

LBM

Decision No. 19767.

ORIGINAL

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
 CALIFORNIA WATER SERVICE COMPANY,
 a corporation, for (1) order author-
 izing the issue of stocks and bonds;
 (2) order authorizing mortgage of
 certain public utility properties and
 (3) jointly with C.B.Jackson, Chico
 Water Supply Company, a corporation,
 Port Costa Water Company, a corpora-
 tion, Fresno City Water Corporation,
 a corporation, Visalia City Water
 Company, a corporation, Electric Water
 Company, a corporation, Bakersfield
 Water Works, a corporation, and Hermosa-
 Redondo Water Company, a corporation,
 respectively, for order authorizing
 the purchase and sale of certain public
 utility securities and properties, and
 jointly with Petaluma Power and Water
 Company, a corporation, Belvedere Water
 Corporation, a corporation, and C.B.
 Jackson, for order authorizing the
 purchase and sale of certain public
 utility securities and properties,
 additional petitioners.

Application No. 13514

McCutchen, Olney, Mannon and Greene, for applicants;
 Arthur H. Garland, Deputy Commissioner of Corporations;
 E.F.Brittan, City Attorney for City of Bakersfield;
 Loren A. Butts, City Attorney for City of Fresno and
 City of Visalia;
 J. L. Johnson, City Attorney for City of Stockton.

BY THE COMMISSION:

SECOND SUPPLEMENTAL OPINION

By Decision No. 18084 dated March 21, 1927, as amended,
 the Commission authorized applicants, Chico Water Supply Company,
 Port Costa Water Company, Visalia City Water Company, Fresno City
 Water Corporation, Electric Water Company, Bakersfield Water
 Works and Hermosa-Redondo Water Company, to sell and convey their
 properties to California Water Service Company, which was also

authorized to acquire the stock of said corporations. It also authorized applicant, C.B. Jackson, to sell to the California Water Service Company the business and properties comprising the Chico Vecino Water Company (unincorporated), the business and properties comprising the W.E. White Water Company (unincorporated), a lot at Visalia, and all his right, title and interest in and to the contract dated December 7, 1926, between him and Pacific Gas and Electric Company.

The Commission also authorized Pacific Gas and Electric Company to sell and convey direct to the California Water Service Company the properties, businesses, rights and privileges included in said contract of December 7, 1926, and any amendments or modifications thereof.

Subdivision seven of the order, in Decision No. 18084 reads as follows:-

"Applicant, California Water Service Company, is hereby authorized to issue \$2,000,000. par value of common stock and sell said \$2,000,000. of common stock, together with such additional stock (common and/or preferred) and bonds, which the Commission may hereafter authorize to be issued for not more than \$9,422,475. and use said \$9,422,475., or lesser amount, for the purposes set forth in the foregoing opinion, provided that the Commission is under no obligation to authorize the issue of securities equal in par value to the \$9,422,475., or lesser amount, and, provided further, that only such part of the \$9,422,475., or lesser amount, as may hereafter be determined by the Commission, shall be charged to fixed capital account."

In its petition filed on March 4, 1927, California Water Service Company asked, among other things, permission to issue and sell \$6,600,000. face value of five percent first mortgage bonds to net the company 90 percent of the face value thereof; \$2,150,000. par value of six percent preferred stock to be sold at par less a commission of thirteen percent to net the com-

pany 87 percent of the par value thereof; and \$2,149,300. par value of common stock to be sold in such manner as to net the company 75 percent of the par value thereof.

On October 1, 1927 a second amended and supplemental petition was filed in which California Water Service Company seeks permission to purchase the properties of Belvedere Water Corporation, which supplies water to the inhabitants of the City of Belvedere and vicinity in Los Angeles County; of Petaluma Power and Water Company properties, which supplies water to the inhabitants of the City of Petaluma and vicinity, Sonoma County, and the water system owned by C.B. Jackson, and known as the Tuxedo Water Company, which supplies water to the inhabitants of a part of the City of Stockton, San Joaquin County. In said supplemental petition California Water Service Company, among other things, also requests permission to sell and issue the securities for cash, set forth in the amended supplemental petition filed on March 4, 1927; to issue and deliver to the Belvedere Water Corporation in full consideration for its properties and assets subject to its liabilities, \$1,036,000. of five percent first mortgage bonds, \$362,000. par value of six percent stock and \$362,000. par value of common stock. It also asks permission to issue and sell \$394,000. of first mortgage five percent bonds at ninety percent of the face value thereof, \$133,000. par value of six percent preferred stock at par, less a commission of thirteen percent, and \$133,000. of common stock at par, less a commission of twenty-five percent, and use the proceeds obtained from the sale of such securities to acquire the entire issue of capital stock and the redemption of the outstanding bonds of the Petaluma Power and Water Com-

