

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

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ORIGINAL

In the matter of the Application of)
 COAST VALLEYS GAS AND ELECTRIC COMPANY)
 for authority to issue \$100,000.00 of)
 bonds.)

Application No. 1418.

Decision No. 2267

Warren Gregory of Chickering & Gregory for applicant;
 Carter P. Pomeroy for certain bondholders of Monterey
 and Pacific Grove Railway Company;
 R.E. Cross for certain bondholders of Monterey and
 Pacific Grove Railway Company;
 H.H. Ashley of Pillsbury, Madison & Sutro for H.L.E. Meyer;
 W.F. Williamson for certain bondholders of Monterey and
 Pacific Grove Railway Company.

GORDON, Commissioner.

O P I N I O N.

On December 4, 1914, in Decision No. 1985, this Commission authorized Coast Valleys Gas and Electric Company, hereinafter called the Coast Valleys Company, to issue \$100,000.00 of its first mortgage six per cent. 40-year bonds under its trust indenture to Mercantile Trust Company of San Francisco, dated March 1, 1912. The order specified that the bonds should be sold at not less than 95 per cent. of their face value and that the proceeds should be used for the following purposes:

(a)-- To extinguish the following notes payable:--

<u>Name</u>	<u>Date</u>	<u>Int.</u>	<u>Amount</u>
California Railway & Power Co.	7/1/13	7%	Bal. \$5,900.00
California Railway & Power Co.	7/1/13	7%	10,000.00
California Railway & Power Co.	7/1/13	7%	10,000.00
Sierra & San Francisco Power Co.	7/31/13	7%	7,251.34
Sierra & San Francisco Power Co.	7/31/13	7%	3,726.21
Sierra & San Francisco Power Co.	7/31/13	7%	7,666.95
Sierra & San Francisco Power Co.	7/31/13	7%	7,352.24
Total,			\$51,896.74

- (b)-- To apply upon accounts payable incurred for additions and betterments, \$17,495.69
- (c)-- For feeders, extensions and service lines in the vicinity of King City to serve prospective consumers, . \$10,000.00
- (d)-- For other additions and betterments, \$20,607.57

Thereafter there came to the attention of this Commission a possible additional liability against the Coast Valleys Company, which

had not been presented for consideration at the hearing. This possible liability was concerned with a guarantee which had been given upon the bonds of the Monterey and Pacific Grove Railway, -hereinafter called the railway company,- a railway property $5\frac{1}{2}$ miles in length extending from Del Monte to Pacific Grove and from the City of Monterey to the Presidio at Monterey, the stock of which is owned by the Coast Valleys Company.

It further came to the attention of the Commission that on January 1, 1915, default was made in the payment of interest upon the bonds of the railway company. Thereupon on January 13, 1915, this Commission issued its order suspending until further notice its previous order, which had authorized the Coast Valleys Company to issue the \$100,000.00 of bonds. The matter was set down for further hearing. A hearing was held on February 8, 1915, and a subsequent hearing on February 18, 1915. At these hearings, the Commission directed its inquiry to determine the relationship between the Coast Valleys Company and the outstanding bonds of the railway company. Representatives of various bondholders of the railway company were present and participated in the investigation.

The Commission conducted on its own account an audit of the books of the railway company, and through its engineering department had a valuation made of the railway company's properties. The matter has been submitted and is now ready for decision.

The applicant has not issued any of the \$100,000.00 of bonds authorized by the Commission in its Decision No. 1985. The Commission is therefore to determine at this time whether it will vacate in whole or in part its order of January 13, 1915, suspending its previous order authorizing the issue of the \$100,000.00 of bonds.

The investigation necessitated a very wide range of inquiry, but it will suffice for the purposes of the present situation to summarize the facts developed.

The Coast Valleys Company conducts a water,

gas and electric utility business in Monterey County, operating in Salinas, Monterey, Pacific Grove, King City and other localities in Monterey County. It has an outstanding issue of \$900,000.00 of bonds. It has estimated the value of its properties as high as \$1,600,000.00. The engineers of this Commission have submitted evidence tending to establish a value of not less than \$1,100,000.00, but substantially less than \$1,600,000.00.

