,515,491 by the rate base gave a return of 9.25%

In authorizing an increase of rates, the Public Service Commission proceeded on the basis that the MERALCO as public utility should receive a reasonable return on its investment, equivalent to 12% on the rate base, the present market or replacement value of the properties devoted to the service less depreciation, plus operating capital equivalent to 2 months operating income. In so doing, the Public Service Commission only followed the constant doctrine of the cases heretofore adjudicated by this Court. Said the Commission in its decision:

"According to the evidence for applicant, as of December 31, 1968, Meralco's gross book value was P870,030,089 and P703,676,398 as of December 31, 1967. The average gross book value for 1968, therefore, was P786,853,243.00. For purposes of rate base determination, however, this Commission and our Supreme Court have consistently ruled that the controlling standard in determining the value of the property which should be included in its rate base is the present or market value. The cases upholding this doctrine are numerous, among them are: Metropolitan Water District vs. Public Service Commission, 58 Phil. 397, 400 (1933); Municipality of Pagsanjan vs. Cacho & Hidalgo Electric, G. R. No. 36544 (1933); Philippine Railways Co. vs. Asturias Sugar Central, Inc. 72 Phil. 454 (1941); Fortunato F. Halili vs. Ice & Cold Storage of the Philippines, 77 Phil. 823 (1947); Phil. Power Development Co., PSC Case No. 2981 (1955); and Manila Electric Co. vs. Public Service Commission, G.R. No. L-24762 (Nov. 14, 1966).[2]

In following the doctrine of this Supreme Court, the Public Service Commission can hardly be accused of abuse of discretion. In our previous decision in 1966, Manila Electric Co. vs. Public Service Commission, G.R. No. L-24762, 14 November 1966, 18 SCRA 651, objections raised against the 12% rate of return, identical to those interposed in the present case, were examined and overruled. This Court, per the present Chief Justice Concepcion, then ruled:

"With respect to the return allowable to the MERALCO it is urged that the rate authorized by the PSC is higher than that prevailing in the United States. It is well settled, however, that the rate of return permissible depends upon existing conditions. In the Philippines, our decisions have consistently adopted the 12% rate for public utilities and the PSC has done no more than adhere to the established jurisprudence thereon. Indeed, the GAO report concedes that 12% is the fair rate of return for the Meralco. This is not the proper occasion to inquire into the wisdom of such jurisprudence, although it is a matter of common knowledge that the prevailing rates of interest on loans in the Philippines are generally higher than those charged in the United States. The fact is that, in view of the circumstance, nobody would lend the necessary funds to the MERALCO, if its returns were fixed at a lower rate. The reason is obvious: Capitalists would prefer to lend their resources to other public utilities because the latter would, generally, be in a better position to pay a higher rate of interest and offer a greater assurance of stability and capacity to meet its obligations, all other things being equal.

"Then, also, the interest due to the lenders would have to be paid by the MERALCO out of its net earnings. As a consequence the same would have to be somewhat higher than otherwise, in order that the borrower could reasonably warrant to the lender its (borrower's) ability to pay the debt, and still retain a margin of earning sufficient to encourage or justify its (borrower's) investment in the enterprise. Otherwise, the stockholders of the public utility would prefer, either to withdraw their investment and shift the same to another more profitable venture, or to refrain, at least, for the time being, from embarking on a program of replacement of its old lines, installations, equipment and other facilities, as well as of expansion and improvement of this service.

In either case, the public would suffer thereby."

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"If the MERALCO were not constrained to borrow for the purpose of financing the undertakings it proposes and is required by the circumstances to pursue, the rate of return for its investments could, in all probability, be reduced. Indeed, before it had decided to initiate said undertakings, MERALCO had, not only never increased its rates — despite the fact that almost all other enterprises have raised their rates — but also, volunteered to reduce the same.

'It goes without saying that the rates of return are understandably lower in the United States where there is a comparative abundance of capital and it is, therefore, relatively easier to raise funds locally, either by increasing the capitalization — without the danger adverted to above — or through loans, under conditions less onerous than those usually obtaining in the Philippines.'" — *Manila Electric Company vs. Public Service Commission*, G.R. No. L-24762; *Ricardo Rosal vs. Manila Electric Company*, G.R. No. L-24841; *Republic of the Philippines vs. Public Service Commission*, G.R. No. L-24854; *City of Manila vs. Public Service Commission, et al.*, G. R. No. L-24872, November 14, 1966, pages 19-23.

Oppositors vigorously criticize the method utilized in the appealed decision in determining the rate base and fair returns for MERALCO. We are not unaware of the fact that various theories or formulae have been proposed to appraise the assets and determine what are fair rates for public utilities. Of them three appear to have gained favor of various times: (1) the historical cost or prudent investment formula; (2) that of present cost or market value; and (3) the cost to reproduce theory (43 Am. Jur., page 646). The decided weight of authority, however, is to the effect that property valuation is not to be solved by formula, but depends upon particular circumstances and relevant facts affecting each utility as to what constitutes a just rate base and what would be the fair return, just to both the utility and the public. The historical cost formula had been proposed by oppositors in the 1965 MERALCO case, and in our 1966 decision (18 SCRA, 668) We noted that -

"x x x. Upon the other hand, Ricardo Rosal urges that the rates should be founded upon the amount of the investment made by MERALCO's stockholders or the "historical cost" formula. The PSC has adopted the present or market value theory, as the basis for the computation of the earnings allowable to and the rate schedule chargeable by the MERALCO, as well as the method of valuation used and the appraisal made by the same, after making therefrom some deductions recommended by GAO.

With respect to the "historical cost" formula urged by Rosal, it should be noted that the present or market value theory adopted by the PSC is in consonance with the practice consistently adhered to in this jurisdiction and upheld in an uninterrupted line of decisions of this Court. And said decisions are borne out by the weight of authority in other jurisdictions."

Oppositors then, as they do now in the case at bar, argued that the Hope Natural Gas decision of the United States Supreme Court had rejected the present value theory as obsolete. This contention was examined in our previous decision and found incorrect.

"It is urged that the present value theory is now an obsolete doctrine, it having been rejected by the Supreme Court of the United States in *Federal Power Commission vs. Hope Natural Gas Co.* (320 U.S. 591, 88 L. ed. 333), in which the prudent investment or modified original cost theory was allegedly adopted. This assertion is inaccurate. In said case the Court did not reject the present or fair market value theory. It merely refused to interfere with the action taken by the Federal Power Commission in applying said prudent investment or modified original cost theory."

