

YNCHAUSTI STEAMSHIP CO. ET AL., PETITIONERS, VS. THE PUBLIC UTILITY COMMISSIONER AND THE BOARD OF APPEAL, CREATED BY SECTION 30, ACT NO. 2307, AS AMENDED, RESPONDENTS.*G. R. No. 17665. January 09, 1922*

Ponente: JOHNS, J.

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The petitioners are members of the Philippine Shipowners' Association and engaged in the operation of vessels in and around the Philippine Islands. By reason of a decrease in the volume of business handled by its members and for and on their behalf, it duly filed with the Public Utility Commissioner of the Philippine Islands a declaration that on and after May 1, 1920, it would make a 10 per cent increase in shipping rates above those allowed under Order No. 16 of the Board of Rate Regulation.

This increase was allowed and became effective by an order of the Public Utility Commissioner dated April 24, 1920, and final on May 1, 1920.

In a short time and on account of low wages, there was a general strike of the seamen and officers operating the vessels owned by the members of the association and it became necessary to increase the wages paid the men and to make other concessions which materially increased operating expenses, by reason of which the 10 per cent increased rate v/as insufficient to meet the increased operating expense. June 21, 1920, the association filed an amended declaration with the Public Utility Commissioner, praying for a further raise of 10 per cent on freight rates over those established May 1, 1920, to the effect that from and after July 20, 1920, it would make a 15 per cent increase on the freight rates fixed by Order No. 16, and that the increase would be in addition to all others which had been approved and authorized by the Public Utility Commissioner.

The proposed 15 per cent increase was suspended and a hearing was ordered. At this the Commissioner ordered that a representative of each shipowner in interest should appear and submit an operating account of each of their steamers, one covering the expenses for the month of December, 1919, another for the period from January 1 to April 30, 1920, and the third from May 1 to June 30, 1920, with the exception of some of the steamers, among which were the Cebu and the Vizcaya, which were requested to submit reports for the year 1919. The accounts were presented as requested, and on October 19, 1920, the Commissioner refused to make any increase on the rates for the following:

Steamers Owned by—

Sorsogon..... Ynchausti Steamship Co.

Vizcaya..... Ynchausti Steamship Co.

Panglima..... Ortiga Hermanos.

Gabrielle Poizat... Juan M. Poizat & Co.

Cebu..... Compañia Maritima.

Perla..... Ruiz y Rementeria, S. en C.

Granted an increase of 10 per cent to the

Steamers Owned by—

Churruca..... Ty Camco Sobrino.

San Vicente..... Li Seng Giap.

and 20 per cent to the steamer Maria Luisa owned by Teodoro R. Yangco, and allowed an increase of 25 per cent over the rates fixed by Order No. 16 of the Board of Rate Regulation, on the rest of the steamers, the names and owners of which are not before this court.

As to the parties here, it appears that the rate allowed by the Commissioner was based on the original cost of the vessel as distinguished from its present value, and that the 5 per cent per annum depreciation was allowed upon the original value of the vessel as opposed to the cost of replacement. From this decision a hearing was granted and heard before the Board of Appeal, under section 30 of the Public Utility Act No. 2307, as amended, and on April 15, 1921, that board affirmed the decision of the Public Utility- Commissioner, and the proceedings are brought here for review.

The petitioners assign several different errors, contending among other things that there is no evidence to reasonably support the decision; that the 5 per cent depreciation is based on the original cost of the ship and not on replacement; that the allowance of 10 per cent per annum on the investment is based on the original cost of the ship and not on its present value; and that the average cost of repairs for the past five years should not be substituted for the actual cost of such repairs for the operating period which was submitted to the board.

In so far as we are advised, the important question in this case is one of first impression in this court. There is a legal presumption that the fixed rates are reasonable, and it must be conceded that the fixing of rates by the Government, through its authorized agents, involves the exercise of reasonable discretion and, unless there is an abuse of that discretion, the courts will not interfere. Also that, although the fixing of rates is a legislative and governmental power over which the Government has complete control, it has no power to fix rates that are unreasonable or to regulate them arbitrarily, and that as to whether a given rate is fair and reasonable is a judicial question over which the courts have complete control. In addition to what is known as the net earnings rule, there are four different theories of ascertaining what constitutes a reasonable rate, each of which is supposed to give a fair return on the reasonable value of the property. First, the original cost; second, cost of reproduction; third, outstanding capitalization; and, fourth, present value. After discussing the merits of these different theories, Pond on Public Utilities, section 484, says:

"Present value true test.—While all accurate available evidence of the original cost as well as the cost of reproduction is desirable and helpful in determining the extent of the actual investment necessary to render the service in any particular case, neither these nor the amount of capitalization are conclusive.