For the year ending December 31, 1914, Coast Valleys Gas and Electric Company submitted the following statement of earnings and expenses:

ELECTRIC OPERATIONS:

Operating Revenues,.....	\$179,663.28
Operating Expenses,.....	97,299.16
Net Operating Revenue,.....	\$82,364.12

GAS OPERATIONS:

Operating Revenue,.....	\$ 45,561.05
Operating Expenses,.....	40,568.87
Net Operating Revenue,.....	4,992.18

WATER OPERATIONS:

Operating Revenue,.....	\$ 21,322.71
Operating Expenses,.....	20,561.79
Net Operating Revenue,.....	760.92
Total Net Operating Revenue,.....	\$88,117.22

Rents from Buildings, Land and Apparatus,.....	937.50
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Interest Revenues on Funded Debt Owned, \$4,365.00	
Miscellaneous Interest Revenues,.....	2,320.02
Total Interest and Dividend Revenues,.....	6,685.02

GROSS CORPORATE INCOME,	\$95,739.74
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DEDUCT:

Uncollectible Bills,.....	\$1,021.12
Rent Expenses,.....	2.78
Miscellaneous Non-Operating Expenses	166.65
Interest Accrued on Funded Debt, ..	54,000.00
Other Interest Deductions,.....	5,021.76
Amortization of Debt Discount and Expense,.....	1,505.92
Total Miscellaneous Deductions,.....	\$61,718.23

BALANCE OF YEAR CARRIED TO CORPORATE SURPLUS,	\$34,021.51
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The Coast Valleys Company was organized on March 18, 1912. The properties which it acquired had previously been owned by Monterey County Gas and Electric Company. These properties were sold by Monterey County Gas and Electric Company in

1911 to F.G. Baum, and by Mr. Baum transferred to California Consolidated Light and Power Company. Thence they passed to L.H. Rich and from Mr. Rich to Coast Valleys Gas and Electric Company.

At the time of the transfer of these properties to Mr. F.G. Baum, Monterey County Gas and Electric Company owned the stock of the railway company. Previous thereto, on July 1st, 1907, the Railway Company had authorized an issue of \$300,000.00 of its 30-year 6 per cent. bonds. These bonds were guaranteed at the time as to principal and interest by Monterey County Gas and Electric Company, and a statement of this guarantee appears on the face of the bonds of the railway company in language as follows:--

"For value received, Monterey County Gas and Electric Company, a corporation, agrees, to and with the holder of this bond and the attached coupons, that if the several sums of money agreed to be paid thereby are not paid in the manner therein stated, as they severally become due, then and in that event the Monterey County Gas and Electric Company aforesaid will pay the same.

"This contract is duly authorized by a resolution of the Board of Directors of the Monterey County Gas and Electric Company."

MONTEREY COUNTY GAS AND ELECTRIC COMPANY."

At the hearings held on February 8 and 18, 1915, to determine the relationship of the Coast Valleys Company to these bonds of the railway, counsel for the Coast Valleys Company maintained that the guarantee had not passed to the Coast Valleys Company. Counsel took the position that the guarantee of the bonds of the railway company had been assumed by one of the parties in ownership which had intervened between Monterey County Gas and Electric Company and the Coast Valleys Company, or had not passed from the original guarantor.

It is, of course, beyond the powers of this Commission to adjudicate the issue of liability arising from the guarantee of the bonds of the railway company. It is within the province of this Commission, however, and it is its duty to make full inquiry into

any matter that may affect the financial condition of a public utility, or which may have a bearing upon its securities. In this instance, the securities of two public utilities are involved, -those of the Coast Valleys Gas and Electric Company and of the Monterey and Pacific Grove Railway Company. While it will not be my purpose, therefore, to attempt to determine the liability under this guarantee, I shall review such facts as may be pertinent to this Commission's authority.

Monterey and Pacific Grove Railway Company was organized on June 2, 1893, under the name of The Monterey and Pacific Grove Street Railway and Electric Power Company. The present name was conferred upon the railway by court decree on August 24, 1903.

