

ORIGINAL

Decision No. 2461

Decision No.

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of Central California Gas Company for an order authorizing the issue by said company of bonds of the face value of \$8,000 and common capital stock of the par value of \$8,800; also order authorizing said company to use the proceeds of the sale of said securities for the purpose of defraying the cost of additions to its plant and distributing systems.

Application
No. 1427

In the matter of the application of Central California Gas Company for an order authorizing the issuance of bonds of the face value of \$6,000 and common capital stock of the par value of \$3,250 and authorizing use of the proceeds from the sale of said securities for certain specified purposes.

Application
No. 1520

In the matter of the application of Central California Gas Company for authority to issue bonds of the face value of \$25,000 and common stock of the par value of \$14,500, or in lieu of such issuance of said bonds and stock said company may at its option issue its preferred stock of the face value of \$43,750.

Application
No. 1543

Lloyd S. Ackerman for applicant.

EDGERTON, Commissioner.

O P I N I O N

There are here under consideration three applications by Central California Gas Company. Under Application No. 1427 an order has heretofore been made granting a part of this application. This application, together with Application No. 1520 and Application No. 1543 was set down for hearing subsequently and it now becomes necessary to finally consider and pass upon all three of these applications.

In Application No. 1427, authorization was sought to issue \$8,000 first mortgage bonds and \$8,800 par value of stock.

Under this application an order was made authorizing the issue of \$8,000 first mortgage bonds. The rest of the application for the issuance of stock was held in abeyance pending a further investigation due to certain irregularities disclosed in the financial methods employed by the applicant.

The last mentioned order was made December 15, 1914, and immediately thereafter the stock and bond department, the auditing department and the engineering department recommended, in view of the discovery of these irregularities, that a complete investigation be made of the affairs of this company and such investigation has been continuing ever since.

In Application No. 1520 authorization is sought to issue bonds in the face value of \$6,000 and common stock of the par value of \$3,250. Under Application No. 1543 authorization is sought to issue bonds of the face value of \$26,000 and 145 shares of common stock of the par value of \$14,500, or in lieu of the above, authorization to issue preferred stock of a par value of \$43,750.

From time to time, at intervals, applicant has received from this Commission authorization to issue stocks and bonds. Under the orders of this Commission, and beginning with the purchase of existing and operating plants at Porterville and Visalia, this company has built up a gas generating and distributing system in Tulare County of considerable extent.

At the hearing herein the engineers of this Commission presented an estimate of reproducing new the physical elements of property based upon all of the information then obtainable, which estimate was very materially less than the amount claimed by the president of applicant to have been spent in acquiring and constructing the property.

Because of this marked discrepancy, and for the further reason that the auditing department of the Commission had called

attention to the condition of the accounts of applicant's books and to several apparently dubious transactions engaged in by the president of this company with relation to its finances, it was determined to make a complete investigation of the properties of applicant and of all of its accounts.

This careful and painstaking investigation is now completed. It has consumed several months' time of a number of the Commission's experts and has necessarily delayed a determination of the applications herein.

Of course, the Commission was in no wise bound to make this exhaustive investigation as the burden of making sufficient showing to justify the issuance of the securities asked for, was upon applicant. However, it was determined to make a thorough investigation so that no injustice would be done this corporation, its stockholders or patrons.

The investigation of the engineers and of the auditor of this Commission has been made first to determine from applicant's own books of account and data the actual cost of its properties and the condition of its finances. In addition, and separately, the engineers have produced a careful estimate of what it would cost to reproduce this plant new, taking the Porterville and Visalia plants at the cost set up in applicant's books, and deducting therefrom the property listed as being acquired with said plants and which the Commission's engineers, after a most careful investigation, have been unable to find.

On the first branch of this investigation the engineers have considered every voucher, numbering several thousand, with the result that many irregularities are disclosed by the company's books.

Applicant was authorized in the various orders of this Commission to sell or exchange for property, stocks and bonds to net a total of \$367,778 cash and property of a reported value of

\$47,349, and this amount was reported under oath by Mr. Forney, president of applicant, to the Commission as having been received and expended for plant.

In addition to the above amount, applicant claims to have expended \$17,429.74 for which its treasury has not been reimbursed by the sale of securities.

After a most careful investigation by our engineers they have been unable to find parts of the Visalia and Porterville plant taken over complete, which parts, at the price alleged to have been paid, amount to \$19,904.48, exclusive of property known to have been abandoned.

Mr. Forney, president of applicant, about the time of the organization of Central California Gas Company, applicant herein, organized a construction company called the "General Operating and Construction Company", either entirely or largely owned by himself. Under oath Mr. Forney stated to the Commission that he could produce plant for Central California Gas Company cheaper by having the Construction Company construct this plant and turn it over to the Gas Company. Under a contract with the Construction Company the sum of \$106,485 was paid by the Gas Company to the Construction Company for a portion of the transmission and distribution system.