Much of the opposition to the appealed decision springs from the improper insistence in valuing the stockholder's equity at the par value of the shares, entirely ignoring the fact that when the present Filipino stockholders acquired

the stock of the American owned MERALCO company, they did so at several times the par value. To compute the equity of the stockholders at par value of the shares is evidently unjust and would result in fixing the returns of a utility at confiscatory levels, particularly for recent stockholders that acquired shares at a premium. Measured against actual cost, the dividend percentage does not appear abnormal.

The Republic and other oppositors also insist that the GAO did not have or was not given adequate time to check the accuracy of the figures submitted by MERALCO; and yet from 25 June 1970, when the GAO report was filed in the Public Service Commission, down to the time the case was submitted for decision in June, 1971, the oppositors have failed to submit any concrete figures to show error in the data relied upon by the Commission.

It is argued that from 1965 to 1969 out of P181.375 million revenues, MERALCO only retained in business P80.688 million. This is difficult to believe considering the findings of the Commission that for the same period MERALCO's construction expenditures amounted to P778,227,082, which is more than the revenue from the rate increase (P181,374,434) and its foreign loans (P318,661,869) added together (P500,036,303). These figures of the Public Service Commission are nowhere disputed.

As to the argument that the trending or repricing of MERALCO's properties resulted in inflated values, the decision appealed from (Brief for Petitioner, page 53) correctly observed:

"Atty. Bautista argues that Meralco has trended or repriced its properties three times since 1963 resulting in overvaluation of its utility plant in service. He contends that the dollar components of Meralco's property in service prior to 1963 were already trended in 1963, then trended again in 1968 and then their dollar cost was multiplied by 6 (P6 to \$1). This argument stems from a misapprehension of the purpose of the trending method which, as has been stated hereinbefore, is to give recognition to changing economic conditions and variations in the purchasing power of the currency between the time of investment and the time of the rate base computation. While it is true that, in 1963, the dollar portion of power plants, substations, and buildings were trended by using the trend factor applicable for the period from date of acquisition of the equipment to 1963, the equipment was merely brought to 1963 replacement cost or 1963 present value. To trend to 1968 cost level, the 1963 dollar cost was multiplied by the trend factor applicable for the period beginning from 1963 to 1968 to bring the dollar cost to 1968 cost levels. The total of the dollar component trended as above stated to 1968 cost levels was then multiplied by six on the basis of the exchange rate of P6.00 to U.S. \$1.00. The contention, therefore, of Atty. Bautista, is without merit."

The oppositors likewise point out that the GAO report disallowed P10,621,803 of MERALCO's yearly 1968 operating expenses.

Of this amount, P5,077,517 includes advertising, life insurance premiums, and other fringe benefits to employees, which certainly did not go to the stockholders of the company and largely contributed to its trouble free service and labor relations. Of these items, the decision under appeal observed -

"With respect to the Jollys Recreation Center which is a place within the compound of Meralco where employees engage in sports and athletics activities, the Commission believes that the same should not have been disallowed considering that this contributes to the efficiency of employees in the performance of their work and therefore benefits perhaps indirectly the public that they service.

The Commission also notes that GAO has disallowed the following disbursement as part of Meralco's operating expenses:

- (a) Group Insurance premiums
- (b) Institutional Advertising; and
- (c) Franchise Taxes.

Group insurance premiums are those that are paid by Meralco for the insurance policies of Meralco's employees. Those are actually part of the salaries of employees as the Commission understands it and since these are considered as included in the computation of the salaries of the employees, they are proper operating expenses.

Institutional Advertising expenses have been allowed by this Commission in the past as proper operating expenses. In the case of Meralco it may appear that there is no need to advertise its business considering that there is no competitor, yet the Commission takes judicial notice of the fact that all television programs sponsored by Meralco are those that instruct the consumers on how to save on electricity and how to avoid accidents such as electrical fire by the improper use of electrical appliances and connections. Such being the case, the Commission rules that these institutional advertising expenses are allowable.

With respect to franchise taxes, the GAO representative, Mr. Pablo Bumanlag, testified that these are franchise taxes that have not been paid by Meralco because they are being disputed. He admits, however, that in the past, GAO has allowed these as operating expenses and that this is the first time that GAO has disallowed contested franchise taxes. This Commission has not been given any valid reasons for the sudden departure by the GAO of its treatment of these disputed franchise taxes and therefore holds that the disallowance is improper."

These observations We find correct. But even if We disregard the entire P10,621,803 operating expenses objected to by the GAO, only 1/6 of the amount (P1,770,300) would have to be deducted from the 2 months working capital allowed by the Commission (P28,135,449) and considered as forming the rate base in addition to the value of the property in service (P913,447,085). Therefore, deducting the P1,770,300 from the working capital leaves P26,365,148; and the rate of return can be computed as follows:

Property in service P913,447,085 (Decision, page 18)

2 months working capital P 26,365,148

Rate base P939,812,233

(as against the base fixed in the decision at P941,582,534).

Dividing the operating income of P107,325,875 by this reduced rate base of P939,812,233 yields a rate of return of 11.4%, well within the 12% heretofore considered reasonable in previous decisions of the Commission and of this Supreme Court.

It is noteworthy that the GAO computation, despite excluding the P10,621,803 disallowed from MERALCO's annual operating expenses and using only the book value of the property in service, without even trending property values or considering normalization adjustment of expenses, found a rate of return amounting to 12.12% for 1968 and 11.86% for 1969. Since book values are below present values, that have consistently run higher, the actual rates of return of MERALCO are even lower than those found in the GAO report. The oppositors persistently ignore the difference in the purchasing value of the pesos spent when the company plants were acquired or constructed, and the lower peso values of the utilities' current income in the years 1968-1970, specially since the floating rate was imposed.

It is unnecessary to stress that these peso values are not truly comparable.

Finally, the objection that MERALCO failed to set up a depreciation reserve account that could have been used by it to cushion the effects of the floating rate is contrary to the express prescription of Section 16(1) of the Public Service Act, providing that the depreciation fund "shall not be expended otherwise than for depreciation, improvements, new construction, extensions or conditions to the property of such public service." Thus MERALCO could not lawfully use the depreciation fund to meet the deficit in its operational expenses, as

oppositors contend. On the other hand, the Public Service Commission did find that the company had used its depreciation fund for constructions, as authorized by law, and this finding has not been disputed or contradicted. The objection, therefore, is devoid of merit.

By and large, oppositors have not shown any errors in the appealed decision important enough to warrant reversal. It must be borne in mind that rate fixing involves a series of technical operations into the details of which We are ill-equipped to enter, and which is primarily entrusted to the Public Service Commission.