pany and purchase the business, franchises and property comprising the Tuxedo Water Company. It is of record that after the acquisition of the stock of the Petaluma Power and Water Company, that company, if permitted, will cause its properties to be transferred to the California Water Service Company. The Belvedere Water Corporation, the Petaluma Power and Water Company, as well as C.B.Jackson, request permission to sell the properties now owned by them and referred to in the second supplemental petition to the California Water Service Company and thereafter to discontinue their respective public utility obligations and service.

On November 8, 1927 the third amended and supplemental petition was filed, in which California Water Service Company asks permission to issue \$240,000. face value of first mortgage five percent bonds at ninety percent of face value and accrued interest, \$50,000. par value of six percent cumulative preferred stock to net the company eighty-seven percent of par value thereof and \$50,000. par value of common stock, at seventy-five percent of the par value thereof, and use the proceeds to pay the cost of additions and betterments to the following properties:-

California Water Service Company	\$232,594.73
Belvedere Water Corporation	57,614.21
Petaluma Power and Water Company	18,021.86
Tuxedo Water Company(C.B.Jackson)	<u>6,819.73</u>
Total.....	<u>\$315,050.53</u>

The following statement shows in summary form the amount of securities which the California Water Service Company

asks permission to issue;-

(a)	\$8,270,000. of five percent first mortgage bonds at 90, netting	\$7,443,000.
(b)	2,695,000. of six percent preferred stock at 87, netting	2,344,650.
(c)	2,694,300. of common stock at 75, netting	2,020,725.
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Total	<u>\$13,659,300.</u>	<u>\$11,808,375.</u>

It is of record that California Water Service Company has expended, or will, if authorized by the Commission, expend approximately \$11,344,000. to acquire the properties mentioned in this application. Deducting the \$11,344,000. from the proposed net yield of the securities (\$11,808,375.) leaves \$464,375. available for working capital. Further reference will hereafter be made to these matters.

Appraisals of the properties referred to in this proceeding have been made by The Loveland Engineers, Inc., and introduced as Exhibits 13-A, 13-B, 13-C, 14, 15 and 16 (for the appraisal of the Tuxedo Water Company properties, See Application No. 13848.) The Loveland Engineers report the reproduction cost new of the properties at \$18,396,566.00 and reproduction cost new less depreciation at \$16,540,651.00, and the estimated original cost at \$13,379,348.00. These figures do not include the \$315,050.53 alleged by the company to have been expended for additions and betterments, nor the \$464,375.00 of working capital which the company is providing in its proposed security issue.

The reproduction cost new, the reproduction cost new less depreciation and the estimated original cost of the

properties is segregated by The Loveland Engineers as follows;-

Item	Reproduction cost new	Reproduction cost new less depreciation	Estimated original cost
Lands	\$ 662,598.00 :	\$ 662,598.00 :	\$ 662,598.00
Physical properties	12,842,904.00 :	11,178,989.00 :	9,690,841.00
Total.....	<u>13,505,502.00 :</u>	<u>11,841,587.00 :</u>	<u>10,353,439.00</u>
Additions to 1/1/27	50,485.00 :	50,485.00 :	50,485.00
Preliminary ex- penses	86,000.00 :	86,000.00 :	86,000.00
Organization ex- penses	276,000.00 :	276,000.00 :	276,000.00
Cost of securing franchises . . .	73,500.00 :	71,500.00 :	20,345.00
Water rights	506,000.00 :	506,000.00 :	496,000.00
Cost of acquiring lands and search- ing titles	35,598.00 :	35,598.00 :	35,598.00
Going concern value	1,745,000.00 :	1,745,000.00 :	1,745,000.00
Paving over mains not cut by com- pany	1,802,000.00 :	1,612,000.00 :	-
Additional mater- ials and supplies	166,481.00 :	166,481.00 :	166,481.00
Working capital	150,000.00 :	150,000.00 :	150,000.00
Total Loveland Engineers	<u>18,396,566.00 :</u>	<u>16,540,651.00 :</u>	<u>13,379,348.00</u>
Additions and bet- terments	<u>315,050.53 :</u>	<u>315,050.53 :</u>	<u>315,050.53</u>
Grand total.....	<u>\$18,711,616.53 :</u>	<u>\$16,855,701.53 :</u>	<u>\$13,694,398.53</u>