On June 25, 1902, its stock passed into the ownership of Monterey County Gas and Electric Company. On July 1, 1907, the board of directors of the railway company authorized a bond issue in the sum of \$300,000.00 to consist of 6 per cent. bonds dated July 1, 1907, and maturing July 1, 1937. The bonds were issued under a mortgage and deed of trust to Mercantile Trust Company of San Francisco. The railway company has an authorized issue of 10,000 shares of stock of the par value of \$30.00 per share, all of which -with the exception of qualifying directors' shares- were owned by Monterey County Gas and Electric Company at the time it transferred these properties.

Soon after the deed of trust was executed, the directors of the railway company voted to turn over \$150,000 face value of the railway company bonds to Monterey County Gas and Electric Company. The records show that in December, 1907, the railway company was indebted to Monterey County Gas and Electric Company in the sum of \$40,976.95 for moneys advanced. Apparently, it was the intention that the Monterey County Gas and Electric Company should from the sale of the railway company bonds reimburse itself for moneys advanced, and should thereafter turn the proceeds from the bond sales into the treasury of the railway company. The sale of the railway

company bonds by Monterey County Gas and Electric Company began in October, 1907, and continued until June, 1910, during which time \$198,000.00 face value of the railway company bonds were sold, realizing in cash \$177,930.00, or approximately 90 per cent of face value. In this way, the railway company became the creditor of the Monterey County Gas and Electric Company, and in September, 1908, the Monterey County Gas and Electric Company had ^{become} indebted to the railway company in the sum of \$51,283.53. Subsequent bond sales brought the account as of June 30, 1911, to \$126,093.16. On or about June 30, 1911, this item of \$126,093.16, representing an account receivable of the railway company, was written off the books, and the investigation made and the evidence submitted have failed to show the consideration, if any, that led to the cancellation of this indebtedness. The amount was charged to the plant account of the railway company.

The books of the Monterey County Gas and Electric Company show that the corresponding liability to the railway company was also written off at that time and no consideration is shown in the records. In the case of Monterey County Gas and Electric Company, the amount was credited to profit and loss account. From the investigation made and from the evidence submitted in this matter, I have been unable to find that the railway company received anything in exchange for its cancellation of the indebtedness due it by the Monterey County Gas and Electric Company in the sum of \$126,093.16.

Up to the time of the bond issue, the railway company had been gradually increasing its earning power, but with the increasing fixed charges, its surplus earnings suffered a large decrease.

The books of the railway company show the sale of only the \$198,000 of bonds heretofore referred to out of the total issue of \$300,000.

With the sale of the other properties formerly owned by Monterey County Gas and Electric Company through the various channels heretofore enumerated, the stock of the railway company passed ~~into~~

into the possession on March 18, 1912, of the Coast Valleys Company.

Mr. F.J. Blanchard, secretary, treasurer and auditor of the railway company, testified that he assumed charge of the books of the railway company in March, 1912. At that time, it is stated, the books showed -

Bonds outstanding amounting to, \$198,000.00

and Bonds in the treasury amounting to, 102,000.00.

Mr. Blanchard testified that he later learned that \$90,000 of the railway company bonds were attached to certain notes of the Monterey County Gas and Electric Company and the California Consolidated Light and Power Company, presumably having been used as collateral security for the notes of these corporations. He found \$12,000 of bonds on hand in the treasury of the railway company. When the notes of the Monterey County Gas and Electric Company and the California Consolidated Light and Power Company were satisfied, the \$90,000.00 of railway company bonds were placed in the treasury of the Coast Valleys Company. In September, 1912, to adjust his books to this condition, Mr. Blanchard made an entry crediting bonds in the treasury in the sum of \$90,000.00 and charging this amount to plant. No evidence has been submitted, nor has the investigation revealed anything in the minutes to indicate under what authority the Monterey County Gas and Electric Company and California Consolidated Light and Power Company had possession of the railway company bonds, nor under what authority they made use of them for their own purposes.

Mr. Blanchard was asked if he had looked up the records to determine whether the Monterey and Pacific Grove Railway Company received anything from the Monterey County Gas and Electric Company and California Consolidated Gas and Electric Company for the \$90,000.00 of bonds. He replied -- "I have searched the minute books to find some authority for issuing them and I have been unable to find it". (Transcript -page 69).