Much stress has been laid on the fact that MERALCO is one of the largest corporations in the Philippines with high earnings. Assuming this to be correct, although no competent evidence has been introduced in support thereof, what really matters is whether or not this particular utility renders efficient and satisfactory service and whether its net income bears a just relation to the size of its investment. As previously shown, even the GAO report is that MERALCO returns do not exceed 12% of its service assets. While a public utility like MERALCO may in effect be deemed to be a monopoly, its favored position as such is more than counterbalanced by the regulatory limitation on the rate of return on its capital and its unavoidable obligation to maintain and expand its services as demand therefor increases. Of course, its rates must always be just to the public, but protection of the latter does not necessarily mean that only reduced rates, regardless of economic conditions, can be just (PLDT vs. Medina, supra).

After the main briefs were filed in this case, the oppositor Republic submitted a motion for the remand of the case back to the Public Service Commission, to enable it to propound a new formula allegedly better fitted to determine a rate that would be more just to both the utility and the public, in lieu of the method heretofore used, that are claimed to have become obsolete. Appended to the motion is a report of the Presidential Economic Committee (PEC) on "Policy for Regulating Public Utility Earnings" dated 20 May 1971. Subsequently, in its reply brief, the Republic has likewise invoked a memorandum of the Presidential Staff to the Secretary of Justice, dated 28 May 1971, proposing that MERALCO rates be adjusted to a level not to exceed 5.93% over the 1968 rates on the basis of a so-called decision rule or "end result" doctrine. The first report of the PEC held that an increase of 25.4% was reasonable (as compared with the 36.5% allowed by the Public Service Commission).

We do not believe that a remand at this stage would be justified, for the following reasons:

- (a) MERALCO's evidence establishes that the confidence of its foreign creditors and suppliers requires a stable rate of return adequate to satisfy them of its ability to meet its obligations. Any delay in fixing its just returns would hamper the utility's efforts to obtain needed financing that is not locally available, to the ultimate detriment of its services, specially since MERALCO does not depend upon Government guarantees.
- (b) The wide divergence of the proposals of the PEC and the PES is evidence that the implications of the new formulae have not been thoroughly explored and they are still in the experimental stage, with still untested results. MERALCO contends, not without reason, that it would be more consonant with logic to apply first these new methods of computing rates to the tariffs of public utilities controlled by the government, like the National Power Corporation and the Philippine Railways.
- (c) To suspend the effects of the decision of 30 June 1971, allowing the increased rates, would result in the revival of the provisional rates approved on 20 May 1971 (as provided in the Public Service Commission resolution of 1 July 1971), when said provisional rates are admittedly more unfavorable to the consumers.
- (d) At all events, the Republic can institute new proceedings in the Public Service Commission, with due notice to the parties concerned, where the merits of the new proposed formulae, and their factual basis, can be thoroughly tested and inquired into, and thereafter either adopted or rejected.

Likewise, the Court does not believe that it should now inquire into the merits of MERALCO's appeal (G. R. No. L-32402) to render the schedule of rates more flexible by allowing an upward or downward change in the rates of 1-1/4% for every P0.10 variation in the dollar exchange rate, instead of the authorized charge divergence of 3% for every P0.30, for the reason that MERALCO's motion to this effect was not previously heard by the Commission due to lack of quorum therein.

WHEREFORE, the appealed decision of the Public Service Commission of 30 June 1971, in its Case No. 70-2966, is hereby affirmed, without prejudice to the right of the oppositors to initiate proceedings in the Commission for the adoption of the new formulae heretofore discussed. The right is also reserved to MERALCO to file proceedings seeking to increase the flexibility of the rates fixed by the decision. No costs.

Concepcion, C.J., Dizon, Makalintal, Zaldivar, and Fernando, JJ., concur.

Ruiz Castro, J., in a separate opinion, concurs in the result.

Barredo, J., concurs but reserves his right to file a separate opinion.

Teehankee, Villamor, and Makasiar, JJ., did not take part.

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[1] V. Francisco on Revised Rule 132, Section 35, page 1001.

**[2] 18 SCRA, 651.**

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### **CONCURRING IN THE RESULT**

#### **CASTRO, J.:**

My concurrence is limited to the result reached by the majority of my brethren because of misgivings I entertain with respect to a number of adjective aspects of the cases at bar.

I am hard put to agree that there was no unseemly haste with which the hearings below were conducted and terminated. The nagging impression that abides with me after a conscientious perusal of the proceedings below is that Commissioner Enrique Medina was racing against time to terminate the hearings, because he had set, as the deadline for the handing down of the decision (of the division of the Commission which he headed), the day before the date of his compulsory retirement from public service. This unseemly haste cannot command the approval of people (whether lawyers or persons unschooled in the law) who have an innate love for orderliness. Expedition is no doubt desirable in the disposition of cases, but it must nonetheless always observe due process, which of course basically means formal opportunity afforded to all parties to be fully heard. When due process is impaired because of inordinate haste, perceptive observers would draw the implication that legal processes have been eroded. And there would be dark, albeit veiled or circumlocutory, imputations of malfeasance, nonfeasance or misfeasance, or a combination of two or all of these. Deliberate speed is to be commended; inordinate haste deserves only condemnation.

I likewise view with some degree of concern an innovation in public utility adjudication that in effect has received the sanction of the majority here. This Court has proceeded to decide the cases at bar despite its awareness that a motion for reconsideration of the decision a quo is pending before the Public Service Commission en banc, which motion could not for some length of time be resolved because of the lack of quorum in that body.

Realizing, however, that the demands of moral justice indicate need for positive forward action on the part of this Court, I cannot, in conscience, completely disagree with the position taken by the majority that this Court can and

should go ahead, peremptorily sweeping away procedural roadblocks, to decide these cases in order the better to subserve the public interest. Nevertheless, I want to place on record my reservation that the manner by which the majority, impelled by the peculiar factual milieu, has disposed of these cases, should properly be regarded as ad hoc.

There is yet another matter upon which I differ with the majority. It is indeed a salutary doctrine, implied in the majority opinion ably penned by Mr. Justice J.B.L. Reyes, that the Solicitor General, in representation of the consuming public, may, at any time he deems necessary, petition the Public Service Commission for a revision of the rates fixed by this regulatory agency, since there is no *res judicata* in rate-making adjudication. Nowhere, however, in the said opinion is there a recognition in affected private parties in general the right to seek a revision of rates. The dispositive portion of the said opinion, as I construe it, reserves the right to seek a revision only to the parties in these cases and only in reference thereto. If this is so, then I say that this Court has unduly constricted the coverage of the doctrine. For my part, I would expand the doctrine explicitly to authorize the mayor and the municipal or city council of a municipality or city directly affected by a previous adjudication to initiate action for rate revision. In such an event, the Solicitor General may ask, and should be allowed, to intervene. I would not leave the representation of the consuming public exclusively to the Solicitor General, for a number of reasons, the basic of which are that (1) the Solicitor General is not necessarily better situated than municipal or city officials to determine the need and the time for a re-examination of previously adjudicated rates, and (2) it undoubtedly can happen that exercise by the Solicitor General of his initiative may, for one reason or another, be slow in coming (if it comes at all), and, when it comes, is feeble and therefore ineffectual.

