

BEFORE THE RAILROAD COMMISSION  
OF THE STATE OF CALIFORNIA.

ORIGINAL  
Decision No. 783

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In the Matter of the Application :  
of the ECONOMIC GAS COMPANY, a cor- :  
poration, for an order approving an : Application No. 500.  
issue of bonds of said corporation :  
of the face value of \$930,000. :  
.....

Chickering and Gregory for applicant.  
Lucius P. Greene for certain consumers, protestants.  
Herbert J. Goudge and Paul Overton for Los Angeles  
Gas and Electric Corporation, protestant.

ESHELMAN, Commissioner.

O P I N I O N

On December 20, 1912, the attention of this Commission was directed to the fact that the applicant herein had issued certain bonds without complying with the provisions of the Public Utilities Act. On investigation such was found to be the fact, and on January 9, 1913, applicant was instructed to appear before this Commission and make whatever showing it desired in this matter, and the present application is the result of this action.

The company urges that whatever violation of law it may have committed is due to a misconception of its rights. It is my belief, however, from the evidence in this case that it was the design of this applicant to evade the provisions of the Public Utilities Act, which induced it initially to take the steps which have brought about its present condition. Yet, while this is true, and this applicant and its officers have violated the provisions of the Public Utilities Act, I do not believe that a denial of the application on this ground is imperative. Since the matter has been formally before the Commission there has been a complete submission to the Commission's authority by the company and its officers, and the regulation of this company's affairs is now well within this Com-

mission's powers.

Two protests were filed against the granting of this application, one by Jacob Swallow, Mae Laws and Clarence W. Martin, consumers of the company, represented by Lucius P. Greene, and the other by the Los Angeles Gas and Electric Corporation, which also serves the territory served by applicant. The good faith of the former protest was questioned by the applicant and no appearance was made at the final hearing by these protestants.

The protestants asked that the application be denied on the following grounds:

1. That the approval of bonds as applied for would authorize plant duplication and perpetuate a so-called economic fallacy.
2. That \$695,000 of the \$930,000 of bonds were issued subsequent to March 23, 1912 without the approval of this Commission, and, therefore, were illegally issued.
3. That the properties of Economic Gas Company are insufficient to justify a bond issue in the sum of \$930,000.
4. That the earnings and income of Economic Gas Company are insufficient to justify an issue of bonds as applied for.
5. That the Commission has not the authority under the Public Utilities Act to approve an issue of bonds subsequent to such issue.

In the main these objections embrace the points of the Commission's usual inquiry particularly as to Nos. 3 and 4. I shall consider these various objections *seriatim*.

Los Angeles Gas and Electric Corporation urges that the authorization of these bonds would mean plant duplication. Economic Gas Company was organized in 1909 and purchased the properties of the Peoples Gas and Coke Company. It entered the territory, therefore, at the time when the laws of the State did not require it to secure the permission of any State authority, and proceeded to make whatever

duplication exists in a legal manner, and this duplication now exists and it is not within the power of this Commission to prevent it. Having franchise to operate within the City of Los Angeles, which does not confine its field of operation to any particular portion of the city, the Commission has heretofore taken the position that extensions within the city by a company already authorized to operate therein are questions for the city to determine. I cannot see, therefore, that plant duplication is an issue at this time.

Illegal issue of bonds: On January 9, 1913, Mr. L. P. Lowe, President of the Economic Gas Company, on the matter being brought to his attention by the Commission, reported to the attorney of this Commission, Commissioner Thelen, that \$1,445,000 par value of bonds were turned over on March 19, 1912 by the Economic Gas Company to the California Light and Fuel Company, which latter company is controlled also by Mr. Lowe. Mr. Lowe at this time stated that these bonds had been turned over to California Light and Fuel Company under a contract under which the latter company paid \$83,333.33 cash for bonds of the face value of \$100,000.00, and also secured the right up to a time specified of selling the bonds of the Economic Gas Company as agent, and then of turning the proceeds over to the Economic Gas Company. In this way, according to the report then made by Mr. Lowe, bonds of the face value of \$459,000 were sold subsequent to March 23, 1912, without securing the consent of this Commission. This contract, Mr. Lowe stated, had been entered into on the advice of his attorney.

