

Decision No. \_\_\_\_\_

**ORIGINAL**

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

Decision No. 8211

In the matter of the application  
of Peoples Water Company for re-  
organization. )

Application No. 1531

EDGERTON, Commissioner.

FIRST SUPPLEMENTAL OPINION

This Commission has heretofore, on July 10, 1915, Decision No. 2586, (Vol. 7, Opinions and Orders of the Railroad Commission of California, page 597) authorized Peoples Water Company to transfer all of its properties to a corporation to be hereafter organized in consideration of the issue and delivery by the new corporation of \$8,400,000 face value of bonds bearing interest not to exceed 6 per cent per annum and \$8,640,000 par value of stock. It was proposed that the bonds and stock thus issued by the new corporation should be distributed according to a specified plan to the existing bondholders, noteholders and stockholders of Peoples Water Company.

The order of the Commission approved the issue of the stocks and bonds in the amounts as prayed for. Thereafter, on January 31, 1916, Peoples Water Company filed an application for a modification of the Commission's decision heretofore rendered in this matter. In this petition Peoples Water Company asks for authority to transfer all of its properties to a new corporation to be called "East Bay Water Company," and requests that East Bay Water Company be authorized to execute a mortgage and to issue to Peoples Water Company, in

consideration for the properties transferred, \$9,128,000 of first mortgage thirty-year 5½ per cent bonds and \$8,000,000 par value of stock.

In a consideration of the supplemental application herein, it will be unnecessary to review the circumstances which have brought Peoples Water Company to its present condition or to set forth the details in regard to its present status, and the value of its assets. These matters are covered in the decision heretofore referred to, No. 2586.

A general statement of this supplemental application would indicate that it varies in only minor degree from the original application in this matter. Such is not the fact, however. There is a wide difference in certain important particulars. The present supplemental application was inspired by the failure of the various classes of security holders to agree among themselves on the plan originally submitted by them and approved by this Commission.

These security holders have, to a very large degree, adjusted their differences and join in the supplemental application now before the Commission.

While the original plan proposed the issue of \$8,400,000 of bonds and \$8,640,000 par value of stock, and the present plan proposes an issue of \$9,128,000 of bonds and \$8,000,000 of stock, there is the important variation that the original plan contemplated a single class of stock, whereas the amended plan calls for three classes of stock. The original plan provided for an issue of stock to the owners of Peoples Water Company bonds, whereas the amended plan calls for an issue of \$700,000 of bonds to these Peoples Water Company bondholders in addition to an allotment of stock.

The Proposal here under consideration for the issue of stocks and bonds by East Bay Water Company may be summarized as follows:

Bonds -

To issue to the holders of the \$5,600,000 of divisional or underlying bonds of Peoples Water Company an equal amount of new bonds of East Bay Water Company in the sum of ..... \$5,600,000

To issue to the holders of Peoples Water Company collateral notes, bonds of the new company equal to the face value of such notes not to exceed..... 2,300,000

To issue to the holders of Peoples Water Company bonds, an amount of bonds of the East Bay Water Company sufficient to take care of unpaid interest on such bonds, of a total not to exceed ..... 700,000

To issue bonds to be used to provide for unpaid interest on underlying or divisional bonds ..... 308,000

To issue bonds to retire purchase money mortgages ..... 220,000

Total..... \$9,128,000

Stock -

To issue to the holders of Peoples Water Company bonds, Class "A" 6 per cent Cumulative preferred stock of East Bay Water Company equal to one-half the face value of such Peoples Water Company bonds..... \$3,700,000

To issue to Peoples Water Company bondholders, Class "B" preferred stock equal to one-half the face value of such Peoples Water Company bonds..... 3,700,000

To issue to present stockholders of Peoples Water Company, common stock of East Bay Water Company..... 600,000

Total..... \$8,000,000

It is proposed that the bonds shall mature in thirty years, shall bear interest at the rate of 5½ per cent per annum, and shall be issued under a mortgage or deed of trust providing for a total issue of \$15,000,000 and restricting the issue of

new bonds to 80 per cent of the cost of necessary capital additions.