At all events, because I believe that what ultimately is important in public utility adjudication is the end result, I hold no brief against the end disposition of these cases arrived at by the majority, which in my considered view, is morally just.

This limited concurrence should end here. But because these cases have posed a sharp controversy on what factors should be considered in the determination of the rate base and in the computation of the rate of return on investment, I am compelled to go farther and give expression to my own study and perspective on what the determinants should be.

I regard the power of the State to regulate the level of return that businesses "clothed with a public interest" may generate from those who make use of their properties and services as being fundamentally a matter of law. It is therefore relevant to assume that in the ever-recurring contest of determining the precise constitutional boundaries of that power, the administrative implementation of rate-fixing legislation will always be elevated to this Court for judicial review. An inquiry, therefore, into judicial attitudes toward the various factors affecting this problem is imperative.

This Court's opportunity to articulate on the subject has necessarily been limited by the mere handful of cases that have come up for review from the Public Service Commission. My study therefore perforce looks to and emphasizes American pronouncements. American courts and administrative bodies have had long and constant exposure to the various problems involved in rate-fixing, and their experience is certainly to be valued, within the context of our own legal and political systems.

In the United States, the landmark pronouncement that accorded recognition to the State's power to fix the rates that regulated businesses may charge, was handed down in 1876 in *Munn vs. Illinois*.<sup>[1]</sup> The U.S. Supreme Court, in striking down the contention that an Illinois statute which prescribed a maximum on the amount of charges that grain elevator operators may demand from the public violated the due process clause of the U.S. Constitution, said:

"... Looking then, to the common law, from whence came the right which the Constitution protects, we find that when private property is 'affected with a public interest, it ceases to be *juris privati* only.' This was said by Lord Chief Justice Hale more than two hundred years ago, in his treatise *De Portibus Maris*, 1 Harg. Law Tracts, 78, and has been accepted without objection as an essential element in the law of property ever since... When, therefore, one devotes his property to a use in which the public has an interest, he, in effect, grants to the public an interest in that use, and must submit to be controlled by the public for the common good, to the extent of the interest he has thus created. He may withdraw his grant by discontinuing the use; but, so long as he maintains the use, he must submit to the control."

Legislative power over these businesses in the matter of price-fixing is not, however, unlimited. As early as 1894, the U.S. Supreme Court in *Reagan vs. Farmers' Loan & Trust Co.*[2] said that:

". . . while it is not the province of the courts to enter upon the merely administrative duty of framing a tariff of rates for carriage, it is within the scope of judicial power and a part of judicial duty to restrain anything which, in the form of a regulation of rates, operates to deny to the owners of property invested in the business of transportation that equal protection which is the constitutional right of all owners of other property. There is nothing new or strange in this."

This assumption by the U.S. Supreme Court of the ultimate responsibility to adjudge what is a constitutionally permissible structure or level of rates for public utilities naturally called for the setting up of an acceptable and sufficient standard. The Court held in *Reagan* that the rates should be reasonable.[3] But what is a reasonable rate? By what method or basis can this be determined so that the dollar amount that is arrived at may be said to be reasonable?

In the leading case of *Smyth vs. Ames*,[4] the U.S. Supreme Court took occasion to enumerate the bases upon which the reasonable rate may be calculated. It said:

"We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public. And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there might not be other matters to be regarded in estimating the value of the property.

"What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience..."

The foregoing opinion, if construed as laying down a specific formula by which to quantify numerically a reasonable rate, can be said to have entirely failed to accomplish its purpose. In spite of its being all things to all men, however, it did serve one laudable end, for it did indicate quite plainly that a reasonable rate is a rate that gives a fair return on the fair value of the property being used for public convenience.

The "fair value" rule has undoubtedly its own share of practical difficulties which the Court itself was quite frank to recognize. In the so-called *Minnesota Rate Cases* decided in 1912, the Court said:[5]

"The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment, having its basis in a proper consideration of all relevant facts..."

Any realistic appreciation of all the relevant facts in a valuation problem, however, must have to begin with the premise that values are necessarily dated values. In the choice of the particular space-in-time valuation of public

utility properties, the U.S. Supreme Court, in these early decisions and for a long time thereafter, took the position that what the utility company is entitled to demand, in order that it may have just compensation for the public's appropriation of its property, is a fair return upon the reasonable value of the property at the time it is being used for the public.[6] The position taken by the U.S. Supreme Court in this respect is what has been known as the "cost of reproduction new" theory.

The adoption of this theory of property valuation did not, of course, mean that it was the only basis to be considered in determining the public utility company's rate base. This was apparent in *Smyth vs. Ames* and the other cases decided by that Court.[7] It was, however, clearly written in these decisions that the "cost of reproduction new" would control or should be given more weight in fixing utility property values. The U.S. Supreme Court's adoption of this posture undoubtedly reveals the practical difficulties entwined in the problem which it thought itself competent to disentangle.

A slight modification of this theory did not therefore take long in coming. In *Knoxville vs. Knoxville Water Company*,[8] the Court held that the cost of reproduction appraisal should include a deduction for accrued depreciation. Thus:

"The cost of reproduction is not always a fair measure of the present value of a plant which has been in use for many years. The items composing the plant depreciate in value from year to year in a varying degree. Some pieces of property like real estate depreciate not at all, and sometimes, on the one hand, appreciate in value. But the reservoirs, the boilers, meters, tools and appliances of every kind begin to depreciate with more or less rapidity from the moment of their first use. It is not easy to fix at any given time the amount of depreciation of a plant whose component parts are of different ages with different expectations of life. But it is clear that some substantial allowance for depreciation ought to have been made..."