The present market value of the plant or its worth as a going concern is the ultimate practical basis for determining the value of the investment upon which to fix a rate which will produce a fair return * * *."

The question was discussed in the City of Knoxville vs. Knoxville Water Company (212 U. S., 1; 53 L. ed., 371). That leading case involved the value of a waterwork system which "was determined by the master by ascertaining what it would cost, at the date of the ordinance, to reproduce the existing plant as a new plant." The court says:

"The cost of reproduction is one way of ascertaining the present value of a plant like that of a water company, but that test would lead to obviously incorrect results if the cost of reproduction is not diminished by the depreciation which has come from age and use. * * * 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. * * * It is entitled to see that from earnings the value of the property invested is kept unimpaired, so that, at the end of any given term of years, the original investment remains as it was at the beginning * * *."

In section 486, Pond further says:

"Valuation as of the time question determined.—The same court in the case of Willcox vs. Consolidated Gas Co. (212 U. S., 19; 53 L. ed., 382), decided in 1909, that the value of the property is to be determined as of the time when the inquiry is made regarding the rates, for as the court said: 'There must be a fair return upon the reasonable value of the property at the time it is being used for the public'"

The case of National Waterworks Co. vs. Kansas City (62 Fed., 853; 27 L. R. A., 827), speaking of the basis for a rate, says:

"* * * Capitalization of the earnings will not, because that implies a continuance of earnings, and a continuance of earnings rests upon a franchise to operate the waterworks. The original cost of the construction can not control, for 'original cost' and 'present value' are not equivalent terms * * *."

In Des Moines Water Co. vs. City of Des Moines (192 Fed., 193), the court says:

"* * * What is the value of the plant today? There must be a reasonable rate of interest or dividends allowed on the value of the plant * * *. There can be no true test, other than the physical valuation, and to such physical valuation there may be added certain other items."

That the true basis is the present value of the investment is held in Cedar Rapids Gas Light Co. vs. Cedar Rapids (144 Iowa, 426; 223 U. S., 655; 56 L. ed., 594), in which the Supreme Court of the United States on a writ of error from the decision of the Supreme Court of Iowa, says:

"In this case the court fixed a value on the plant that considerably exceeded its cost, and estimated that, under the ordinance, the return would be over six per cent. Its attitude was fair, and we do not feel called upon to follow the plaintiff into a nice discussion of details.

* * *" In Willcox vs. Consolidated Gas Co. (212 U. S., 19; 53 L. ed., 382), it is said:

"* * * There must be a fair return upon the reasonable value of the property at the time it is being used for the public. * * * In order to determine the rate of return upon the reasonable value of the property at the time it is being used for the public, it, of course, becomes necessary to ascertain what that value is. * * * And we concur with the court below in holding that the value of the property is to be determined as of the time when the inquiry is made regarding the rates. If the property which legally enters into the consideration of the question of rates has increased in value since it was acquired, the company is entitled to the benefit of such increase. This is, at any rate, the general rule. We do not say there may not possibly be an exception to it where the property may have increased so enormously in value as to render a rate permitting a reasonable return upon such increased value unjust to the public. * * *

"* * * In ascertaining values in this way, the worth of a new plant of equal capacity, efficiency, and durability, with proper discounts for defects in the old and depreciation for use, should be the measure of value rather than the cost of exact duplication." [Cedar Rapids Gas Light Co. vs. Cedar Rapids, 144 Iowa, 426.] In San Diego Land & Town Co. vs. Jasper (189 U. S., 439; 47 L. ed., 892), the court says:

"* * * It no longer is open to dispute that under the constitution 'what the company is entitled to demand, in

order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public' "

In *Smyth vs. Ames* (169 U. S., 466; 42 L. ed., 819), it is 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. * * * What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. * * *"

Section 494 of Pond says:

"Current market price and rate of interest.-That the valuation should be made contemporaneous with the fixing of the rate and that the proper test in determining the value is the market price of the property upon which the current rate of interest is commonly regarded as a fair return and a proper basis for fixing the rate is the effect of the decision in the case of *Consolidated Gas Co. vs. New York* (157 Fed., 849), decided in 1907, where the court said: 'As to the realty, the values assigned are those of the time of inquiry; not cost when the land was acquired for the purposes of manufacture, and not the cost to the complainant of so much as it acquired when organized in 1884, as a consolidation of several other gas manufacturing corporations * * *. What the court should ascertain is the "fair value of the property being used" (*Smyth vs. Ames*, 169 U. S. at page 546); the "present" as compared with "original" cost; what complainant "employs for the public convenience" (169 U. S. at page 547) ; and it is also the "value of the property at the time it is being used" (*San Diego Land Co. vs. National City*, 174 U. S. at page 75?) * * *. The value of the investment of any manufacturer in plant, factory, or goods, or all three, is what his possessions would sell for upon a fair transfer from a willing vendor to a willing buyer * * * "

In *State vs. Southern Pacific Co.* (31 Pac, 960), the Supreme Court of Oregon says:

" * * * It is the actual value of the road, appurtenances, and equipments upon which a just and fair return must be allowed under the commission act of this state * * *."

It is the theory of the law that a public utility should have a fair and reasonable return upon its property which is used by the public, and, under the modern authorities, the rate is based upon the physical valuation of the property, because in effect the property is both used and consumed by the public. In an action to condemn land to a public use, it would not be contended that the measure of damages to the owner would be the original cost of the land, or that if at one time the land was of a much greater value and had depreciated, the owner would then be entitled to recover the once greater value. In such a case the measure of damages would be the actual value at the time of the appropriation. So, on principle, the vessel here is deemed taken and condemned by the public at the time of the filing of the petition, and the rate should go up and down as the physical valuation of the vessel goes up and down, and the purpose of the hearing is to place a physical valuation upon the vessel and then base a reasonable rate upon that valuation. Hence, the original cost of the vessel is not the basis for the valuation and is not important, except in so far as it may enable the Commissioner to determine the present value of the vessel.

When a public utility once enters the public service, it is no longer a free agent and the control and operation of its property is subject to reasonable rules and regulations by the public, and to that extent and for that purpose it is a taking of the property by the public. As one of the conditions upon which you can operate a public utility, the public says you must operate it under reasonable rules and regulations, otherwise you cannot operate a public utility. Hence, when property becomes a public utility, it ipso facto, for operating purposes, amounts to an actual taking and appropriation of the property to the public use, so long as it is a public utility. In legal effect, such operation amounts to a pro tanto taking and appropriation.

It is elementary constitutional law that private property cannot be taken for public use without just compensation

is first assessed and tendered. But where the taking is not full, final, or complete, but is in the nature only of a continuous daily taking and appropriation, it must follow that there will be a fluctuation in the market value of the property during the period of public service, which, as to a vessel, would change with the cost of labor and material necessary for its construction. But in fixing the rate, it would not be fair to the public to base it upon a peak cost, and, for the same reason, it would not be fair to the owner of the property to place it upon a minimum cost. Neither would it be fair to either party to base the rate upon any abnormal condition. A just rate must be founded upon conditions which are fair and reasonable both to the owner and the public.

The rule is well stated in *Brooklyn Borough Gas Co. vs. Public Service Com.* (P. U. K., 1918F, p. 347), where it is said:

"While it is important to consider the cost of reproduction in determining the fair value of a plant for rate-making purposes, it cannot be said that there is a constitutional right to have the rates of a public service corporation based upon the estimated cost of the reproduction of its property at a particular time regardless of circumstances. To base rates upon a plant valuation simply representing a hypothetical cost of reproduction at a time of abnormally high prices due to exceptional conditions would be manifestly unfair to the public, and likewise to base rates upon an estimated cost of reproduction far lower than the actual bona fide and prudent investment because of abnormally low prices would be unfair to the company * * *. But it is a different thing, after cost has been defrayed, and the question is as to the compensation to be allowed in excess of cost, to take as the basis for a compensatory return an asserted plant value, far above the actual investment, which is reached merely by expert estimates of a cost of reproduction under abnormal conditions * * *."