On the 12th day of July, 1913, the Commission made an order in Application No. 606, and in the opinion preceding this order, the following statement is made:

"It is evident that Mr. Forney has used his position in both of these companies to reap for the General Operating and Construction Company undue profit out of this work at the expense of the Central California Gas Company."

It was determined at that time that a profit of approximately \$15,000 had been made by the Construction Company out of work done for Central California Gas Company, but a more extended investigation has been made of the books of account, vouchers

and data of the Construction Company, with the result that it is shown that out of \$106,485 the Construction Company made a profit of \$33,859.47, or, in other words, for a part of the transmission and distribution system, costing Mr. Forney, operating as the Construction Company, \$72,625.53, the Gas Company, of which Mr. Forney is president, paid the Construction Company a profit of \$33,859.47, making a total cost to the Gas Company of this property of \$106,485. Either Mr. Forney grossly deceived this Commission in stating that he could operate cheaply through the Construction Company, or he must justify the payment of a profit to himself of 46.6 per cent on the cost of the work. This cost of \$72,625.53 is arrived at after allowing Mr. Forney or his Construction Company the benefit of every doubt in the accounts as shown by his books and also includes an allowance to Mr. Forney of a salary of \$350 a month and expenses of \$150 a month for four months.

Mr. Forney's Construction Company's books show a book entry of profit of \$9,830.92. In a letter of the Commission dated January 24, 1914, Mr. Forney's attention was called to the fact that the books of his Construction Company showed a large difference between the cost to it of the property contracted for by Central California Gas Company and the money paid therefor by the latter company, even allowing a profit of \$9,830.92. Mr. Forney offered the explanation that a contract had been made between the Construction Company and one W. H. Brown, by which Brown was to be paid the same compensation for constructing a part of the transmission line and distributing system as had been agreed to be paid by Central California Gas Company to the Construction Company; that Brown had completed approximately one-half of this work when he fell ill and a settlement was made with him by the Construction Company whereby he was paid \$25,070.80; and that thereafter the Construction Company completed the work of in-

stalling a part of the transmission line and distributing system, charging therefor the same price as was provided in the agreement with Central California Gas Company.

I cannot accept this explanation of Mr. Forney because it is entirely unsupported by evidence. Furthermore, it appears from the books of his Construction Company that payment was made by the Construction Company to other parties for the identical work which Forney alleges was done by Brown and for which Forney claims to have paid Brown the \$25,070.80, referred to above. Furthermore, there is no voucher nor receipt of any kind to support this alleged payment to Brown, nor is there any written evidence of a contract with Brown. Mr. Brown is dead, and notwithstanding the refusal of Mr. Forney to disclose to the employees of this Commission the whereabouts of his widow, after considerable effort she has been located and she states positively that Mr. Brown never received for his work for the Operating Company in excess of \$1,500.

It appears that applicant has actually and properly expended for this part of the transmission main and distributing plant not in excess of \$72,625.53 and if complaint is made by applicant on the score that this results in a loss to them of the difference between \$106,485, which it paid to the Construction Company for this property, and the \$72,625.53 which is the maximum that this property cost, we can only suggest that it recover this money from the person who is responsible for its diversion.

The accounts of applicant are in such condition that it is impossible to determine with any accuracy what money was expended properly chargeable to plant or capital account, because the vouchers show total expenditures for a number of items, some of which are not properly capital items. Therefore, in order to arrive at a conclusion as to what this plant cost, it has been necessary to make a segregation and analysis of charges, separating

the expenditures so as to distinguish between operating expenditures and capital expenditures. In the majority of instances even this was impossible and resort was had to an estimate from the vouchers obtainable of the cost of constructing portions of the plant. The engineers of this Commission allowed the full price paid for the Porterville and Visalia plants, but deducted from this price an amount representing property alleged to have been acquired with said plants as a part thereof which they were unable to find.

The following table shows the results arrived at by our engineers with reference to construction work done by the Gas Company itself as compared with the claims of the company:

	<u>C.R.C.</u>	<u>Company</u>	<u>Difference</u>
Material	\$43,921.93	\$50,530.34	\$ 6,608.41
Labor	11,230.64	28,611.55	17,380.91
Material & Labor	1,879.75	1,182.53	- 697.22
Sub-Total	\$57,032.32	\$80,324.42	\$23,292.10
Freight	1,731.66	1,785.05	53.39
Hauling	177.39	1,093.82	916.43
Indirect Charge & Overhead	7,836.02	7,985.68	149.66
Questionable		3,043.01	
Operation & Appliances		1,397.27	
Errors		133.05	
Total			\$28,984.91

That irregularities may easily arise in the conduct of the financial affairs of this corporation is apparent from the system which has been employed. Mr. Forney acts in the various capacities of president, engineer and auditor. Under this system Mr. Forney, as president, may authorize that a certain piece of work be done, as engineer he estimates the cost thereof, as president he approves his own estimate, and as auditor he approves the disbursements. In this way the financial authority is centered in one individual without the usual and proper check that ordinary business judgment would dictate.