This transaction increased the amount of bonds outstanding, as shown by the books of the railway company from \$198,000

to \$288⁰00.00. Thereafter, the Coast Valleys Company turned into the sinking fund of the railway company \$18,000 of bonds, leaving the amount outstanding \$270,000.00, -\$198,000.00 being in the hands of the public and \$72,000.00 free treasury securities of the Coast Valleys Company.

In connection with this transaction, the annual report to this Commission of the railway company dated June 30, 1912, contains a letter signed by Mr. Blanchard, in which occurs the following language:

"It is not the intention of the Coast Valleys Gas and Electric Company to collect interest on the \$90,000 of bonds, unless the interest should be earned by the railway company, and for this reason no interest is being accrued upon the books of the railway company or of the Coast Valleys Company, covering these bonds."

It appears that the interest was not collected on these bonds by the Coast Valleys Company until June, 1913, and thereafter, as interest payments on these bonds fell due, the Coast Valleys Company took the note of the railway company for the amount of the interest. It also appears that sinking fund requirements of the railway company were met by the Coast Valleys Company, which turned over to the railway company bonds and accepted the railway company's note in payment.

It appears further that the Coast Valleys Company regularly advanced money to the railway company to enable it to meet the interest on its bonds outstanding in the hands of the public. For such advances, the Coast Valleys Company accepted the railway company's note. This continued until January, 1915, when the interest was defaulted by the railway company.

In this proceeding, it is necessary to consider the relationship of the Coast Valleys Company to the bonds of the railway company in two aspects. First, -there is the matter of the guarantee; and Second, -there is the relationship of the Coast Valleys Company by reason of its ownership of the stock of the railway company.

It appears, as hereinbefore indicated, that the Coast Valleys Company advanced necessary moneys to the railway company up to January, 1915, the total of such advances amounting to \$56,530. These evidences of the company's relationship to these bonds may be explained on either one of the two bases of guarantee or stock ownership.

As to the company's own belief of its responsibility in this matter, we have the present statement that it does not regard itself obligated under the guarantee, and we have the opening entry on the books of the Coast Valleys Company under date of March 20, 1912. This opening entry in the journal on page one is as follows:

"The Company agreed to pay certain liabilities of California Consolidated Light & Power Company and Monterey County Gas and Electric Company, and assume the contingent liability of a certain guarantee dated July 15, 1907. Min. 155 by Monterey County Gas & Electric Co. of the principal and interest of the First Mortgage 6% bonds of the Monterey & Pacific Grove Railway Company, authorized issue \$300,000 amount outstanding \$198,000. This company owns unencumbered the \$300,000 par value outstanding stock of the Monterey & Pacific Grove Railway Company

"Opening entry includes in assets the interest of company in M & P G Ry. Co. by including it in \$5,698,472.53 Property acct."

Mr. Blanchard testified that this opening entry was made upon instructions from the New York offices of The Sierra and San Francisco Power Company, which controlled the stock of the Coast Valleys Company.

The railway company submitted the following statement of its assets and liabilities covering the calendar years 1913 and 1914:

ASSETS:

	<u>Dec.31,1914</u>	<u>Dec.31,1913</u>	<u>Increase or Decrease</u>
Property,.....	\$612,420.25	\$612,420.25	\$
Cash,.....	1,939.97	803.11	1,136.86
Accounts Receivable,.....	156.67	139.83	16.84
Material and Supplies,.....	1,567.88	1,564.98	2.90
Prepaid Insurance,.....	105.29	120.83	-15.54
Items in Suspense,.....	2,713.76	—	2,713.76
Mercantile Trust Co.,.....			
Coupon Deposit.;.....	60.00	8,400.00	-8,340.00
Profit and Loss,.....	<u>18,609.21</u>	<u>6,708.09</u>	<u>11,901.12</u>
	\$637,573.03	\$630,157.09	\$7,415.94

LIABILITIES:

Capital Stock,.....	\$300,000.00	\$300,000.00	\$
Bonds,.....	270,000.00	279,000.00	-9,000.00
Notes Payable,.....	36,530.00	22,030.00	14,500.00
Accounts Payable,.....	3,967.35	1,917.07	2,050.28
Pay Rolls Payable,.....	1,389.45	1,298.25	91.20
Coast Valleys Gas & Elec.Co.,	16,120.40	16,120.40	
Bond Interest Accrued,.....	—	—	
Taxes Accrued,.....	1,360.83	1,391.37	-30.54
Bond Interest Matured,.....	<u>8,205.00</u>	<u>8,400.00</u>	<u>-195.00</u>
	\$637,573.03	\$630,157.09	\$7,415.94

Net decrease in Asset Accounts,.....\$7,198.94

Deferred Expenses Paid,.....2,713.76

\$4,485.18

Net Increase in Liabilities,.....7,415.94

Total,.....\$11,901.12

Loss in 1914,.....\$11,901.12.

The railway company also submitted the following statement of earnings and expenses for the calendar years 1912, 1913 and 1914:

	<u>1914</u>	<u>1913</u>	<u>Incr.or Decrease</u>	<u>Per Cent</u>	<u>1912</u>
Gross Earnings,..	\$36,091.05	\$42,562.71	\$-6,471.66	-15.20	\$43,710.86
Operating Expenses	27,104.16	25,868.96	1,235.20	4.78	29,534.61
Taxes,.....	<u>2,432.29</u>	<u>2,662.70</u>	<u>-230.41</u>	<u>-8.62</u>	<u>1,654.69</u>
Total Operating Expenses and Taxes,.....	\$29,536.45	\$28,531.66	\$1,004.79	3.50	\$31,189.30
Net Earnings,...	6,554.60	14,031.05	-7,476.45	-53.28	12,521.56
<u>Deductions from Income:</u>					
Interest on Bonds,16,245.00	16,245.00	16,785.00	-540.00	-3.22	17,280.00
Interest on Floating Debt,...	<u>2,240.98</u>	<u>1,235.59</u>	<u>1,005.39</u>	<u>81.35</u>	<u>200.05</u>
Total Deductions from Income,.....	\$18,485.98	\$18,020.59	\$465.39	2.58	\$17,480.05
Deficit,.....	\$-11,931.38	\$-3,989.54	\$-7,941.84	198.90	\$-4,958.49

The decrease in revenue during 1914, was explained upon

the basis of the competition from the automobile bus service.

It would appear from these statements, however, that during 1912 and 1913, the company earned the interest on the bonds in the hands of the public, amounting to \$198,000. For the calendar year 1914, however, the company apparently failed to earn its interest on this amount of bonds.

The applicant in this case submitted an appraisal of the railroad properties made by Ford, Bacon and Davis in June, 1912, placing the value of the properties of the railway company at \$220,483.27. Of this amount, \$53,381.00 was ascribed to intangibles, leaving as the value of the physical property \$167,102.27. A tentative valuation made by the Engineering Department of this Commission estimated the reproduction cost of the physical properties to be \$145,929.46 and the depreciated reproduction cost to be \$113,167.53.

In connection with the inquiry into the railway properties, it developed that this railway is now operating under two franchises, -one granted by the City of Monterey on December 16, 1912, for a period of 50 years, and -one granted by the City of Pacific Grove on December 16, 1912, for a period of 50 years.

These franchises have not been submitted to this Commission and this railway company, therefore, has not obtained a certificate of public convenience and necessity granting it authority to operate under these franchises. It will be necessary, of course, that application be at once made to this Commission, so that this matter may be properly and regularly determined.

In view of the facts as herein developed, I believe that the Coast Valleys Company should not be authorized by this Commission to increase its bonded indebtedness in any way that could be prejudicial to the rights which the holders of the outstanding bonds of Monterey and Pacific Grove Railway Company may have. If the parties to this matter can adjust their differences as to the responsibility of the Coast Valleys Company for these bonds, either by friendly adjudication or through a recourse to the proper tribunal, the Coast Valleys Company

may thereafter submit again to this Commission its application for the issue of its securities. As this Commission has been advised that an effort will be made to determine the issue of the liability either through general agreement or through recourse to the courts, I do not believe this Commission should at this time authorize the applicant to issue any more securities than would appear to be necessary at this time, or until the question of the liability has been determined.