The rule is well established in *Salt Lake City vs. Utah Light & T. Co.* (3 A. L. R., 715-728; P. U. R., 1918F, 377; 173 Pac, 556), where the Court says:

"* * * It is therefore of the utmost importance that the Commission should proceed with great care in changing rates. While caution in that regard should always be exercised, yet, at this time, when the whole world is engaged in a most destructive war and every condition is grossly abnormal, to do so is of special importance. While, generally speaking, every utility that serves the public must be allowed a fair and reasonable return on its investments, over and above the actual cost and expense of providing adequate, efficient, and safe service when economically managed, yet it is not true that such a return must be assured to every utility when, as now, the conditions are grossly abnormal on account of the war, and while such conditions are necessarily temporary. At such a time and under such conditions every individual and every enterprise must bear his or its share of the burden incident to the great conflict; and while rates should be made adequate to permit every public utility to pay a reasonable wage to its employees and to provide adequate, safe, and efficient service, yet rates should not be so high as to become oppressive, and they should be so regulated as to be fair both to the utility and to the public. * * *"

The Attorney-General agrees "that it is error to base the reasonableness of rates on the original cost exclusive of all other consideration," but contends that it does not appear that the Commissioner based the rates exclusively on the original cost, and that, therefore, his rulings must be sustained. He also contends that the Commissioner had only two data upon which to base a rate. The original cost and the estimated cost. That he could not accept the estimated cost, because it was based upon abnormal war prices and, as no evidence of the reasonable value was presented, the Commissioner accepted the original cost, and, hence, it should be presumed that he was of the opinion that the original cost represented the fair value or something near the fair value of the property.

The purpose of the hearing was to determine what was a just and reasonable rate. Under the authorities above cited, such a rate should not be based upon the original cost of the vessel. Neither, under existing conditions, should it be based upon the estimated cost. The one is not fair to the shipowner, and the other is not fair to the public. For example, the original cost of the *Venus* was P115,000, and the estimated cost of reproduction was

P409,446.03. The original cost of the Vizcaya was P120,000, and the estimated cost was P533,318.73. The figures of these two vessels fairly show the relative difference in the cost of reproduction and the original cost of the different vessels, and are strong evidence of the existence of abnormal conditions. In addition, this court will take judicial knowledge of the recent World War and that Peace was declared in November, 1918, and the amended declaration upon which the hearing was had was filed June 21, 1920, a little more than eighteen months after peace was declared, and that conditions were then more or less abnormal. If, as the Attorney-General says, the Commissioner based the annual income rate on the original cost of the vessel, it was legal, prejudicial error, and was not fair to the owner.

As the above authorities hold, the original cost of a vessel should only be considered for the purpose of determining its present or market value. Although it may be true that it was the duty of the owner of a vessel to have submitted evidence to the Commissioner of the present or market value of the vessel under normal conditions, yet the failure to do this would not justify the Commissioner in basing- the rate on the original cost. As a fair and impartial tribunal, it should require competent proof of the necessary facts upon which to base the rates, and where, as in this case, the only proof offered was the original and estimated costs, neither of which is competent except as it tends to show the present or market value of the vessel, the Commissioner had no right to accept either rate as the true basis, or one to the exclusion of the other, and should have required that proof should be furnished of the present or market value of the vessel under reasonably normal conditions. The basing of the rate on the original cost of the vessel was prejudicial, legal error. This same principle should apply to the 5 per cent depreciation. The percentage for depreciation should be based on the market value and not on the original cost of the vessel. Complaint is made that 10 per cent return on the investment is not sufficient. The question as to what is a reasonable rate is one which largely rests in the discretion of the Commissioner, with which, without some good reason, this court is not disposed to interfere. Complaint is also made that "the average of repairs for the past five years is substituted in place of actual expenditures for repairs during the period covered by the operating statements thus bringing into the average a period when labor and material costs were far below what they were today." Under normal conditions this contention would be sound, but as shown here the conditions were not normal. It is the order of this court that this cause be reversed and remanded with directions to the Commissioner to require and take proof of the present or market value of the vessel, and that, in arriving at such value, he consider the actual cost of the vessel, its cost of reproduction, and any other evidence which will tend to show its present or market value, and that when the present or market value of the vessel is thus determined, he shall then fix a reasonable return on the investment based on such value, and that also the depreciation percentage be based on the same value. On all other questions this court declines to interfere with the order of the Commissioner. Neither party will recover costs.

Araullo, C. J., Johnson, Street, Malcolm, Avanceña, Villamor, Ostrand, and Romualdez, JJ., concur.

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