A complete investigation by the auditor of this Commission of the accounts, vouchers and other data of applicant discloses that whereas applicant claims a surplus of \$611.19 on December 31, 1914, in reality it had a deficit of \$14,753.41.

A fictitious surplus has been built up as hereinafter specified in detail by concealing a certain amount of operating expenses which results in a false statement of surplus.

Dividends have been paid out regularly and it is probable that in order to get the cash in surplus out of which to pay these dividends, applicant has used moneys derived from the sale of stocks and bonds which the Commission had ordered to be used for capital purposes.

A portion of the request of these applications is that treasury be reimbursed for capital expenditures, but it is obvious that the real, but concealed, purpose is to obtain money in the treasury out of which to pay the operating expenses and to reimburse the company for the moneys paid out in dividends.

There are certain items of operating expense and interest applicable to the year 1914 which have been withheld and carried on the Balance Sheet submitted with the Annual Report for the year ending December 31, 1914, as assets under the caption "Due from Consumers and Agents". These items total \$7,334.18. These items include such expenses as freight bills, salaries, traveling expenses, telephone bills and general current office expenses. These items are so clearly operating expenses that to charge them otherwise evidences a design to deceive.

There are certain additional items of operating expense amounting to \$2,448.87 incurred during the year 1914 and applicable to that year but which were not entered upon the books until 1915. The result of this was that the operating expenses in 1914 were actually higher by \$2,448.87 than shown on applicant's books.

There is, of course, no excuse for this as the Annual Report for 1914 was not filed with this Commission until February 5, 1915, hence there was every opportunity to properly charge all operating expense for 1914.

Certain additional expense items amounting to \$3,319.56 have been carried on the books as an asset under the caption of "Prepaid Development Expense". This is a proper operating charge and the failure to properly set it up adds to the apparent but fictitious surplus out of which dividends have been paid.

The further sum of \$638.96 for gas consumed at the various offices of the company was carried on accounts receivable. Of course, this should not have been included as a part of the income.

There are other items which should be charged against surplus for the year 1914 and which have not been so charged. These items total \$1,622.93.

It is very significant that almost the exact amount by which surplus has been improperly swelled is represented by the amount of \$15,069.50 paid out in dividends in 1914.

It logically follows that the practices and methods here adopted would place the responsible officials of this corporation in the position of declaring dividends out of a deficit; of issuing bonds for operating expenses, contrary to the order of this Commission; and of obtaining bonds from the trustee through false representations of earnings.

For this Commission to authorize the securities here applied for as this matter has been presented, and in the light of the disclosures here revealed, would be for this Commission to sanction and to perpetuate these fraudulent financial practices. The Commission cannot lawfully do so, nor would it in the exercise of its discretion be willing to do so. There is no provision in the Statutes that empowers this body to authorize securities

to reimburse a public utility for dividends illegally paid. There is, on the contrary, express prohibition against such practice.

As this application cannot be granted in view of the condition into which this utility has been brought, it will be necessary for me to recommend a denial. It is essential, however, that Central California Gas Company should continue to perform its proper public utility functions and for that reason steps should be taken as soon as possible to restore this corporation to a proper financial basis. In order to do this it will be necessary for those responsible for the conduct of this public utility's affairs to take steps to restore the moneys improperly paid out in dividends so as to eliminate the existing deficit. Proper steps should also be taken to secure an accounting as to the other sums to which attention has been called.

It is, of course, the desire of the Commission that the customers of the company be properly served and that necessary funds be obtained to install necessary additions and betterments from time to time to that end.

When the deficit has been made good, and proper adjustments have been made on the books of this utility, and satisfactory evidence has been submitted of such restoration and of such adjustments, or when this utility shall have submitted and received the approval of this Commission to plans for the restoration of its financial affairs to a proper basis, this utility may again apply to this Commission for such issue of stocks or bonds or other evidences of indebtedness as may be necessary to enable it to raise the funds to go forward with its public utility business.

During the course of this proceeding the applicant has submitted various other matters to this Commission, none of which require a ruling or other expression from this Commission.

Accordingly I recommend the following form of order:

O R D E R

Central California Gas Company having made applications to this Commission as recited in the foregoing opinion, and a hearing having been held and it appearing that for the reasons set out in the opinion preceding this order the applications should be denied,

IT IS HEREBY ORDERED that the applications herein be and the same are hereby denied.

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 7th day of June, 1915.

Max Shelen
H. S. Glavin
Alex Gordon
Edwin C. Edgerton
Franz P. Dehler

Commissioners.