While I believe this Commission should not authorize securities to be issued by the Coast Valleys Company in a way that would injure such rights as the railway company bondholders may have, I am nevertheless of the opinion that it would be more injurious to these railway company bondholders to deny the Coast Valleys Company the right to issue a limited amount of securities if it were apparent that the earnings therefrom would swell the income of the Coast Valleys Company in such a way as to place it in a stronger position financially to meet any liability which it may have on the railway company bonds.

Here we have a situation where this Coast Valleys Company proposes to issue \$100,000 of bonds. As to \$70,000 of these bonds, it may be that they would produce no increased earnings. Of the remaining \$30,000, \$20,000 are to be issued for unspecified additions and betterments and are, therefore, not urgent at this time. There remains, however, \$10,000 of bonds, which it is proposed to issue for feeders, extensions and service lines in the vicinity of King City to serve prospective consumers.

At the original hearing in this matter, the applicant submitted a statement that it would be able to sell an additional 700 horse power when it had constructed the new feeders and service lines now requested for the vicinity of King City. This power is to be used for agricultural pumping purposes.

If the applicant be authorized to issue these bonds, it

will increase its fixed charges by approximately \$625.00 per year. At the same time, it may be that through the expenditure of this amount it will increase its earnings by several times \$625.00 per year. In addition, there are many prospective patrons in the vicinity of King City who are entitled to this service, and if it can be obtained for them without injury to these bondholders, I certainly believe this company should be authorized to issue the \$10,000 of bonds necessary to provide for these extensions to serve these persons.

I am unwilling, however, to recommend that the applicant be authorized to issue any of the remaining \$90,000 of bonds until it shall have determined the degree of its liability on the \$198,000 of railway bonds. Accordingly, I recommend the following Order:

O R D E R.

This Commission on December 4, 1914, in the above entitled matter having authorized Coast Valleys Gas and Electric Company to issue \$100,000.00 of bonds on the conditions therein specified, and this Commission on January 13, 1915, having suspended said Order until further notice, and a further hearing having been held on the application herein,

IT IS HEREBY ORDERED that Coast Valleys Gas and Electric Company be granted authority and it is hereby granted authority to issue \$10,000.00 of its first mortgage six per cent. forty-year bonds under its trust indenture to Mercantile Trust Company of San Francisco, dated March 1, 1912.

The authority herein granted is granted upon the following conditions and not otherwise:

- (1). The bonds herein authorized to be sold shall be sold at not less than 95 per cent. of the face value thereof less accrued interest thereon.
- (2). The proceeds derived from the sale of said bonds shall be used for feeders, extensions and service lines in the vicinity

of King City to serve prospective consumers with electric power.

(3). Coast Valleys Gas and Electric Company shall keep separate, true and accurate accounts showing the receipt and application in detail of the proceeds of the sale of the bonds hereby authorized to be issued; and on or before the twenty-fifth day of each month the company shall make verified reports to the Commission stating the sale or sales of said bonds during the preceding month, the terms and conditions of the sale, the moneys realized therefrom, and the use and application of such moneys, all in accordance with this Commission's General Order No. 24, which order, in so far as applicable, is made a part of this order.

(4). The authority herein granted is conditioned upon the payment by applicant of the fee prescribed in the Public Utilities Act.

(5). The authority herein granted shall apply to such bonds as shall have been issued on or before March 15, 1916.

IT IS FURTHER ORDERED that the Order herein shall supersede all former orders made upon the application herein.

The foregoing Opinion and Order are hereby approved and ordered filed as the Opinion and Order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this ^{31st} day of March, 1915.

FEE PAID ON ORIGINAL APPLICATION

No. 1418 Decision No. 1985

Dated 4th day of Dec 1914

Assistant Secretary,
Railroad Commission State of California.

Max Thelen
H. D. Loveland
Alex. J. Brown
Harry R. DeLong
Commissioners.