In a subsequent case,[9] the Court held that accrued depreciation should be a deduction against the current value of the fixed assets rather than their actual cost, as is usually followed in accounting procedure. This ruling was adhered to in the Philippines in the case of *Ynchausti Steamship Co. vs. Public Utility Commission*. [10]

Another problem that was elevated to the U.S. Supreme Court for resolution in connection with its favorable attitude toward the "reproduction cost new" theory was whether the public utility should be priced on the basis of average prices or spot prices. The critical importance of an adequate and reasonable basis for fixing the prices of public utility assets under the reproduction cost calculation standard cannot be overemphasized since the prices of commodities in the market are in a continuous state of flux, influenced as they are not only by social and political turbulences but also by the expectations of buyers and suppliers. Thus, one authority on public utility regulation, writing in 1928, observed:

"Until very recently the most favored basis for the determination of unit costs has been a five-year or a ten-year average of prices covering the period immediately preceding the date of the appraisal, but the abnormal fluctuations in construction costs during and subsequent to the World War has inclined the United States Supreme Court to be indulgent to the guesses and forecasts of experts. Apparently, conditions have seemed to be so abnormal and unsettled as to destroy, or at least greatly impair, the usefulness of current prices, or of prices covering the war and postwar period, as a means of measuring fair present value. Actual cost has been largely remote and based on prices which have seemed to be entirely out of line with present conditions. So the courts, undoubtedly with reluctance, have been forced to turn away from abnormal present conditions and the obsolete facts of the past, to speculation on what the future is going to be ..." [11]

The use of "spot prices," with a reasonable allowance for future price changes, was sought to be justified in one case, as follows:[12]

"It is impossible to ascertain what will amount to a fair return upon property devoted to public service without

giving consideration to the cost of labor, supplies, etc., at the time the investigation is made. An honest and intelligent forecast of probable future values made upon a view of all the relevant circumstances, is essential. If the highly important element of present costs is wholly disregarded such a forecast becomes impossible. Estimates of tomorrow cannot ignore the prices of today."

Justice Brandeis, in a dissenting opinion written in another case<sup>[13]</sup> where spot reproduction cost was used instead of the average price of a utility company's assets for a ten-year period, criticized this ruling of the majority as impossible of accomplishment without the aid of Aladdin's lamp. He intoned:

"There is, so far as I recall, no statement of this court that value is tantamount to reproduction cost.

"Nor do I find in the decisions of this court any support for the view that a peculiar sanction attaches to 'spot' reproduction cost, as distinguished from the amount that it would actually cost to reproduce the plant if that task were undertaken at the date of the hearing. 'Spot' reproduction would be impossible of accomplishment without the aid of Aladdin's lamp. The actual cost of a plant may considerably indicate its actual value at the time of completion or at some time thereafter. Estimates of cost may conceivably approximate what the cost of reproduction would be at a given time. But where a plant would require years for completion, the estimate would be necessarily delusive if it were based on 'spot' prices of labor, materials and money. The estimate, to be in any way worthy of trust, must be based on a consideration of the varying costs of labor, materials, and money for a period at least as long as would be required to construct the plant and put it into operation ...."

The use of the "reproduction cost new" standard as the predominant factor in the determination of a public utility's rate base has not, however, been entirely free from dissent. Justice Brandeis criticized this theory as time-consuming, expensive and unreliable. In *Southwestern Bell Telephone*, supra, Justice Brandeis, dissenting, explained the various State Commissions' disenchantment with this theory, in this wise:

"At first reproduction cost was welcomed by commissions evidence as of present value. Perhaps it was because the estimates then indicated values lower than the actual cost of installment. For, even after the price level had begun to rise, improved machinery and new devices tended for some years to reduce construction costs.... The engineer spoke in figures — a language implying certitude. His estimates seemed to be free of the infirmities which have stamped as untrustworthy the opinion evidence of experts common in condemnation cases. Thus, for some time, replacement cost, on the basis of the prices prevailing at the date of the valuation, was often adopted by state commissions as the standard for fixing the rate base. But gradually it came to be realized that the definiteness of the engineer's calculations was delusive; that they rested upon shifting theories; and that their estimates varied so widely as to intensify, rather than to allay, doubts. When the price levels had risen largely, and estimates of replacement cost indicated values much greater than the actual cost of installation, many commissions refused to consider valuable what one declared to be assumptions based on things that never happened and estimates requiring the projection of the engineer's imagination into the future and methods of construction and installation that have never been and never will be adopted by sane men ...."

The "reproduction cost new" concept was also criticized by the U.S. Interstate Commerce Commission in these words:<sup>[14]</sup>

"Synthetic estimates of cost of reproduction based upon statistics showing price and wage changes do not make allowance for improved methods of assembly and construction. As will hereinafter be more fully indicated, we found in *Texas Midland Railroad*, supra, at page 140, that the increase in the cost of labor and materials between 1900 and 1914 was largely offset by improvement in the art of construction. How far there may have been a similar offset, so far as costs in the period from 1920-1923 are concerned, is not disclosed of record."

Viewed from another angle, the same Commission, through the concurring opinion of one of its commissioners, said:

"... Approximately one-third of the investment in railroad property is represented by common stock. The remaining two-thirds is represented by bonds, notes, or preferred stock, the holders of which are limited to a fixed or maximum return. The benefits of an excess in valuation from a rise in the general price level would, therefore, be reaped three-fold by the holders of common stock ..."

The accuracy of this conclusion is demonstrated below.

Let us assume that a simplified balance sheet contains the following data:[15]

Assets

Net Plant Account P1,000,000

Liabilities and Capital

4% Bonds

P500,000

5% Preferred Stock

250,000

Common Stock

250,000

P1,000,000

Upon the above assumptions, if the company is allowed and earns a 6% return on its assets based on original cost, it will have P60,000 with which to pay P20,000 of bond interest and P12,500 of preferred dividends, leaving P27,500 for common stock — a return of 11%. If 80% of this amount were paid out in common dividends, the yield on the common stock would be 8.8%.

Let us now assume that the company's rate base is increased by 30% to lend significance to reproduction cost or trended original cost under the existing price levels. If the same return of 6% were applied to this new rate base, the company will have P78,000 in net income. Deducting again the bond interest payment of P20,000 and the preferred dividend of P12,500, there would be available for common stock the sum of P45,500, a return equivalent to 18.2%. Assuming an 80% pay-out to common, the yield will be over 14.5%. Obviously, such stock would perform well in the securities market.

The above example provides much of the basis for the charge of "unjust enrichment" of the common stockholders of public utilities. Undoubtedly, the application of an undifferentiated rate of return to the rate base, given a

capital structure where the debt capital predominates, does open up good attractions for "trading on the equity."

Proponents of the "reproduction cost new" theory argue, however, that the intrinsic value of the peso as a result of inflation has greatly depreciated and therefore public utility owners should be given a corresponding increase in profits. It is pointed out, for example, that if prices rose from an index of 100 in 1960 to 225 in 1967, this means that in 1967 the peso bought less than half as much. If, however, the rate base is increased proportionately (the rate of return remaining more or less unchanged), the return in pesos would likewise increase, thereby giving the same purchasing power in 1960 as in 1967. If a person, therefore, had invested P1,000 in 1960 and received 6% or P60 for it a year, that investment should be valued in 1967 at P2,250 and earn P135. In this situation the P135 in 1967 would then have the same purchasing power as P60 in 1960.