The amended plan proposes further that the Class "A" and Class "B" stock to be issued by East Bay Water Company shall be linked in a single certificate so that each share of such Class "A" stock shall be joined in a certificate with a like share of Class "B" stock. It is provided that these shares shall be thus tied together until the Class "B" stock shall, for a period of three years, have earned and received a 6 per cent annual dividend.

All of the stock is to be pooled under an agreement which places it in trust under the direction of a trustee for five years from January 1, 1916. It is further provided that the trustee shall vote the stock for thirteen directors whose names are specified as follows, these directors to serve for a period of five years:

Harry E. Bothin,	J. Y. Eccleston,
P. E. Bowles,	Robert M. Fitzgerald,
J. F. Carlston,	Stuart S. Hawley,
William Cavalier,	E. A. Heron,
George H. Collins,	Percy T. Morgan,
John S. Drum,	Frank Otis,
	F. W. Van Sicklen,

These men have been selected by the various interests involved,

That the new plan has the endorsement of nearly all of the outstanding security holders, is indicated by the following statement submitted at the hearing, which shows the total face value of each class of securities outstanding and the amount deposited in accordance with the plan here proposed.

	<u>Total Issued</u>	<u>Total Deposited</u>
Contra Costa Water Company First Mortgage Bonds .....	\$2,000,000.00	\$1,286,000.00
Contra Costa Water Company General Mortgage Bonds.....	1,000,000.00	976,000.00
Oakland Water Company Bonds ...	1,500,000.00	1,443,000.00

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4,500,000.00      4,405,000.00

	<u>Total Issued</u>	<u>Total Deposited</u>
Brought Forward -	\$4,500,000.00	\$4,405,000.00
East Shore Water Company Bonds.....	500,000.00	485,000.00
Alameds Artesian Water Company Bonds.....	<u>600,000.00</u>	<u>592,000.00</u>
Total Underlying.....	\$5,600,000.00	\$5,482,000.00
Peoples Water Company General Mortgage Bonds.....	\$7,400,000.00	\$6,850,000.00
Peoples Water Company Notes.....	2,300,000.00	2,115,157.50

While I believe the original plan as submitted, providing for an issue of \$8,400,000 face value of bonds and \$8,640,000 par value of stock, representing but a single class of such stock, was sounder in principle and calculated to prove of greater advantage to this utility, to all classes of its security holders and to the public than the present amended plan: I nevertheless believe that the supplemental proposal is both reasonable and sound as to its general character. Some of the details however should be changed.

Taking a valuation of the properties of Peoples Water Company of \$14,100,000 as heretofore found for the purposes of this proceeding and adding thereto the sum of \$400,000, representing the cash on hand, the total available assets appear as \$14,500,000.

On a basis of this valuation and on the company's past and present earnings and future prospects, a bond issue of \$9,128,000 may well be predicated. It is a simple matter to apportion the residual assets among the holders of one class of stock, but in this instance it is intended to split the stock three ways and at once the financial fabric assumes a wholly new aspect. It is apparent, that ample assets remain to provide for the issue of \$3,700,000 of Class "A" 6 per cent cumulative preferred stock. With the bonds and preferred stock assumed on a par basis, the sum of \$1,672,000 remains for apportionment among the \$3,700,000 of Class "B" stock and the \$600,000 of common stock.

It is immediately apparent that the \$600,000 of common stock is left in an exceedingly doubtful or wholly negative position as to assets. An analysis of the company's revenues brings a similar conclusion as to the relation of this common stock to earnings.

As the original plan and the amended plan include something for the present stockholders of Peoples Water Company it is apparent that the security holders of Peoples Water Company deem it equitable that some participation be allotted to the present stockholders of that company.

In the original plan this participation took the form of a limited amount of stock, which had the effect of placing these holders of Peoples Water Company stock on a parity as far as the class of their beneficial interest in the new corporation was concerned, with the Peoples Water Company bondholders, the relative positions being adjusted by the amount of stock apportioned to each.