It is of record that the additions and betterments represent the amount of moneys expended for such purposes since the date of the Loveland appraisals of the properties. It would, therefore, appear that the \$50,485.00 which The Loveland Engineers report as additions to January 1, 1927, should be eliminated, for the reason that such additions are included in the \$315,050.53. It should also be noted that The Loveland Engineers include an allowance for working capital, and materials and supplies. They estimate the depreciation reserve calculated on a six percent sinking fund basis applicable to the original cost of the properties at \$1,056,745.00.

The valuation division of the Commission's Engineering Department has examined the cost estimates contained in Exhibits 13-B and 13-C. It estimates the reproduction cost new of the properties referred to in Exhibit 13-B at \$9,740,049. as compared with \$10,960,871. by The Loveland Engineers. The Commission's engineers calculated depreciation on a five per cent sinking fund basis instead of a six percent basis, and also on a straight line basis. The Loveland Engineers report the depreciated reproduction cost new on a six percent sinking fund basis at \$9,588,091., the Commission's engineers on a five percent sinking fund basis at \$8,246,694. and on a straight line basis at \$7,328,414. The estimated historical cost of the properties, contained in Exhibit 13-C, is estimated by the Commission's engineers at \$7,562,427. and by The Loveland Engineers at \$8,316,781. The estimated historical cost less depreciation is reported by The Loveland Engineers on a six percent sinking fund basis at \$7,754,652., by the Commission's engineers on a five percent sinking fund basis at \$6,582,246., and on a straight line basis at \$5,838,999.

Mr. C. T. Chenery, president of the California Water Service Company, testified that in his opinion the fair or sound value of the properties involved in this application, including the \$464,375. of cash mentioned, is approximately \$15,500,000.

For the year ending October 31, 1927 the California Water Service Company reports the operating revenues of the properties involved in this proceeding at \$1,888,760.16 and the nonoperating revenues at \$9,005.06, making a total of \$1,897,765.22. The operating expenses, and taxes, exclusive of depreciation and federal income tax, are reported at \$1,031,689.61, leaving net operating income of \$866,075.61.

The \$866,075.61 represents the amount available for depreciation, interest, amortization of debt discount and expense, federal income tax, dividends and surplus.

We are not here concerned with the financing of properties to be constructed de novo, but, rather with the re-financing of properties in operation. Some of the properties have been in operation prior to, and ever since, March 23, 1912, the effective date of the Public Utilities Act. Some of the corporations whose properties California Water Service Company seeks permission to acquire, have been organized since that date and financed under the Commission's supervision. These several utilities have regularly filed reports with the Commission and it, from time to time, has been called upon to adjust the rates of certain of them and investigate the service rendered by them. It appears to us that we are, in effect, asked to disregard whatever action the Commission may have taken as to these properties in the past and proceed to authorize a capitalization on a basis which will yield an amount of money equal to the price which the Federal Water Service Corporation or its subsidiaries or representatives have agreed to pay for the properties. We are told that as the purchaser is a

"corporation specializing in the operation of water properties, buying them and operating them in many states, it would be a reasonably fair assumption that, as we were spending our own money, we would not pay too much for these properties. In other words, that we would be in a position to make a fair and intelligent estimate of the value of these properties, and that any price that we were willing to pay for them would certainly not be an unreasonable price, and would certainly represent at least the true value of the properties, - minimum true value. In all cases we believe that the value is substantially more. But we thought this was a basis on which there could be very little controversy about financing. "

In further support of the security issue, we are told that the sound value of the properties is \$15,500,000. and that the proposed bond issue is only \$8,270,000. or about sixty percent of the sound value; that the interest on such bond issue was earned more than twice, which is regarded as a very favorable showing by underwriting syndicates; that the dividend on the preferred stock is likewise well protected and that the earnings on the common stock are about \$4.00 per share and therefore a price of \$75.00 per share is an adequate consideration to be paid for the common stock by the Federal Water Service Corporation.