To this argument, opponents of the theory counter, however, that this line of reasoning would be valid only if (a) investments generally are so rewarded during periods of declining purchasing power; and (b) the increased pesos of return go equally to the security holders. Experience has shown, unfortunately, that these assumptions do not occur in fact. Utility bonds, notes, and preferred stocks have specific yields which are fixed obligations regardless of the fluctuations in the purchasing power of money. Thus, if one is a holder of a ten-year bond in 1960, the interest on this bond of, say, 6% would still be the same 6% in 1967. Hence, if an original investment of P100 were to earn P12 because of new a valuation, only P6 would go to the bondholder, and all the rest to common stock which ordinarily occupies a mere minority position in the over-all capital structure of utility companies. And if a sizable portion of the company's common stock is owned by a holding company, it is easy to see that the latter stands to benefit the most under a cost of reproduction formula.[16]

Due to these various weaknesses of the "reproduction cost new" theory, it appears that even the U.S. Congress has not been amenable to its continued observance by Federal courts and regulatory agencies. For instance, the Federal Power Act of 1920 expressly directed that the rate base in water projects licensed by the Government should be the "actual legitimate original cost." [17] Likewise, the Public Utilities Act of 1935 which placed electric utilities engaged in the wholesale sale of electric energy in interstate commerce under the jurisdiction of the Federal Power Commission, directed the latter to investigate the "actual legitimate cost" of the properties of the said utilities.[18] The Federal Power Commission has also, in several cases, interpreted the Natural Gas Act[19] as authorizing it to utilize the original cost of production and transmission properties of gas companies as the rate base. Its interpretation of the Act has been, in fact, sanctioned by the U.S. Supreme Court as early as 1944 in *Federal Power Commission vs. Hope Natural Gas Co.* (320 U.S. 591 (1944)). Moreover, an overwhelming majority of the States in the United States have likewise refused to adopt the reproduction cost formula for purposes of rate-base determination.[20] These States have preferred the use of original cost figures in estimating the rate base.

Justice Brandeis explained the advantages of the original cost — prudent investment tests, as follows:[21]

"The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors involved in rate controversies which are now shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable. The rate base would be ascertained as a fact, not determined as matter of opinion. It would not fluctuate with the market price of labor, or materials, or money. It would not change with hard times or shifting populations. It would not be distorted by the fickle and varying judgments of appraisers, commissions, or courts. It would, when once made in respect to any utility, be fixed, for all time, subject only to increases to represent additions to plant, after allowance for the depreciation included in the annual operating charges. ...

". . . Twenty-five years ago, when *Smyth vs. Ames* was decided, it was impossible to ascertain with accuracy,

in respect to most of the utilities, in most of the states in which rate controversies arose, what it cost in money to establish the utility; or what the money cost with which the utility was established; or what income had been earned by it; or how the income had been expended ... Now the situation is fundamentally different. These amounts are, now, readily ascertainable in respect to a large, and rapidly increasing, proportion of the utilities. The change in this respect is due to the enlargement meanwhile, of the powers and functions of state utility commissions. The issue of securities is now, and for many years has been, under the control of commissions, in the leading states. Hence, the amount of capital raised (since the conferring of these powers) and its cost are definitely known, through current supervision and prescribed accounts, supplemented by inspection of the commission's engineering force...."

We have mapped out, in our jurisdiction, a course quite different from that advocated by Justice Brandeis,[22] but in rate controversies, it would seem that the result reached rather than the method employed is, in actuality and in the end, the main concern of this Court whenever it sits to review a decision of the Public Service Commission.

We now come to the problem of determining the correct rate of return which should be applied to the rate base. Leading court decisions in the United States have apparently provided three primary tests for determining or measuring the rate of return, namely, (1) cost of attracting capital; (2) maintenance of the integrity of investment or preventing the flight of capital; and (3) comparable earnings for comparable risks.[23] One of the earliest statements of recognition of these tests by the U.S. Supreme Court is found in *Bluefield Water Works Co. vs. Public Service Commission*, where the Court held:[24]

"What annual rate will constitute just compensation depends on many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

Obviously, the use of these tests in practice requires pragmatic adjustments and rational processes generally accepted in the fields of finance, economics and accounting. This conclusion finds ample support in the fact that as early as 1914, the U.S. Interstate Commerce Commission already imposed a uniform system of accounting for electric railway companies. This was followed in 1926 by another uniform system of accounting prescribed for telephone companies and steam railroad systems.[25] The Federal Power Commission, under the Federal Power Act, has also done the same.[26]

A brief illustration of how, in particular, the Federal Power Commission has approached the problem of rate regulation, was described in one law journal as follows:[27]

"The revised regulations for electric utilities and licensees require a full cost-of-service study as part of the information submitted at the time of filing a change in a rate schedule. The required information is to provide an analysis of the electric system's cost for a test period of 12 consecutive months, including return, taxes, depreciation, operating expenses, and allocation of the cost of services rendered. Cost of plant, accumulated depreciation, operating expenses, and depreciation expense must be shown for the test period by functional classification (production, transmission, distribution and general functions). The filing is required to present information in the following categories:

"(1) The percentage rate of return claimed, with a brief statement of the basis for the claim, together with

information on costs of debt, preferred stock capital, and returns experienced by the company on the common stock outstanding over the preceding 5 years — including (a) earnings offering price ratios and (b) earnings and dividend price ratios.

"(2) Income taxes computed on the basis of the rate of return claimed, together with the basis on which income taxes are assigned among the jurisdictional business, other utility department and non-utility operations.

"(3) The cost of service allocated to the sale or sales for which the increased rate is proposed and the cost of service related to any special facilities devoted entirely to the given service.

"(4) Computations to show 'energy responsibility' and 'demand responsibility' of the service. Non-coincident and coincident data are required for each month of the test period together with an explanation of how the unit demand costs are derived."

A regulatory commission's field of inquiry, however, is not confined to the computation of the cost of service or capital nor to a mere prognostication of the future behavior of the money and capital markets. It must also balance investor and consumer expectations in such a way that the broad requirements of public interest may be meaningfully realized. It would hence appear in keeping with its public duty if a regulatory body is allowed wide discretion in the choice of methods rationally related to the achievement of this end.

The value of this kind of approach is well-recognized by the U.S. Supreme Court. In *Federal Power Commission vs. Hope Natural Gas Co.*, that Court said:[28]

"Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not the theory but the impact of the rate order which counts. 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. 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."