A careful inspection having been made of the books of the company by the Commission's auditor, it was found that up to March 23, 1912, there had been issued altogether by the Economic Gas Company, bonds to the amount of \$295,000, and since that time the issue has been increased by \$635,000, making a total amount of \$930,000. face value for the issuance of which the approval of this Commission is now asked. Because of the fact that this contract was entered into by this applicant with a corporation controlled by

the same parties as control the applicant, on the 19th day of March, 1912, leads me to believe, as I have already stated, that the design of this applicant was to get around the provisions of the Public Utilities Act. It may well be as stated at the hearing, that there was no design to violate the law and a belief that the procedure followed would not constitute a violation, but the facts are that it was desired to circumvent the law, and the distinction is purely technical. This applicant did not intend to submit itself originally to the jurisdiction of the Commission and adopted this method of attempting to issue its bonds just before the effective date of the Public Utilities Act so that it might thereafter be freed from the restraint to which other utilities are subjected. This procedure on the part of public utilities has heretofore been commented on by this Commission and it is not necessary to add here to what has already been said in this regard. The fact that the applicant is mistaken as a matter of law and has not succeeded in escaping the power of regulation of the State on a technicality does not, in my mind, put it in any worse position than though it had accomplished the result desired, and it and its officers could not complain if all the penalties provided by the Public Utilities Act should attach. The successful evasion of the law, in my mind, is no less culpable than its violation.

The fact that the applicant has not been able to evade legal regulation and that no harm has been done to the public by its action persuades this Commission to take its present course, but it does not, as already stated, excuse the utility for its attempted violation of the law.

I find from the evidence that of the \$930,000 issued, for which the approval of this Commission is desired, \$635,000 par value has been illegally issued since March 23, 1912, and therefore, under the provisions of the law, is void and constitutes no obligation against the property of this company. Of this illegal issue \$270,000 was for refunding indebtedness of \$225,000, leaving a balance of \$365,000 issued for alleged capital expenditures since March 23, 1912.

While, of course, this Commission has no authority to render a void act valid, and the bonds illegally put out hereunder are, of course, not issued at all, yet this fact does not at all interfere with the Commission's power to consider the matter de novo, and to authorize or refuse to authorize the issue of \$635,000, for which its approval is now sought, and having determined that the public interest has not been adversely affected by the attempted illegal act of this applicant, I shall consider the matter the same as though the applicant were before the Commission in the regular way, and the question is whether or not the condition of this company's property is such that it should be allowed to issue bonds of the par value of \$635,000 in addition to its present indebtedness.

The Commission has before it several estimates of the value of applicant's property, but before considering these, it is well to state briefly the history of this applicant so as the better to understand its present condition.

Some year ago, Peoples Gas and Coke Company, predecessors of the applicant, was serving a certain portion of the territory in Los Angeles. Geo. H. Hayes was the principal owner of this corporation. It was seriously involved in litigation. Finally, the property was sold under foreclosure and Mr. Hayes purchased it. The applicant, Economic Gas Company, was then formed and issued \$1,500,000 of stock and authorized the issue of \$1,500,000 of bonds. Mr. Lowe took the stock and has since sold a considerable portion of it, but none of the proceeds of such sales have gone into the treasury of the company, and Mr. Lowe still controls approximately two-thirds of the capital stock. Bonds were issued from the authorized issue, according to the testimony as follows:

January, 1910.....	\$175,000	issued at par
March, 1910.....	10,000	" " "
December, 1910.....	50,000	" " "
December, 1911.....	12,000	" " 83-1/3
December, 1911.....	12,000	" " "
January, 1912.....	48,000	" " "
March, 1912.....	60,000	" " "
July, 1912.....	130,000	" " "

August, 1912.....	\$ 19,000	issued at 83-1/3
September, 1912.....	30,000	" " "
November, 1912.....	270,000	issued to take up a \$225,000 note which had been given by the company to Mr. Hayes, the original owner and \$9000 indebtedness assumed.
December, 1912.....	6,000	issued at 83-1/3
January, 1913.....	60,000	" " "
March, 1913.....	60,000	" " "