I am convinced that a more satisfactory method may be devised of meeting the equities as far as the holders of the stock of Peoples Water Company are concerned than the medium of a common stock of such doubtful character as is here suggested.

In the reorganization of a utility of such a character as the one here under consideration, the new securities and stock should be issued upon a proper foundation of assets or earnings. For this Commission to approve a \$600,000 issue of common stock as here requested, would violate all the sounder principles of conservative finance.

Whatever it is intended to convey to these stockholders of Peoples Water Company may be reduced to a measure of value and expressed in terms of a stock resting upon substantial assets.

Under the plan here proposed, the following issues precede this stock:

Bonds.....	\$9,128,000
Class "A" preferred stock...	3,700,000
Class "B" preferred stock...	<u>3,700,000</u>
Total.....	\$16,528,000.

These issues it is proposed to place upon the property heretofore estimated to be of the value of.....\$14,500,000.

It is apparent, of course, that nothing is left for the common stock. This condition arises because of the arrangement which cuts the stock into three divisions. It is necessary, of course, in any general distribution, to exhaust the equity in each class of stock before making an apportionment for the next succeeding class. This would exhaust the assets before the common stock is reached. If, however, the stock were of a single class or of two classes, assets would be available for apportionment among all.

If the \$600,000 of common stock is eliminated, the preference which it is now proposed to attach to the Class "B" stock would be nullified. With only preferred and common stock nothing is to be gained by tying them together.

In authorizing the issue of stock it will be essential to hold in mind the efficiency of this utility as an operating company, the rights and interests of the security holders of Peoples Water Company, and the public welfare.

Throughout the proceedings emphasis has been placed upon the need of expansion, immediate and elaborate, of the water facilities in the communities of Alameda and Contra Costa Counties served by Peoples Water Company. Any extensive program of construction or improvement can be carried forward with greater facility, safety, and with smaller ultimate cost when there is present the ability to finance through stock as well as through bonds.

All concerned agreed that the requirements of the communities demanded improvements and extensions of the water facilities which would cost upward to \$9,000,000.

Such improvements and extensions could be financed primarily by an issue of bonds. Under the deed of trust which it is proposed shall be executed by East Bay Water Company, it will be entitled to issue <sup>bonds</sup> up to 80 per cent of the cost of these additions, leaving a margin of 20 per cent to be taken care of from some other source. The sponsors of the plan of reorganization stated that this secondary financing to take care of the 20 per cent not covered by bonds could be met through the use of the net earnings of the new company.

The earnings statement submitted for the year 1915 indicates net revenues, after the payment of the dividend on the Class "A" preferred stock, of approximately \$150,000. I do not believe that the earnings of this company at this time are such that we may rely wholly upon this source to furnish the revenues for this secondary financing, particularly when it is also in testimony that it is proposed to pay the 6 per cent dividend on the Class "A" preferred stock.

It would place a demand, heavier I believe than the facts warrant, upon these net earnings to expect them to provide for the payment of fixed charges, the maintenance of an adequate depreciation reserve, for the distribution of dividends on the Class "A" preferred stock and perhaps for the discharge of sinking fund obligations, and in addition for the auxiliary capital necessary to carry forward the extensive program of immediate development. If this development entails an expenditure of \$9,000,000, 20 per cent, or \$1,800,000 would be imposed upon these net earnings over a period of a few years.

I do not believe it is safe or reasonable to look to the revenues for such a sum,

I am therefore of the opinion that in any reorganization of Peoples Water Company properties, a way should always be left open for further financing through stock.



I believe, that it would be to the interest of all concerned that the Class "A" and Class "B" preferred stock should be issued upon separate certificates, each to stand on its own footing. With the common stock eliminated, the Class "B" will naturally become the common and its preferential attributes will vanish.

With preferred stock available for sale, I believe an immediate and ready avenue would be at hand through which to obtain some or all of the 20 per cent of new capital necessary for the proposed additions and betterments. I believe the East Bay Water Company could readily finance itself through the sale of its bonds for 80 per cent of the cost of improvements and the sale of preferred stock for the remaining 20 per cent.

