

Decision No. _____

ORIGINAL

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

Decision No. 3227

In the matter of the application
of Pacific Gas and Electric Company,
a corporation, for an order of the
Railroad Commission of the State of
California authorizing it to issue
its common capital stock in the man-
ner and for the purposes specified
herein.

Application No. 2056

Charles P. Cutten and W. B. Bosley
for applicant.
E. P. E. Troy for Public Ownership
Association.

EDGERTON, Commissioner.

O P I N I O N

This is an application of Pacific Gas and Electric Company for authority to issue 10,211 shares of its common capital stock of the par value of \$100 per share.

Applicant proposes to issue this stock to refund sinking fund payments of the face value of \$1,021,100.

Pacific Gas and Electric Company is engaged in the sale and distribution of gas and electricity in the cities of the San Francisco Bay section, including San Francisco, Oakland, Berkeley and Alameda; the Santa Clara Valley, including San Jose; the San Joaquin Valley as far south as Fresno; and a large section of the Sacramento Valley, including the city of Sacramento. The company also operates water systems, and owns and operates a street railway system in the city of Sacramento. It is the largest distributor of gas and electricity in the State of California.

The affairs of this corporation have been reviewed in

detail in previous decisions of this Commission, and it will not be necessary herein to set forth a full description of its properties nor of the territory which it serves.

Applicant desires to capitalize its surplus profits used to pay or to be used to pay sinking fund obligations devoted to the redemption of bonds during 1914, 1915 and 1916. It reports the following:

Sinking Fund Payments made from Jan. 1, 1914 to Jan. 1, 1916 - - - -	\$2,376,000.00
Sinking Fund Payments to be made from Jan. 1, 1916 to Dec.31,1916 - -	<u>762,015.63</u>
Total - - - - -	\$3,138,015.63
Less amount capitalized in pur- suance of Decision No. 2385, Dated May 12, 1915 - - - - -	<u>1,926,558.00</u>
Balance not capitalized -	\$1,211,457.63

Pacific Gas and Electric Company urges that if it uses \$1,021,100 of its earnings to retire outstanding bonds, it should be permitted thereafter to issue its common capital stock of equal par value, or \$1,021,100. The company states that it could use this money for distribution among its stockholders and could thereafter sell its common stock to such stockholders, re-acquire this sum of \$1,021,100 and devote it to the redemption of bonds, thus accomplishing by various steps what it now proposes to do directly.

This application is made on the theory that if common stock be authorized in the sum requested it will be distributed as a dividend on the company's outstanding common capital stock.

Pacific Gas and Electric Company reports stock authorized and outstanding as of January 1, 1916, as follows:

<u>Class</u>	<u>Authorized</u>	<u>Outstanding</u>
First Preferred	\$50,000,000	\$12,206,200.00
Original Preferred	10,000,000	10,000,000.00
Common	100,000,000	65,732,724.66
Total	160,000,000	87,938,924.66

Of the common stock, \$34,035,858 is held by the public, and not subject to dividends \$31,696,866.66/by subsidiary companies.

In Decision No. 2031, dated January 3, 1916, this company has been authorized to issue an additional \$2,500,000 of preferred stock.

The original preferred stock of the applicant is convertible into first preferred stock on the basis of one share of original preferred for 1.025 shares of first preferred stock, and we may, therefore, assume that the original preferred stock will later be changed into first preferred.

For the calendar year ending December 31, 1915, the applicant submits the following statement of operating revenues and expenses:

INCOME ACCOUNT PACIFIC GAS AND ELECTRIC COMPANY
FOR YEAR ENDED DECEMBER 31, 1915.

<u>Item</u>	<u>Amount</u>	
ELECTRIC OPERATIONS.		
Operating Revenues	\$10,124,560.89	
Operating Expenses	<u>5,505,686.43</u>	
Net Operating Revenues		\$4,618,874.46
GAS OPERATIONS.		
Operating Revenues	7,560,185.33	
Operating Expenses	<u>4,400,597.19</u>	
Net Operating Revenues		3,159,588.14
WATER OPERATIONS.		
Operating Revenues	420,218.85	
Operating Expenses	<u>208,204.24</u>	
Net Operating Revenues		212,012.61
ELECTRIC RAILWAY OPERATIONS.		
Operating Revenues	425,337.97	
Operating Expenses	<u>333,990.04</u>	
Net Operating Revenues		91,347.93
TOTAL NET OPERATING REVENUE		\$8,081,823.14

Brought Forward

\$8,081,823.14

NON OPERATING REVENUES.

Miscellaneous Rent Revenue	20,918.91
Interest	51,561.92
Dividends	512.40
Sinking and Reserve Fund Accretions	165,734.41
Miscellaneous Non Operating Revenues (Net)	<u>151,639.90</u>

TOTAL NON OPERATING REVENUE

390,367.54

GROSS CORPORATE INCOME

\$8,472,190.68

DEDUCTIONS

Uncollectible Bills	108,000.00
Non-Operating Taxes	10,034.71
Interest Accrued on Funded Debt	3,808,507.75
Other Interest Deductions	176,902.77
Rents of Conduits, poles and supports (electric)	4,431.33
Amortization of Debt Discount and Expense	<u>160,410.43</u>

TOTAL DEDUCTIONS

4,259,424.33

BALANCE OF YEAR CARRIED TO CORPORATE SURPLUS

\$4,212,766.35

Note--Foregoing income accounts include \$398,288.23 charged in excess of ordinance rates now in litigation in Federal Courts.

