

LBM

Decision No. 21608.

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
FRANCIS LAND AND WATER COMPANY,
a corporation, for permission to sell
its water system to Public Utilities
California Corporation, a corporation,
and of Public Utilities California
Corporation to acquire and operate
said system and to issue \$103,000.00
par value of its capital stock in
connection with the acquisition
thereof.

ORIGINAL

Application No. 15650

Orrick, Palmer and Dahlquist,
by Hillyer Brown and Christopher Jenks,
for Public Utilities California Corporation.

James W. Henderson, for
Francis Land and Water Company.

BY THE COMMISSION:

OPINION

In this proceeding the Railroad Commission is asked to approve the transfer of the public utility water properties of Francis Land and Water Company to Public Utilities California Corporation and authorize said Public Utilities California Corporation to acquire and operate said properties and to issue in payment therefor, as said properties existed on September 30, 1928, \$103,000.00 par value of its common capital stock.

Francis Land and Water Company is a California corporation and has for many years been engaged in the business of distributing water to the inhabitants of Ferndale and vicinity, in Humboldt County. Under date of September 19, 1928, the Francis Land and

Water Company granted to W. B. Foshay Company an option (Exhibit "A") to purchase all of its properties constituting its water works^{and water}/system with adjustment for taxes, consumers advances and accounts at the time of closing, for the sum of \$51,500.00. Subsequently on January 7, 1929, Francis Land and Water Company reduced the option price to \$49,000.00. On February 1, 1929, W. B. Foshay Co., successor of W. B. Foshay Company, agreed to sell all of its rights under said agreement to the Public Utilities California Corporation for a consideration of \$103,000.00 of stock of said Public Utilities California Corporation.

The properties to be transferred are said to consist of about 113 acres of land, 2.51 miles of water collection mains, 7.97 miles of transmission and distribution mains, two concrete reservoirs, two red-wood tanks, services and meters. It appears that there are 387 connected services, of which 261 are metered; 116 are on a flat rate basis; while 10 services are inactive. The storage capacity of the reservoirs is reported at 1,597,500 gallons.

Appraisals of the properties have been submitted by The Loveland Engineers, Inc. and by representatives of the Engineering Department of the Commission. The Loveland Engineers Inc. submitted the following figures as of September 30, 1928;-

ITEM	Reproduction Cost New	Reproduction Cost Less Depreciation	Estimated Original Cost	Sinking Fund Accumulation
Physical properties	\$102,751.	\$ 86,042.	\$ 69,610.	\$ 9,902.
Organization and Preliminary expense	2,000.	2,000.	2,000.	-
Franchise	250.	250.	250.	-
Cost of acquisition of:				
lands	758.	758.	758.	-
Water rights	7,500.	7,500.	7,500.	-
Going concern value	10,000.	10,000.	10,000.	-
TOTAL	\$123,259.	\$ 106,550.	\$90,118.	\$ 9,902.

The physical properties include a total of \$13,775.00 for lands and rights of way.

Representatives of the Engineering Department of the Commission testified as to what in their opinion was the original cost of the properties, including present value of land and the original cost of such properties less depreciation, calculated on a five percent sinking fund basis. Their testimony shows the following:-

ITEM	: Estimated Original Cost New	: Estimated Original Cost Less Depreciation
Tangible capital	: \$ 59,427.00	: \$48,712.00
Intangible capital:		
Organization.....	: 600.00	: 600.00
Franchises.....	: 250.00	: 250.00
Water rights.....	: 700.00	: 700.00
TOTAL.....	: \$ 60,977.00	: \$50,262.00

The testimony of the Commission's engineers was limited to an estimate of the original cost of the properties, which are the subject matter of this application, including present value of land. They did so because the Commission, as applicants--particularly Public Utilities California Corporation--well know, has repeatedly held that the capitalization of public utility properties should be based on the actual or estimated cost of the properties. In the event the properties are not new and the actual cost is not known, it is willing to accept an estimate of such cost. It requires that allowance be made for accrued depreciation and that consideration be given to the earnings of the properties. The reason why accrued depreciation is considered is because the purchasing company assumes the liability to make replacements. In the majority of cases the purchaser does not acquire any cash set aside to pay for such replacements. Its only means to secure such cash is through the issue of securities or advances. Obviously, if the Commission were to accept the actual or estimated original cost new of the properties and then also authorize the issue of securities to make replacements, over-capitalization would result.

The Loveland Engineers Inc. in their appraisal of the properties include \$10,000.00 as going concern value. In our opinion, such a value has no place in an estimate of the original cost of the properties. The Commission in Decision No. 19467, dated March 4, 1928 (Volume 31, Opinions and Orders of the Railroad Commission of California, pages 327 and 334) and in many others, has held that an alleged going concern value is not an element of value which should be capitalized through the issue of securities. In Decision No. 19467 the Commission rejected an alleged going concern value of \$1,745,000.00 and in so doing said--

"This Commission has never heretofore allowed the capitalization of potential values, nor has it permitted public utilities after a period of operation to re-finance or re-capitalize their properties upon such a basis that the outstanding securities thereof would be increased to reflect an alleged 'going concern value' claimed to have been established subsequent to the construction of the properties in question."