C. T. Chenery testified that the common stock could not be sold to the general public under their financial program, and that the amount of common stock is immaterial, except for one reason, which he states as follows;-

"The only reason that the amount of common stock involved is important is in the question of the control in the corporation. And under the California law I am told preferred stock has equal voting power with common. We stand squarely back of this financial program, take full responsibility for it, our full credit is involved in it, and therefore to that extent, we must have full voting power to make sure that the financial policies of this corporation are entirely sound ones. And that is the only reason that the question of the amount of common stock issue is of any moment to us at all."

In this connection it should be said that Federal Water Service Corporation, or its subsidiary, plan to acquire only the common stock of California Water Service Company. The plan submitted contemplates that the bonds and preferred stock will be sold to the general public and of course to the extent that moneys are realized from the sale of such bonds and preferred stock, the Federal Company is not providing the moneys

necessary to pay for the properties. In authorizing the issue of stocks and bonds the Commission has heretofore held that the actual cost of constructing public utility properties, or if such cost is not known, the estimated original cost, giving due regard to the earnings thereof, is the proper basis for the capitalization of the properties. In case of refinancing existing properties, consideration must be given to depreciation. To deviate from this policy merely because some one has acquired operating public utility property and for some reason has seen fit to pay for the property more than their actual or estimated cost depreciated, is in our opinion, neither sound finance nor in the public interest. We believe that when we are called upon to authorize the issue of stock and bonds to refinance public utility properties, we should adhere in general to the same principles as are followed by us when authorizing the issue of securities to finance properties to be constructed anew. An estimate of what it would cost to reproduce the properties now, whether depreciated or not, an alleged sound value, or even what a purchaser may have or has agreed to pay for the properties, are too fanciful to warrant serious consideration.

We have determined that the amount of cash which the California Water Service Company might be permitted to realize through the issue of securities is \$9,631,701.55. This amount was determined as follows:-

Estimated historical cost by Loveland Engineers:-

Physical properties	\$10,353,439.00
Land, present value.	\$662,598.
Other properties	9,690,841.
Additions to January 1, 1927.	50,485.00
Preliminary expense	86,000.00
Organization expense.	276,000.00
Cost of securing franchises	20,345.00
Water rights.	496,000.00
Cost of searching land titles	35,598.00
Going concern value	1,745,000.00
Adding materials and supplies	166,481.00
Working capital	150,000.00
Sub-total	<u>\$13,379,348.00</u>
Cost of additions	315,050.53
Sub-total	<u>13,694,398.53</u>
Working capital which company provides for in proposed security issue in addition to Lovelands	465,000.00
Grand Total	<u>\$14,159,398.53</u>
Deductions:	
Water rights.	321,000.
Going concern value	\$1,745,000.
Cost of searching land titles	35,598.
Difference between Commission's engineers estimate of historical cost and Loveland on properties contained in Exhibit 13-C	754,354.
Working capital	465,000.
Organization and Preliminary expense reduced by	150,000.
Depreciation - 6% sinking fund accumulation - Loveland.	<u>1,056,745.</u>
	<u>4,527,697.00</u>
	<u>\$9,631,701.53</u>