Rate controversies in many cases, however, have not ended in the regulatory commissions. And there is no doubt that they won't. Hence, the recognition in a regulatory agency of ample discretion in the choice of such rational processes as might be appropriate to the solution of its highly complicated and practical difficulties, suggests that it should indicate fully and carefully, in every case, the method or methods it has employed, the purposes which guided its action, and the reasons that made the method or methods chosen and the purposes pursued relevant under the facts of the case.[29] In this way, the Court's evaluation of the Commission's orders would be more accurate, efficacious and sensible. For, after all, the Court's responsibility, as held in *In Re Permian Basin Area Rate Cases*,[30] "is not to supplant the Commission's balance of those interests which are more nearly to its liking, but instead assure itself that the Commission has given reasoned consideration to each of the pertinent factors."

Apart from the question of whether or not the Court should actively intervene in the Commission's choice of an appropriate method by which to measure the rate base and the rate of return, American courts have also dealt with the problem of whether certain properties of the utility company should be included in the rate base for valuation purposes.

One such item pertains to those constructed out of retained earnings. In *Board of Public Utility Commissioners vs. New York Telephone Co.*,[31] the U.S. Supreme Court expressed the view that property constructed out of surplus earnings belongs to the utility and is entitled to yield a fair return from the rates charged the consumers as fully and completely as if it had been furnished by the investors from outside sources. In this case, the New Jersey

Commission found that the company in previous years had earned and set aside for depreciation amounts largely in excess of the actual depreciation accruing, and held that the company could not claim an increase of rates until this excess in the depreciation reserve had been exhausted in making up current operating deficits. In reversing the ruling of the Commission, the Court said:

"... Constitutional protection against confiscation does not depend on the source of the money used to purchase the property. It is enough that it is used to render the service. The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. The revenue paid by the customers for service belongs to the company..."

The Court also justified its decision on the ground that rates which in the past were unchallenged, or, if challenged, were approved by the authorities, should be assumed to have been reasonable, or, at most, not so unreasonable as to give the public a right of action against the utility company to recover any part of the charges paid. Consequently, whatever has been collected under previously approved rates became the property of the company which it is free to use as any other type of private property.

It is difficult to disagree with the approach taken by the American court with respect to property built out of surplus profits. However, it would seem that where its application in specific instances would work hardship on the consumers, there is one way out. And this is the downward adjustment of the rate of return. This solution appears most equitable in a case where security holders regularly receive a reasonable amount of dividends under existing rates, and, in addition thereto, the company has been able to put up betterments and improvements.

Another type of property which has given rise to complicated problems in the process of determining which items should be included in the inventory for valuation purposes, is that acquired by the company without cost or only for a minimal cost, and structures built through company funds but over which when completed it can claim no title. For instance, a provincial government may donate lands or rights of way to a railroad company to speed up the development of the transportation system within the province, or the municipal or city government may require that an electric company in laying down its mains or underground tunnels should reconstruct and pave the streets affected by such constructions. The basic question is, therefore, often asked whether properly so acquired without cost and those built by the utility over which it acquires no title should be allowed to be capitalized against the consumers.

As developed in American case-law, the rule is that the value of the property owned by the utility and devoted to public use must be included in the rate base. It is evident, however, that this rule does no more than lay down a general principle of law to guide regulatory bodies in the solution of their practical difficulties. Indeed, slavish adherence to this rule, in some instances, will produce inequitable results. Thus, writing on the basic problems involved in this type of property, one writer said:[32]

"On this whole matter of contributions, unless there is some good reason to the contrary, the rule should work both ways. That is, the rule adopted should be applicable alike both to donations by the company and to donations by the public. If the reconstruction of a street or the building of expensive street approaches is a necessary part of the expense of constructing a railroad, it is only fair and just that the company should be allowed to earn a fair return on such investment regardless of the fact that the title to such property is not vested in the company but in the city. Similarly if the government has given this same company the land for its right of way, the actual property in which the company has invested capital and not that part to which it has title but which has been donated by the government should be considered in determining reasonable rates. Actual title and possession are not always conclusive. The determination of a reasonable rate is an equitable process and equity will demand that certain property to which the company has no title should be included and

certain property to which the company has title should be excluded. ..."

A lot would depend, therefore, upon the purpose for which a contribution was given in resolving the various disagreements that may be encountered in this particular aspect of rate-base determination.

There is yet another class of utility property about which men of different persuasions may be expected to entertain divergent views in the formulation of specific ground rules for purposes of rate-base inclusion. This has reference to unused utility properties. One authority roughly classifies these properties into four types, namely, (1) property once used, but now become worn-out; (2) property not needed for public service, but conveniently or necessarily acquired in getting other property that is in service; (3) property acquired in anticipation of the future requirements of public service, but not yet put into use; and (4) property acquired as an investment or speculation without regard to present or future public needs.[33]

The decisions of the U.S. Supreme Court provide only a vague notion of what property shall be classed as "used" or "unused." one can easily see this in that Court's free use of such expressions as "property used and actually useful in a public service"[34] "properties devoted to public service"[35] "property at the time it is being used for the public,"[36] to determine what should be included in the rate base. Such statements are rather quite difficult of applications since a certain degree of use can always be claimed for almost any piece of property.

It would seem to me, however, that, in general, this Court can do no more than say that what should be included in the rate base are those properties which are being devoted to public service at the time of the investigation for rate-revision purposes, since whether an item of property is actually being used or is being reasonably held for operations is essentially and primarily a factual question. It involves (in the very least) the exercise of reasoned judgment and a realistic appraisal of values on the part of our regulatory agency.

In the American experience, much of the confusion and uncertainty not only on this aspect of utility regulation, but on almost every step of the regulatory process, has been eliminated through the enactment of uniform systems of accounting or classification of utility property — something which our own regulatory agency might well follow and possibly improve upon. Such standards are not, of course, strictly binding upon appraisers, commissions and courts, but they do tend to bring order out of chaos. Close adherence to such standards where they produce no arbitrary result will not likely provoke reproach from this Court.[37]

We do not expect to follow and observe American techniques and principles all the way; differences do exist between our respective jurisdictions. But if we maintain constant touch with the growth and development of public utility principles and practices in the United States, it is mainly because of our continuing quest for that which, not being circumscribed by any political boundary or not being indigenous to any particular legal system, will provide one good workable formula - together with and among many - for keeping our Philippine society in order.

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**[1] 94 U.S. 113 (1876).**

**[2] 154 U.S. 362 (1894).**

[3] See also *Covington and Lexington Turnpike Road Co. vs. Sandford*, 164 U.S. 578 (1896).

**[4] 169 U.S. 466 (1898).**

[5] See *Simpson vs. Shepard*, 230 U.S. 352 (1912), where the Court repudiated the gross revenue method of arriving at a fair rate of return, reasoning that gross earnings may be consumed by expenses, leaving little or no profit.