All of the transactions occurring subsequent to March 23, 1912 were handled by the California Light and Fuel Company, which Mr. Lowe also controls. It is strenuously contended by Mr. Lowe that the \$234,000 paid for the property did not represent its entire value. What other value there was in this property does not appear to me, and we have a right under the law to assume that this represents the entire value of the property at that time, but in order that entire justice might be done to the applicant, the Commission has gone carefully into its property valuations, independent of its stock and bond operations, and has several estimates of value before it. Mr. Lowe estimates the value of the property at from \$1,000,000 to \$1,100,000, not including property on consumers' premises and the cost of getting business, and including these latter items, Mr. Lowe places an estimate from \$1,117,000 to \$1,217,000 as the value of his property, which is purely an estimate and will be considered as such. Mr. Kelley of the Commission's engineering department, made an independent appraisal and valuation and his reproduction estimate, including installation on consumers' premises, amounts to \$986,364, and this estimate depreciated to present value, including installation on consumers' premises, amounts to \$800,252. Mr. F. C. Millard, an engineer employed by the applicant, places the reproduction value new at \$1,290,965.54, not including installations on consumers' premises, and a present value of \$1,139,247.32. The actual cost of this property to applicant, if we may take the sale of bonds and the money realized therefrom as a guide, is as follows:

\$235,000	of bonds sold at par.....	\$235,000.00
\$299,000	" " " " 83-1/3.....	249,150.00
\$270,000	" " in exchange for notes given and assumed by the company at the time of purchase of the property originally.....	233,792.05

\$126,000 of bonds sold at 83-1/3..... 105,000.00

making a total issue of bonds of \$930,000, from which there was realized \$822,942.05. It will be noted that this latter figure corresponds quite closely with the depreciated reproduction value of \$800,252.00 found by Mr. Kelley.

In this present value, however, there is included an allowance for installations on consumers' premises. These installations do not include meters or service, but appliances such as lamps and stoves, which are given the consumers on a "free rent" basis as long as they purchase gas from the Economic Gas Company. I do not believe that such property affords a proper security for an issue of bonds. It is of rapid depreciation and is being worn out by the consumers, and remains for all practical purposes the property of the consumer as long as he remains a consumer of the company, and only reverts to the company's control when the consumer is lost and then, of course, in a second hand condition. The cost of these appliances is for all practical purposes an operating expense or a part of the cost of getting the business, and not strictly, though perhaps legally, a capital expense. The applicant reports an expenditure for these installations in the sum of \$117,978. Mr. Kelley has allowed the applicant under his present value \$70,787 for these installations. Whatever their value is, it is my belief that it should be deducted from the capital to be considered for bond issue purposes. Taking the smaller amount attributed to these appliances by Mr. Kelley, and deducting it from his present value of \$800,252 we get a balance of \$729,465.

Mr. Kelley has depreciated the other property of the company quite heavily and it is well known that certain portions of such gas properties depreciate rapidly and I have no doubt that Mr. Kelley's estimate is correct, but in order to be liberal with the

applicant, we might accept the smaller percentage of the depreciation suggested by Mr. Millard, thereby adding approximately \$50,000 to the value of the property and getting a present value in the neighborhood of \$200,000, which is approximately what the property should be worth from the original cost basis if depreciation has been taken care of. It is, therefore, apparent that the bond issue of \$930,000 which will be the total amount outstanding against this company, to say nothing of the stock, if this application is granted, is in excess of what this Commission can allow, and the application in part at least must be denied.

Before finally determining what, if any, part of this bond issue should be permitted, it is well to consider the earnings of this company. The earning statement submitted by Economic Gas Company shows losses for 1910 and 1911, and an ostensible profit for 1912 of \$8,336.51. There is an accumulated deficit of \$35,091.73. If a proper proportion of the investment of \$117,978.00 in installations on consumers' premises were charged to operation, this deficit would be far greater. Besides, the applicant has not properly considered depreciation and I conclude that if proper depreciation charges were made and the installation account properly handled that instead of a surplus of \$8,336.51, which applicant claims for 1912, it would show a substantial deficit. Adopting Mr. Kelley's suggestion of 20 per cent depreciation on these appliances, which from their nature would readily be seen not to be too high, the accumulated deficit instead of \$35,091.73 would be in the neighborhood of \$90,000.

It appears, therefore, that although the Economic Gas Company is improving annually as a property and has increased its gross sales from \$49,250.94 in 1910 to \$94,571.29 in 1911 and to \$199,734.76 in 1912, it has not yet reached a point where it can be properly said to take care of its necessities. It would, therefore, appear as true that the earnings of the Economic Gas Company are insufficient to warrant the bond issue in the sum of



\$930,000.