We have no objection if sixty percent of the \$9,631,701.53 is obtained through the issue of five percent bonds, twenty percent through the issue of six percent cumulative preferred stock and twenty percent through the issue of common stock. The order herein will provide that the bonds shall be sold for not less than ninety-two and accrued interest, and the preferred and common stock at not less than ninety percent of par value net to the company. On these bases the company to realize \$9,631,701.53 would have to issue \$6,282,000.00 of bonds, \$2,140,100.00 of preferred and \$2,140,200.00 of common stock. The \$2,140,200.00 of common stock includes the \$2,000,000.00 of common stock authorized by Decision No. 16084 dated March 21, 1927. It will be noted that in determining the amount of securities we have included in the cost of

properties the materials and supplies and working capital included in the Loveland appraisals and also the reported cost of additions and betterments. In the second amended petition it is recited that securities will be delivered in payment for the properties of Belvedere Water Corporation. We will not determine the amount of the securities that may be so delivered. The order will fix the maximum amount of securities which the California Water Service Company may issue and provide that they may be sold for cash and such cash used to pay for properties or stock or the securities in whole or in part may be delivered in payment for all or part of the properties. As a condition precedent to or concurrently with the issue of the securities the California Water Service Company must acquire free and clear of all encumbrances all the properties or stock, except the \$465,000.00 cash for working capital mentioned above, described directly or indirectly in this application. For such properties and stock it may not pay more than \$9,631,710.00. We realize that according to the record in this proceeding some one has agreed to pay more for the properties or stock. If it is necessary to pay more than \$9,631,710.00 for the properties or the stock of the several companies, the difference between the \$9,631,710.00 and the price which the vendors are to receive must be paid by some one other than California Water Service Company.

We re-affirm our opinion expressed in other decisions that to recapitalize operating properties such as are before us in this application on a basis so that they can show only a return of three or four percent on common stock is not in the public interest.

There has been filed in this proceeding a copy of the proposed mortgage and/or deed of trust (Exhibit 4) which California Water Service Company asks permission to execute to secure the pay-

ment of an authorized bond issue of \$25,000,000.00. We have examined the proposed mortgage and/or deed of trust and feel that it should be modified in several particulars. As it now reads, it provides that after the issue of the initial series of bonds, additional bonds may be certified by the trustee subject to the conditions set forth in the instrument in amount equal to not exceeding eighty (80) percent of the cash cost or the fair value, should such fair value be less than the cash cost of property constructed or acquired subsequent to February 1, 1927. This provision we believe should be modified so that the trustee may not certify bonds in excess of sixty (60) percent of said cash cost or fair value, whichever is less. There should also be eliminated from the mortgage and/or deed of trust article nine which gives certain immunity to incorporators, stockholders, officers and directors. The elimination of article nine necessitates a corresponding change in the form of the bond.

Before determining whether section eight of Article III or Subdivision one (1) of Paragraph B under Section three (3) of Article II should be modified or eliminated, we desire to be furnished with a statement showing that an expenditure of an amount equal to nine percent of the gross revenue is sufficient for the proper maintenance and replacement (depreciation) of the properties, when such replacement become necessary. True, the nine percent represents the minimum amount that must be expended for such purposes, but occasionally the minimum becomes the maximum in actual practice. A revised copy of the proposed mortgage and/or deed of trust should be filed with the Commission.

SECOND SUPPLEMENTAL ORDER

The Railroad Commission having been asked to enter its order, as indicated in the foregoing opinion, and in the petitions filed in this proceeding, public hearings having been held and the Railroad Commission being of the opinion that it should authorize the California Water Service Company to issue not exceeding \$6,282,000. of five percent twenty-five year first mortgage bonds, not exceeding \$2,140,100.00 of six percent cumulative preferred stock, and not exceeding \$140,200.00 of common stock, which common stock is in addition to the \$2,000,000.00 of common stock authorized by said Decision No. 18084, that the money, property or labor to be procured or paid for by such issue is reasonably required by applicant, California Water Service Company; that the expenditures herein authorized are not in whole or in part reasonably chargeable to operating expenses or to income; that this application insofar as it involves the issue of \$1,988,000.00 of bonds, \$554,900.00 of preferred stock and \$554,100.00 of common stock should be dismissed without prejudice; and that this application should be granted, as provided in Decision No. 18084, dated March 21, 1927, as amended, and as provided in this Second Supplemental Order, therefore -

IT IS HEREBY FURTHER ORDERED as follows:-

1. C. B. Jackson may sell and convey to, and California Water Service Company may purchase, the properties described in this application as the Tuxedo Water Company.