At the hearing upon this matter attention was directed to the value of applicant's property, the amount of depreciation which had occurred therein, the condition of applicant's surplus and the relationship between applicant's assets and its various classes of stocks and bonds. Such an inquiry was necessary by reason of the statement of witnesses called by the Pacific Gas and Electric Company that it was the intention to disburse to the holders of common stock during the year 1916, not only the stock for the issue of which petition is made herein, but an additional dividend in the form of cash.

In Decision No. 2385, Application No. 1633, Volume 6, Opinions and Orders of the Railroad Commission of California, page 926, this Commission authorized the applicant to issue common stock to be distributed to its stockholders for the purpose of reimbursing the applicant for the use of money in its treasury for the redemption of bonds during the calendar years 1914 and 1915. Such authorization was granted upon certain specified conditions. The Commission ruled that the amount of such stock disbursement should be charged against the company's "Corporate Surplus Unappropriated" and not against its sinking fund reserves. The decision was rendered on the evidence as presented in that proceeding. No evidence was presented in Application No. 1633 showing the valuation of the applicant's entire property, or the relationship between such value and the amount of stock and bonds of applicant outstanding. Such evidence has been presented herein, both by the applicant and the Commission's experts, and demands most careful consideration from this Commission.

Mr. A. F. Hockenbeamer for the applicant company, submitted an estimate of the value of its physical properties as of December 31, 1915, in the sum of \$98,837,489.51. This was the company's estimate of the reproduction cost new of all of its properties, with the exception of water rights, franchises, development cost, going value, patents or rights to patent processes and devices. The company submitted no data bearing upon values other than those embraced within this estimate.

No estimate of reproduction cost depreciated was submitted by the company, although it was admitted that there was such depreciation, and it was stated on behalf of the company that it probably would not exceed 10 per cent of depreciable property.

Mr. L. S. Ready of this Commission's engineering department, analyzed the figures of the applicant. He deducted the sum of \$1,768,151 in accordance with a previous ruling by the Commission in a former proceeding. In all other respects he made no attempt to present an independent appraisal nor to question the unit figures or inventory of the applicant. He did, however, make a calculation as to depreciation, and as a result submitted an estimate of reproduction cost depreciated of \$72,466,375. In order to compare this figure with that submitted by the company, it will be necessary to add the company's figure for construction work in progress and working capital, which will bring Mr. Ready's total to \$79,623,075. The company submitted a statement of its indebtedness as of December 31, 1915, showing bonds outstanding in the hands of the public of \$76,172,800.

It has in addition certain contingent liabilities which might increase this indebtedness.

The applicant reports a bond discount unamortized of \$4,283,526.51.

In the foregoing estimates I have to a very large extent used the figures of the company itself for the purpose of comparative analysis. Upon these properties there have been issued and sold to the public bonds as above stated in the sum of \$76,172,800, on which a discount of \$4,283,526.51 remains to be amortized. First preferred stock had been issued up to December 31, 1915, in the amount of \$12,206,200, on which a discount of approximately \$2,135,000 remains unamortized. Upon these same assets has been predicated an issue of original preferred stock in the amount of \$10,000,000, upon which a discount also remains unamortized. In addition, the applicant has put out to the public \$34,035,858 of its common stock.

It is necessary to consider the original preferred as eventually passing into first preferred and sharing equally with it. This original preferred when converted will amount to \$10,250,000 par value of first preferred.

Inquiry was made at the hearing to determine if the applicant had adequately provided against the depreciation of its properties. It appears that to 1912 this company had made no clear provision for depreciation reserve and such accumulation as now exists has been set up during the past four years. During the years 1912, 1913, 1914 and 1915, inclusive, this company set aside for depreciation the sum of - - - - - \$6,342,462.53 and during the same period charged against this reserve- - - - - 4,472,906.62 leaving as the balance in its depreciation reserve fund as of December 31, 1915- - - - - \$2,772,848.01

Evidence was introduced at the hearing showing the depreciation ratios and reserves of the seven largest gas and electric companies of California, as well as the Spring Valley Water Company. The Spring Valley Water Company was chosen by reason of the fact that it operates also, in the San Francisco Bay territory, a section covered by the Pacific Gas and Electric Company. The figures were taken from the annual reports submitted by these companies to this Commission for the year 1914. While they do not establish final ratios, they are the best comparative statistics at hand and are indicative of the situation of these companies in respect to their depreciation reserves.