The position of these stocks may be more clearly presented by an analysis of the earnings of Peoples Water Company for the calendar year ending December 31, 1915. The company presents the following statement:

Operating Revenue - Water .....	\$1,640,714.72
Expenses - Operating:	
Pumping.....	\$159,168.69
Distributing.....	83,040.45
Commercial.....	70,773.64
General.....	158,294.11
Taxes.....	<u>189,871.14</u>
Total Operating Expenses.....	<u>661,148.03</u>
Net Operating Revenue.....	979,566.69
Net Non-operating Revenue.....	<u>46,182.15</u>
Net Revenue - Total .....	\$1,025,748.84

This analysis may proceed as follows:

Net earnings as reported for year ending December 30, 1915.....	\$1,025,748.84
Assuming depreciation to be approximately.....	<u>150,000.00</u>
Balance.....	\$ 875,748.84
5½ per cent interest on \$9,128,000 of bonds .....	<u>502,040.00</u>
Balance.....	\$ 372,960.84

Brought Forward -

Balance.....	\$372,960.84
6 per cent dividend on Class "A" preferred stock.....	<u>222,000.00</u>
Balance available for dividends on \$3,700,000 of Class "B" stock and \$600,000 of common stock.....	\$150,960.84

In the amended presentation heretofore noted, it is arranged that the stock shall be placed in trust for a period of five years. In its original decision in this matter the Commission expressed its belief that the stockholders should have all of the power and control to which their ownership entitles them. I can only repeat my conviction in this matter. But the stockholders having agreed ~~upon~~ to surrender a portion of their rights this Commission should not under the circumstances in this case interpose further objection.

Under the amended plan as presented, the city of Oakland, a water district or other municipal corporation, is given a year's option to purchase the water properties under certain specified terms, for \$14,100,000.

This proposal is set forth as follows in the plan of reorganization to which the security holders have assented:

"Without affecting any pending action towards reorganization in private ownership, all persons becoming parties to the modified plan will agree that the properties of the Peoples Water Company or the East Bay Water Company may be acquired by the City of Oakland or a Water District or other municipal corporation desiring to supply the community or any of the communities now supplied by the Peoples Water Company with water before January 1, 1917, at the sum of \$14,100,000, plus such sum of money as may have been expended in betterments and extensions and acquisition of new property since January 1, 1915, and plus such sum of money as shall be equal to the value of any material on hand, less such sum of money as the Company may have obtained from the sale of any property. And in the event of sale the Company shall retain its cash, accounts and bills receivable, and other personal property exclusive of material on hand, but shall pay its bonded and floating debts and all its operating and current expenses to the day of transfer, and no other obligations, except those properly incurred after the date of transfer.

"In order that this offer may be carried out the legal title to all stocks in the East Bay Water Company shall be vested until January 1, 1917, in a trustee; and in case of such sale it shall be the duty of the trustee under the deed of trust securing the first mortgage bonds, to declare all bonds due and payable, provided that there be deposited with such trustee, or definite arrangements be made with such trustee for the deposit of, a sum of money sufficient to discharge in full the principal and accrued interest of the first mortgage bonds hereafter mentioned. The balance of the purchase price shall be distributed to the holders of stock in accordance with the respective rights given to the stock as below provided."

A method is also proposed for the distribution of the money in case of such sale, to the various parties in interest, in which the sum of \$400,000 is made available for the present stockholders of Peoples Water Company. We need not here concern ourselves with the distribution of such moneys as may be received from such sale, except to indicate that the elimination of the common stock will, under the contract, result in the \$400,000 becoming payable to the present holders of preferred and common stock of Peoples Water Company.

The Commission is concerned with the proposal to sell this water plant to the city of Oakland, a water district or other municipal corporation, as such sale can only be made upon the authorization of this body.

The Commission will readily give its approval to the sale of these properties to the city of Oakland or a water district. It has heretofore stated its belief that this whole water problem can best be solved by the acquisition of these water properties by the City of Oakland or a district comprising the territory now served by Peoples Water Company. This statement was made before there had been any direct tender.

