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ORIGINAL

Decision No. 14987

Decision No. _____

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of VALLEY NATURAL GAS COMPANY for)
authority to issue shares of its)
common stock.)

Application No. 3339.

Lilienthal, McKinstry & Raymond,
by Joseph Haber, Jr., for applicant.

TERRELL, Commissioner.

O P I N I O N

In its petition herein, Valley Natural Gas Company asks authority to issue such an amount of its common stock as the Railroad Commission may deem proper, for the purpose of capitalizing earnings expended for additions and betterments and the redemption of bonds. Petitioner proposes to distribute as a stock dividend to the holders of its common stock such stock as may be authorized herein.

Petitioner alleges that it and its predecessor in interest, California Natural Gas Company, have expended for additions and betterments the following amounts:-

December 1, 1915 to March 1, 1916	\$25,872.88
March 1, 1916 to July 1, 1916 (credit).....	3,028.05
July 1, 1916 to March 1, 1917	30,171.84
March 1, 1917 to November 1, 1917	<u>24,796.01</u>
Total	\$76,812.68

Petitioner also alleges that from June 30, 1917 to November 1, 1917 inclusive it has used earnings to redeem bonds in the amount of \$60,000.00. As I view the situation, the question before the Commission is not so much the amount of earnings expended for additions and betterments and the redemption of bonds as the amount of earnings properly available for the payment of dividends on petitioner's common stock. The testimony indicates that the earnings available for this purpose have been expended for additions and betterments or for the redemption of bonds. Dividends on petitioner's preferred stock have been regularly paid.

The testimony shows that Valley Natural Gas Company acquired the properties of California Natural Gas Company on or about June 20, 1916, and that the cash paid for the properties as of June 20, 1916 included the additions and betterments from December 1, 1915 to June 20, 1916.

Mr. J. F. McMahon, General Manager of Valley Natural Gas Company, testified that during 1916 no allowance was made for depreciation, except for automobiles, but that during the current year it is the intention of the officials of the company to appropriate from \$50,000.00 to \$60,000.00 of the earnings for depreciation. In readjusting the rates of Valley Natural Gas Company, the Railroad Commission in Decision Number 4485, dated July 27, 1917 allowed \$43,334.64 per annum for depreciation.

Petitioner is engaged in the distribution of natural gas, a business of considerable hazard because of the uncertain life of the field. Mr. McMahon testified that in his opinion if the natural gas supply ceases the property of petitioner will become entirely useless and that any value which it will have will be its salvage value.

Because of the fact that this property is viewed as having a short term life, the function of the depreciation reserve seems to me, in this case, to be not so much to replace the property as worn out and thus to keep the investment intact, as

to restore the investment to the investors. In restoring the investment, the company's obligation naturally goes first to its creditors, and second to its stockholders.

For the purpose of determining the amount of net earnings available for the payment of dividends on common stock, I am inclined to the view that the company should set up for depreciation the amount allowed by the Commission in the recent rate proceeding and that the amount so allowed per annum should not only be applied to the 1917 but also to the 1916 operations.

No matter for what purpose the depreciation fund has been or will be used, I am of the opinion that it should not be capitalized. Counsel for petitioner agrees with me in this conclusion.

A statement submitted by petitioner shows the following results from the operation of the properties here involved.

<u>Item</u>	<u>Jan. 1, 1916 to Dec. 31, 1916</u>	<u>Jan. 1, 1917 to Oct. 31, 1917</u>
Operating Revenues,	\$368,739.58	\$ 476,442.98
Operating Expenses, including taxes but not depreciation	271,519.32	406,335.47
Net Operating Revenues	97,220.26	70,107.51
Less Interest	11,810.36	16,599.84
Net Earnings	85,409.90	53,507.67
From which should be deducted depreciation and dividend on preferred stock:		
Depreciation	43,334.64	36,112.22
Dividend on preferred stock	10,002.00	11,002.00
Total	\$ 53,336.64	\$ 47,114.22
Net earnings available for dividends on common stock	\$ 32,073.26	\$ 6,393.45

The foregoing table indicates that the company has available for the payment of dividends on its common stock the sum of \$38,466.71 less the sum of \$1,278.00, being one month's dividend on preferred stock.

The testimony is to the effect that this amount as well as amounts which more properly should have been charged to depreciation have been expended for additions and betterments and the redemption of bonds. As said, I do not believe that any amount expended out of the depreciation fund should be capitalized regardless as to whether the moneys in the depreciation fund have been used to redeem bonds or expended for additions and betterments or replacements.

Under petitioner's articles of incorporation, any stock which the Commission may authorize to be issued pursuant to the petition herein must be delivered to the common stockholders. Mr. C. C. Spicer, secretary of Valley Natural Gas Company, testified that the common stockholders have agreed with all parties who were in any way interested in the organization and financing of the Valley Natural Gas Company that they would distribute any stock herein authorized as follows:-

50 per cent to the Standard Bond & Mortgage Company.

23 per cent to Mr. C. B. Colby and his associates.

23 per cent to Messrs. C. C. Spicer, Charles Donlon,
J. A. Hughes and A. S. Bradford.

4 per cent to Mr. T. F. Speed.

All parties agree that this distribution shall be regarded as compensation in full for all services rendered in financing the purchase of the properties of California Natural Gas Company.

In view of the facts presented in connection with this petition I am of the opinion that Valley Natural Gas Company may properly be authorized to issue \$37,000.00 par value of its common capital stock for the purpose of reimbursing its treasury for earnings expended for additions and betterments.

I herewith submit the following form of Order:-

O R D E R

VALLEY NATURAL GAS COMPANY having applied to the Railroad Commission for authority to issue common capital stock in such an amount as the Commission may determine, and a public hearing having been held, and the Railroad Commission being of the opinion that the money, property or labor to be procured or paid for by such issue is reasonably required for the purpose or purposes specified in the order and that the expenditures for such purpose or purposes are not in whole or in part reasonably chargeable to operating expenses or to income;

IT IS HEREBY ORDERED that Valley Natural Gas Company be and it is hereby authorized to issue \$37,000.00 par value of its common capital stock for the purpose of reimbursing its treasury because of earnings expended for capital purposes, the authority herein granted to issue said stock being upon the following conditions and not otherwise:-

1.-Valley Natural Gas Company shall keep separate, true and accurate accounts showing the receipt and application in detail of the proceeds of the sale of the stock herein authorized to be issued; and on or before the twenty-fifth day of each month the company shall make verified reports to the Railroad Commission stating the sale or sales of said stock 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.

2.-The authority herein granted to issue stock shall apply only to such stock as shall have been issued on or before May 15, 1918.

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 26th day of December, 1917.

Max Thelen
H. S. Leonard
W. J. S. Carson
Edwin O. Edgerston

Commissioners.