An allowance of \$2,000.00 for organization and preliminary expense claimed by The Loveland Engineers Inc. is not supported by any satisfactory evidence. This property was not conceived as a complete entity or planned at the time of its conception as it exists today. Like many other water systems, it served but a few consumers at the start and since then has gradually been extended until it reached its present stage of development. There is nothing in the record to show that the company has not been reimbursed for any expenditures it may have incurred for development and reconstruction purposes in past years. It is not reasonable to assume that as much was expended for organization and preliminary purposes on this property as would be expended to date for the construction of a water system to serve Ferndale and vicinity. We will allow for organization and preliminary expense the sum of \$800.00.

The \$7,500.00 alleged by The Loveland Engineers as the value of water rights is admittedly not an historical cost figure. It represents their estimate of the present value of the water rights and even as such an estimate, does not appear to be based on any detailed study. We will allow for water rights \$700.00 which, according to the estimate of P. E. Harroun, an assistant engineer for the Commission, represents his estimate of the cost of such rights. In addition, we will allow \$1,500.00 for exploring for water.

As to the physical properties, including land at present value, The Loveland Engineers Inc. report an estimated original cost depreciated of \$60,466.00, including \$758.00 said to represent the cost of acquiring lands, as compared with \$48,712.00, reported by the Commission's engineers. The difference amounts to \$11,754.00. Of this difference, \$7,683.00 applies to lands and rights of way and \$4,071.00 to other physical properties. The \$4,071.00 difference arises from the use of different unit prices, different overhead allowances and the calculation of accrued depreciation on a six and five percent sinking fund basis. The Loveland Engineers Inc. use a six percent, and the Commission engineers, a five percent sinking fund basis. As to the present value of land and rights of way, there is a difference of \$7,683.00, between the engineers. The only evidence offered as to the value of the land by applicants which is worthy of any consideration, is that of D. E. Francis, of Francis Land and Water Company. He testified as to the value of two parcels of land aggregating 106 acres, to which The Loveland Engineers Inc. assigned a value of \$10,600.00. H. R. Robbins, an assistant engineer for the Commission, assigned to the same land a value of \$4,100.00. The testimony of neither appears to us to be conclusive

on the matters at issue. We have considered their testimony and as a result of such consideration, will allow \$6,000.00 for the land and rights of way. As to the other physical properties, we find the estimated original cost less depreciation to be \$41,862.00.

Summarizing; we find that the estimated original cost, including present value of land, of the properties which Francis Land and Water Company asks permission to sell to the Public Utilities California Corporation, to be \$64,827.00 and such cost less accrued depreciation, to be \$53,987.00. The order herein will authorize the Public Utilities California Corporation to issue in payment for the properties \$54,000.00 par value of its common capital stock. The difference between such amount of stock and the estimated original cost of the properties should be credited to the company's reserve for accrued depreciation.

ORDER

Francis Land and Water Company, having asked permission to sell its public utility water properties to the Public Utilities California Corporation, and Public Utilities California Corporation having asked permission to acquire such properties, operate the same, and to issue \$103,000.00 par value of its common capital stock in payment for the properties, a public hearing having been held before Examiner Fankhauser and the Commission being of the opinion that the transfer of the properties is in the public interest, but that Public Utilities California Corporation should not issue more than \$54,000.00 par value of its common capital stock in payment for such properties; that the money, property or labor to be procured or paid for by the issue of the \$54,000.00 par value of common capital stock is reasonably required by applicant, Public Utilities California Corporation, that the expenditures herein authorized are not in whole or in part reasonably chargeable to operating expenses or

to income, and that this application insofar as it involves the issue of \$49,000.00 par value of stock should be denied without prejudice. therefore,

IT IS HEREBY ORDERED as follows;-

1. Francis Land and Water Company may, on or before December 31, 1929, sell and transfer the properties described in this application, and more particularly in Exhibit "C" filed in this proceeding, to Public Utilities California Corporation, which is hereby authorized to acquire such properties and operate the same,

2. Public Utilities California Corporation may issue at not less than par on or before December 31, 1929, \$54,000.00 par value of its common capital stock in payment for the aforesaid properties.

3. This application insofar as it involves the issue of \$49,000.00 par value of common capital stock of the Public Utilities California Corporation, be, and the same is hereby denied without prejudice.

4. Public Utilities California Corporation, if it acquires the aforesaid properties, may charge to its fixed capital or other asset accounts, an amount not exceeding \$64,827.00. If it pays for said properties more than \$54,000.00 par value of its common capital stock, it must charge the difference between the \$54,000.00 and the price paid, to its corporate surplus account.

5. Within thirty days after the acquisition of the properties of Francis Land and Water Company, Public Utilities California Corporation shall file with the Railroad Commission a certified copy of the deed by which it acquires and holds title to said properties.

6. The authority herein granted will become effective ten days after the date hereof.

7. Public Utilities California Corporation shall, within thirty days after acquiring the aforesaid properties, file with the Railroad Commission for approval a copy of the book-keeping entries, by means of which it records the purchase of the aforesaid properties and the distribution of the purchase price to primary accounts. It shall also file with the Railroad Commission reports, as required by the Commission's General Order No. 24, which order insofar as applicable, is made a part of this order.

DATED at San Francisco, California, this 26th day of September, 1929.

Thos. G. Latta
A. L. Leary
Wm. D. Bell
Leon A. Whittell
W. J. Lee
Commissioners.