The matter now comes before the Commission in the form of a definite and concrete proposal to dispose of these properties to the public. The purpose, as I understand it, is to give the public one year in which to determine whether it will acquire these properties at the price named.

I can not leave this subject without directing the

attention of the public officials of Oakland, Berkeley, Alameda and Piedmont, and the citizens of these communities to the unusual circumstance that now confronts them. They have long complained of inadequate water facilities. In fact the Peoples Water Company itself has admitted the inadequacy of its service. These communities have been growing with rapid pace and it may be reasonably expected that their population will increase in even augmented ratio. It is an axiom that complete water service is the first essential to proper municipal development. It was, in fact, in part this very growth which brought Peoples Water Company into its present condition. It could not command the finances to keep pace with the growth of the territory and was wrecked in the effort.

There is practically unanimity in the belief that all larger communities should own their own water supplies. In fact there are very few large cities in the United States where this rule does not hold. San Francisco and Oakland are conspicuous exceptions. I have no hesitation in saying, therefore, that Oakland and its neighboring cities will never solve their water problem until they own and operate their own water systems.

This offer to sell for the sum of \$14,100,000, made in good faith, should receive the very earnest consideration of the public officials whose duty it is to provide for the welfare of their communities.

In the figures heretofore given it has appeared that the earnings of Peoples Water Company for the year 1915, after a deduction for depreciation, amounted to \$875,000. If we assume that the city of Oakland or a water district desired to acquire these properties and issue \$14,100,000 of bonds which would command, at the prevailing rate of Oakland city bonds, not more than 4.25 per cent, we would have the following result:

Net earnings of plant	- - - - -	\$875,000
Interest on \$14,100,000 of bonds, \$599,250, or in round numbers	- - - - -	<u>600,000</u>
Making an annual balance of	- - -	\$275,000

It appears, therefore, that on the present basis of rates, the city of Oakland or a water district assuming all charges as they now are, could issue its bonds for the properties and thereafter operate the system at such a profit that it could not only pay all the interest on these bonds, but earn a surplus of \$275,000 a year. This would be sufficient to retire the whole bond issue in 50 years.

In case such a purchase were consummated the public body making the acquisition would be called upon to provide the additional funds necessary to a full development of the water supply. It may safely be assumed, however, that the growth in territory and population would be sufficient to provide the additional earnings necessary to insure the profitable operation of the plant. There is, of course, the further consideration that such of the land as was not useful for the water service could be sold, thus relieving the water properties from a part of the cost.

The Peoples Water Company reports \$400,000 of cash on hand and it is stated that a portion of this sum will be used to defray reorganization expenses and certain other liabilities. As it has been urged upon the Commission that all of the assets of this company should be conserved as far as may be, to provide for additions and betterments to its facilities, and as attached order contemplates the existence of such assets in the sum of \$400,000, I recommend that such order provide as a condition that money may be paid out of this fund for reorganization and kindred expenses only after they have

been approved by this Commission.

It will be necessary also for applicant to outline and submit with the least delay a complete plan of water development so that this Commission may be assured that any re-organization has in mind the increase of these water facilities for the service of the communities they serve or neighboring communities which it may be desirable for them to serve.

Neither the deed of trust under which the bonds are to be issued nor the articles of incorporation of East Bay Water Company have been submitted, and any authorization will be, of course, dependent upon their approval by this Commission.

I shall not at this time pass finally upon the exact nature of the stock to be issued, but shall recommend the authorization of \$7,400,000 of stock requested, leaving it to the applicant to amend its plan and to re-classify its stock in a manner upon which all parties in interest may agree. Thereafter, upon the presentation of this amended form of stock issue, the Commission may issue a supplemental order, authorizing the issue of stock in lieu of the \$600,000 of common stock herein requested.