[6] *San Diego Land & Town Co. vs. National City*, 174 U.S. 739 (1899).

[7] See *Southwestern Bell Telephone Co. vs. Public Service Commission (Mo.)*, 262 U.S. 276 (1923); *Market Street Co. vs. Railroad Comm. of California*, 324 U.S. 548 (1945).

**[8] 212 U.S. 1 (1909).**

[9] *United Railways & Electric Co. vs. West*, 280 U.S. 234 (1929).

[10] 42 Phil. 621 (1922); also in *Asturias Sugar Central vs. Philippine Railway Co.*, 72 Phil 455 (1944).

[11] Robert H. Whitten, *Valuation of Public Service Corporations* (Banks Law Pub. Co., New York, 1928), p. 665.

[12] *Southwestern Bell Telephone Co. vs. Public Service Commission*, 262 U.S. 276 (1923). The idea of including future price trends in the rate base was first suggested in *Galveston Electric Co. vs. Galveston*, 258 U.S. 388 (1922). See also *Bluefield Water Works & Improvement Co. vs. Public Service Commission*, 262 U.S. 679 (1923).

[13] *McCardle vs. Indianapolis Water Co.*, 272 U.S. 400 (1926).

[14] *Excess Income of St. Louis & O'Fallon Railway Co.*, 124 I.C.C. 3 (February 1927). When this case reached the U.S. Supreme Court, it reproved the Commission for its failure to give at least some weight to the reproduction cost theory. See *St. Louis & O'Fallon Rr. Co. vs. United States*, 279 U.S. 461 (1929).

[15] For interesting illustrations, see A.J.G. Priest, "Public Utility Rate Base," *Iowa Law Review*, vol. 51, no. 2 (Winter, 1966), p. 306. See also Mosher and Crawford, *Public Utility Regulation* (Harper & Bros., New York, 1933), p. 240; Thompson & Smith, *Public Utility Economics* (McGraw-Hill Book Co., New York, 1941), p. 355.

[16] See Thompson, *ibid.* at p. 287.

[17] 16 U.S.C. 791-823 (1946). See James C. Oldham, "Rate-Base Determination and Profits," *Univ. of Colorado Law Review*, vol. 39, no. 4 (summer, 1967), p. 511.

**[18] 16 U.S.C. 824-825 (1946).****[19] 15 U.S.C. 717 (1946).**

[20] See A.J.G. Priest, "Public Utility Rate Base," *Iowa Law Review*, vol. 51, no. 2 (1966), p. 306.

[21] *Southwestern Bell Telephone Co. vs. Public Service Commission of Missouri*, 262 U.S. 276 (1923).

[22] See *Meralco vs. PSC*, L-24762, and allied cases, Nov. 14, 1966, 18 SCRA 651.

[23] For a technical discussion of various methods of estimating rates of return, see Burton Kolb & Otis Lipstreu (eds.), *NEW Concepts and Current Issues in Public Utility Regulation*, (Colorado, 1963 edition).

[24] 262 U.S. 679 (1923). See also *Dayton-Goose Creek Railway Co. vs. United States*, 263 U.S. 456 (1924).

Some published articles on the subject of rate of return determination may be found in Harold Somers' "Cost of Money as Determinant in Public Utility Rates," *Buffalo Law Journal*, vol. 4 (1951), p. 289; Harold Leventhal, "Vitality of Comparable Earnings Standard for Regulation of Utilities in a Growth Economy," *Yale Law Journal*, vol. 74 (May 1965), p. 989; "Rate-making Under Conditions of Regulated Intermodal Competition: The Status of Regulated Incremental Cost-Pricing," *Virginia Law Review*, vol. 55 (May 1959), p. 691.

[25] See Robert H. Whitten, *Valuation of Public Service Corporations*, vol. II (Banks Law Pub. Co., New York, 1928), p. 1820.

[26] *Ibid.*

[27] J. Rhoads Foster, Paul J. Garfield & Henry Herz, "FPC Regulation of Sales of Electric Energy at Wholesale," *Virginia Law Review*, vol. 51, no. 1 (January 1965), p. 76. See also J.H. Foy, "Cost Adjustment in Utility Rate Schedules," *Vanderbilt Law Review*, vol. 13 (June 1960) p. 663; "Evolving Concept of FPC Natural Gas Rate Regulation," *Kansas Law Review*, vol. 16 (April 1968), p. 378.

[28] 320 U.S. 591 (1944). In this case the validity of a rate order of the FPC under the Natural Gas Act (15 USC 717) was contested. The Commission adopted the cost of capital-prudent investment theory in determining fair return and was objected to as contrary to precedent. Section 5(a) of this Act provides that "Whenever the Commission, after hearing ... shall find that any rate, charge or classification demanded, observed, charged or collected by any natural gas company ... is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed and in force, and shall fix the same by order." Section 19(b) of the Act also provides that the "findings of the Commission as to the fact, if supported by substantial evidence, shall be conclusive."

This case is also important in other respects: It apparently overturned the "fair value" rule of *Smyth vs. Ames*, *supra*; considered rate-making an species of the police power rather than eminent domain; and approved the deduction of depreciation based on actual cost rather than upon current value, contrary to the holding in *United Railways & Electric Co. vs. West*, 280 U.S. 234 (1929).

[29] See Harold N. Somers, "The 'End-Result' Approach to Public Utility Regulation," *Buffalo Law Review*, vol. 16, no. 3 (Spring, 1967), p. 689.

[30] 390 U.S. 1361 (1967). A discussion of the significance of the Federal Power Commission's decision in this case appeared in Edmund W. Kitch, "The Permian Basin Area Rate Cases and the Regulatory Determination of Price," *Univ. of Pennsylvania Law Review*, vol. 116, no. 2 (December 1967), p. 191.

**[31] 271 U.S. 23 (1926).**

[32] Robert H. Whitten, *op cit.*, p. 773. See also Francis X. Welch, *Preparing for the Utility Rate Case* (1954), pp. 119-170.

[33] *Ibid.*, p. 808.

[34] *Denver vs. Denver Water Union Co.*, 246 U.S. 178, 190 (1918).

[35] *Southwestern Bell Telephone Co. vs. Public Service Commission (Mo.)*, 262 U.S. 276, 288 (1923).

[36] *San Diego Land & Town Co. vs. National City*, 174 U.S. 739, 757 (1899).

[37] Note that in the Permian Basin Area Rate Cases, *supra*, the U.S. Supreme Court said that "the Commission's

orders may not be disturbed if they produce 'no arbitrary result,'" citing *F.P.C. vs. Hope Natural Pipeline Co.*, 315 U.S. 586, and other cases.

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