I take from this testimony the showing of the ratio of depreciation reserve to tangible capital and to the gross operating revenues for 1914. The result is as follows:

<u>Name of Company</u>	<u>Ratio of Depreciation</u> <u>Reserve</u> <u>to</u>	
	<u>Tangible</u> <u>Capital</u>	<u>Operating</u> <u>Revenues</u>
Pacific Gas & Electric Company	2.21%	14.61%
Pacific Light & Power Corporation	4.95%	72.89%
Great Western Power Company	0.00%	.00%
Los Angeles Gas & Electric Corporation	19.08%	69.04%
Southern California Edison Company	8.75%	45.05%
San Diego Consolidated Gas & Electric Co.	8.38%	31.46%
San Joaquin Light & Power Corporation	5.52%	31.63%
Spring Valley Water Company	4.07%	77.12%

It will be seen from the above that the Pacific Gas and Electric Company falls far below the average in the ratio of its depreciation reserve to tangible capital or to its gross operating revenues. Of all of the companies enumerated it makes the smallest comparative provision for depreciation, with the exception of the Great Western Power Company which has provided no depreciation whatever.

Pacific Gas and Electric Company has made insufficient provision for the depreciation of its properties. The failure is particularly conspicuous prior to 1912 when the Public Utilities Act became effective. Up to that time the company had no reserve to take care of this depreciation.

Exhaustive investigation into the physical condition of many gas and electric companies in this state has developed the fact that even where the properties have been kept in an excellent state of repair and highly maintained, the physical condition is not greater than 85 per cent of new. Comparing the properties of these gas and electric companies with applicant, it is entirely fair to applicant to assume that its physical condition is not greater than 85 per cent of new. Considering the depreciable property claimed by applicant, this comparison with the properties of like companies supports the calculation of depreciation made by Mr. Ready.

At the hearing upon this matter some inquiry was made into the company's surplus and the elements of which it was constituted. The company reported a surplus as of December 31, 1915 in the sum of \$5,120,677.73. This surplus consists in large part of moneys appropriated for sinking fund purposes, the total of these appropriations amounting to \$3,832,398.36.

While I recognize that the relation of a corporation's assets to its capitalization may be such as to make it relatively unimportant whether sinking fund reserves be allowed to remain in surplus, I am convinced that, as has heretofore been shown, the relation of applicant's assets to its capitalization at this time is such as to make it improper that it should set aside sinking fund reserves which are designed to reduce capitalization as compared to assets, and at the same time allow these reserves to appear in surplus out of which dividends will be declared, thus, in effect, nullifying the benefits by way of decreased capitalization

which would result if the money represented by the dividends had been allowed to remain in assets.

If applicant's sinking fund reserves are deducted from surplus as they should be on the facts of this case before dividends are paid, it will leave available for dividends only \$1,288,279.37.

This company has received authority from this Commission to issue \$15,000,000 par value of preferred stock. To date it reports the sale of approximately \$13,387,000 of this stock. In this sale the company has widely advertised the authority given by this Commission. It has through these advertisements and its campaign of salesmanship acquired approximately 5,000 new shareholders who have invested in this preferred stock. This stock, of course, is not guaranteed by the State, nor is any purchaser assured of any peculiar protection or right by reason of its issue.

While the rule of the buyer's risk must be present here as elsewhere, this company, having used this Commission's authority to bring 5000 persons into a new community of its stock ownership, should not adopt a policy that cannot fail to impair the position of these investors. This condition is emphasized by the evidence and the practical admission by the company that its depreciation reserves have been inadequate. At the time when it is clear that revenues should be conserved against this depreciation and to build up assets, it is proposed to distribute these revenues to the holders of the common stock.

It is the announced policy of applicant to continue the payment of cash dividends on common stock once they have been commenced. So we are confronted with a proposed issue of common stock as a part of a dividend, the other part to be cash and thereafter in regular course the payment of dividends on the stock thus issued.

We urge upon applicant the policy of investing in plant a reasonable part of its net earnings until such time as its

assets bear a better relation to its capitalization.

In the absence of agreement by applicant on this policy, I recommend that the Commission take immediate steps to compel the setting up of a proper depreciation reserve out of income or surplus.

With applicant as with other utilities in California, this Commission has never fixed rates on a basis of the least possible legal return to the company. On the contrary the Commission has been liberal with a view to making strong and financially healthy the public utility companies. However, with the benefits of this liberality, should, of course, go the obligation resting upon the company toward the conservation of assets.

If this applicant does not, of its own accord, conserve its assets, it will be necessary for this Commission to require that it do so. In such event I recommend that this Commission call an investigation into the affairs of this company, particularly with reference to its depreciation reserve, its sinking fund appropriations, its surplus account, the unamortized discount on its preferred stock and other matters relating to its books of account, to require that a proper relationship be established and maintained between applicant's assets and its obligations to its bondholders and preferred stockholders.

Accordingly I recommend that this application be denied and submit herewith the following form of order:

O R D E R.

PACIFIC GAS AND ELECTRIC COMPANY having applied to this Commission for authority to issue 10,211 shares of its common capital stock of a par value of \$100. per share, and a hearing having been held and it appearing to the Commission for the reasons set out in the foregoing opinion that the same should be denied,

IT IS HEREBY ORDERED that the same be and it is 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 ^{4th} day of ~~June~~ ^{April}, 1916.

Max Thelen
A. J. Overland
Alex. G. ...
Edwin C. Edgerton
Frank D. ...

Commissioners