Upon the basis of the foregoing, I recommend the following form of order:

FIRST SUPPLEMENTAL ORDER

Peoples Water Company having applied to the Railroad Commission of California for an order authorizing the transfer of its property to a corporation to be hereafter formed and to be known as "East Bay Water Company," and for an order authorizing the issue of stocks and bonds by such corporation,

And Peoples Water Company having applied also for an order authorizing the transfer of its properties by it or East Bay Water Company to the city of Oakland, a water district, or

other municipal corporation.

And a public hearing having been held and the Commission being fully advised in the premises,

IT IS HEREBY ORDERED by the Railroad Commission of the State of California that Peoples Water Company be and it is hereby granted authority to transfer and convey all of its property, real, personal and mixed, to a corporation to be hereafter organized, to be known as "East Bay Water Company," in consideration for the issue and delivery by said new corporation of bonds which shall be a first lien upon all of its property, in an amount not to exceed \$9,128,000, said bonds to bear interest not to exceed  $5\frac{1}{2}$  per cent per annum, and in consideration further for the issue and delivery by said new corporation of stock of the par value of \$7,400,000, and such additional stock as may be hereafter authorized by supplemental order.

IT IS HEREBY FURTHER ORDERED that "East Bay Water Company" is hereby authorized to issue \$9,128,000 of bonds bearing interest at the rate of  $5\frac{1}{2}$  per cent; \$7,400,000 par value of stock and such additional stock as may be authorized in a supplemental order.

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

1. The stock and bonds herein authorized to be issued shall be used to pay off or cancel all of the indebtedness which is a lien upon any of the property of Peoples Water Company; all of the promissory notes of Peoples Water Company secured by Peoples Water Company bonds; and all other indebtedness of Peoples Water Company.

2. The property of Peoples Water Company shall be transferred to a new corporation to be known as "East Bay Water Company," free and clear of all encumbrance.

3. None of the bonds herein authorized to be issued shall be issued until East Bay Water Company shall have submitted a copy of its mortgage or deed of trust and this Commission shall have issued an order approving said mortgage or deed of trust.

4. None of the stock herein authorized to be issued shall be issued until the East Bay Water Company shall have submitted a copy of its articles of incorporation and this Commission shall have issued an order approving said articles of incorporation.

5. Before any of the stock or bonds herein authorized shall be issued, Peoples Water Company shall submit to this Commission a statement of such amounts as it proposes to pay, out of cash on hand, for expenses incidental to its reorganization.

6. Within three months from date Peoples Water Company or its successors shall report to this Commission in detail a plan for enlarging the water facilities of those communities now served by Peoples Water Company, to the end that such communities shall have adequate and complete service of pure water.

7. East Bay Water Company shall keep separate, true and accurate accounts showing the receipt and application in detail of the proceeds of the sale of the stocks and 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 stocks and bonds during the preceding month, the terms and conditions of the sale and the moneys or properties realized therefrom.

8. The authority herein granted is conditioned upon the payment by the applicant of the fee prescribed under the Public Utilities Act.

9. The authority herein granted shall apply to such stocks and bonds as shall have been issued and to such properties



as shall have been transferred on or before January 1, 1917.

10. None of the stock nor bonds herein authorized to be issued shall be issued until this Commission shall have issued a supplemental order finding that the applicant has complied with such of the conditions herein set out as this Commission may deem prerequisite to such issue.

IT IS FURTHER ORDERED that Peoples Water Company or East Bay Water Company be granted authority to transfer its water properties to the city of Oakland, or a water district or a municipal corporation, under the terms and conditions set out in the "Peoples Water Company Letter and Modified Plan of Reorganization with Amendments as Adopted by Reorganization Committee," a copy of which has been filed in connection with the supplemental application herein and marked Exhibit No. 25, or on such other terms and conditions as may hereafter be approved by this Commission, said transfer of its water properties by Peoples Water Company or East Bay Water Company to become effective only after a statement of the exact terms and conditions of said transfer have been filed with this Commission and a supplemental order issued by this Commission approving the same.

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

Dated at San Francisco, California, this 30<sup>th</sup> day of March, 1916.

Max Shelton  
W. H. Boardman  
Alex. Gordon  
Edwin O. Edgerton  
Frank R. Deben

Commissioners