2. California Water Service Company may purchase, hold and own the stock of the Petaluma Power and Water Company.

3. The Belvedere Water Corporation and Petaluma Power and Water Company respectively may sell and convey to, and California Water Service Company may purchase all of the business, assets and properties of said Belvedere Water Corporation and Petaluma Power and Water Company, subject to their outstanding liabilities at the date of the transfer.

4. C. B. Jackson, Belvedere Water Corporation and Petaluma Power and Water Company may abandon and discontinue their respective public utilities, obligations and service if, as and when the transfer of their properties to the California Water Service Company shall become effective.

5. Paragraph seven of the order in Decision No. 18084 dated March 21, 1927 reading-

"Applicant, California Water Service Company, is hereby authorized to issue \$2,000,000. par value of common stock and sell said \$2,000,000. of common stock, together with such additional stock, (common and/or preferred) and bonds which the Commission may hereafter authorize to be issued for not more than \$9,422,475.00 and use said \$9,422,475.00, or lesser amount, for the purposes set forth in the foregoing opinion, provided that the Commission is under no obligation to authorize the issue of securities equal in par value to the \$9,422,475.00, or lesser amount, and, provided further, that only such part of the \$9,422,475.00, or lesser amount, as may hereafter be determined by the Commission, shall be charged to fixed capital account."

be, and the same is hereby amended so as to read--

"California Water Service Company may issue not exceeding \$6,282,000.00 of first mortgage twenty-five year five percent bonds, not exceeding \$2,140,100.00 of six percent cumulative preferred stock and not exceeding \$2,140,200.00 of common stock and sell said bonds at not less than ninety-two percent net of their face value, and said preferred and common stock at not less than ninety percent, net, of its par value. The proceeds obtained from the sale of said bonds and stock shall be used to pay in full for the properties which California Water Service Company is authorized to acquire by the authority granted in this order, and which are referred to in this decision, and by the authority granted in Decision No. 18084, dated March 21,

"1927, provided that if California Water Service Company deems it necessary it may deliver on the bases stated, part of said bonds and stock in payment for the properties of Belvedere Water Corporation."

6. Paragraph six of the order in Decision No. 18084 dated March 21, 1927 reading:-

"The purchase price of the properties which the California Water Service Company is hereby authorized to acquire shall not exceed \$9,422,475.00."

be, and the same is hereby, amended so as to read:-

"The purchase price of the properties which the California Water Service Company is authorized to acquire by the authority granted by the order in said Decision No. 18084 and by this order shall not exceed \$9,631,710.00."

7. California Water Service Company shall keep its accounts and records in accordance with the Uniform Classification of Accounts prescribed by this Commission.

8. This application, insofar as it involves the issue of \$1,988,000.00 face amount of bonds, \$554,900.00 par value of preferred stock and \$554,100.00 par value of common stock be, and the same is hereby, denied without prejudice.

9. The authority herein granted to issue bonds will become effective when applicant has paid the fee prescribed by Section 57 of the Public Utilities Act, which fee is \$3,641.00, and when the Commission has authorized applicant, California Water Service Company, to execute a mortgage and/or deed of trust to secure the payment of such bonds.

10. California Water Service Company shall keep such record of the issue, sale and delivery of the bonds and stock herein authorized and of the disposition of the proceeds as will enable it to file on or before the 25th day of each month a verified report, as required by the Railroad Commission's General Order No. 24, which

order insofar as applicable, is made a part of this order.

11. The authority herein granted to transfer properties, acquire and issue stock, will become effective upon the date hereof.

12. Paragraph nine of the order in Decision No. 18084 dated March 21, 1927 reading:-

"Under the authority herein granted no properties may be transferred and no stock issued after December 31, 1927"

be, and the same is hereby, amended so as to read:-

"Under the authority herein granted no properties may be transferred and no bonds and stock issued after May 31, 1928."

DATED at San Francisco, California, this 23rd
day of December, 1927.

Ernest J. [Signature]

Company

Leon White

Thos D. Rowlett

W. J. [Signature]

Commissioners.

Fee \$3641.⁰⁰/₁₀₀

RECEIVED
STATE OF CALIFORNIA
DEC. 27. 1927

[Signature]
Fee # 2476