There are several other matters which deserve comment before finally disposing of this application. This company carries a heavy item in accounts receivable, which probably represents the amount due on its bonds now held by Mr. Lowe and the California Light and Fuel Company under the contract of sale entered into between the applicant, Mr. Lowe and the California Light and Fuel Company. I have already commented on this matter, and it constitutes in my mind a mere attempt at evasion, and neither Mr. Lowe nor the California Light and Fuel Company own these bonds, and they should be placed in the treasury of the Economic Gas Company until they are properly issued and sold. This is not the first time we have found two companies controlled by the same agencies engaging in this financial flim-flam with an apparent design to profit individuals at the expense of the utility. It also should be noted that in addition to the \$930,000 bonded indebtedness sought to be authorized there is a floating indebtedness of approximately \$80,000, and a \$20,000 mortgage on a portion of this company's land. This will raise its indebtedness, if this application should be granted, to approximately \$1,030,000. It has current assets of approximately \$30,000. If this application should be granted there would be a discount approximately of \$113,000 on the sale of the bonds which should be amortized. If the application is granted for a less amount than applied for, of course, the amount to be amortized would be correspondingly decreased. It also appears that depreciation has not been properly maintained, and large expenditures for operation have improperly been treated as capital.

I have severely criticized the applicant for its method heretofore pursued, but whatever was its original intention, I believe that it has now placed itself completely under the jurisdiction of the Commission and has made every endeavor to acquaint the Commission with the condition of its affairs.

Of the \$635,000 of bonds which have been illegally issued, \$270,000 were for refunding, leaving \$365,000, which the Commission is called upon to approve for additions and betterments. The approval, if given, would, therefore, be in this form:

For refunding indebtedness heretofore incurred.....\$270,000

For betterments and additions..... 365,000.

The other bonds in the sum of \$295,000 were issued prior to March 23, 1912, and are, in my opinion, subsisting and legal obligations against the property of this company which must be recognized.

I believe that the \$270,000 issued for refunding purposes should be approved. This, with the \$295,000 heretofore issued will make a total outstanding bonded indebtedness of \$565,000. Adding to this, \$20,000 mortgage on land, gives us \$585,000. Thus it will be seen that on a valuation of \$800,000 with this part of the application granted, this company would already have outstanding obligations approximating 73 per cent of the value of its property, to say nothing of the stock issued of \$1,500,000, all of which is outstanding, and for which nothing has been realized by the company.

While if this company had been financed as we think is proper and there was outstanding but 73 per cent bonded indebtedness against it, we probably would allow that indebtedness to be added to, yet under the circumstances of this case I do not believe it proper at the present time to permit indebtedness beyond this amount. To begin with the money realized from the sale of the bonds attempted to be issued has gone into the property and as soon as it appears that these supposed bondholders have no security they will necessarily take steps to enforce their rights against the company. In other words, the people who have given the money in return for these bonds illegally issued are in effect unsecured creditors of the corporation, and we have in addition to the 73 per cent bonded indebtedness outstanding unsecured indebtedness which makes it improper to permit a further encumbrance of this company. Besides

all of the stock has been issued and none of the benefits derived from such issue have gone to the corporation. While I do not discredit the testimony of Mr. Lowe that he thinks there was a substantial equity in the property beyond that for which it was purchased from Mr. Hayes, still even from Mr. Lowe's own estimate of the value of the property it will be seen that the issuance of the \$1,500,000 of stock to Mr. Lowe for this equity was not justified. While unquestionably the legal title to stock which has heretofore been appropriated by promoters of enterprises for which nothing has been paid into the treasury of the corporation is in such promoters or their assignees, yet the Commission is not impressed with the propriety of such a procedure notwithstanding. It always has been the design of the constitution and laws of this State that payment should be made into the treasury of a corporation for stock issued, and it does not change the design of the laws for corporation promoters to take this stock as their own property, sell it to the public and retain the proceeds as their own private funds. At the present time L. P. Lowe holds as his private property 8,130 shares, representing a par value of \$813,000, and holds as trustee 2,999 shares representing a par value of \$299,900, thus controlling out of a total issue of 15,000 shares 11,129 shares, representing a par value of \$1,112,900. Before this company may realize any more money from bonds, particularly in view of its earning capacity and its illegal actions heretofore, it should be required to raise something from this stock. I do not desire at all to handicap this company in its operation, but when the entire capital stock is appropriated, as here, for a small and doubtful consideration I am of the opinion that justice to the utility requires that money be realized therefrom if it is possible so to do.

I, therefore, recommend that no order be entered authorizing the issuance of \$365,000 which will be necessary to cover the amount attempted to be issued, and which is entirely void. The bonds referred to and attempted to be issued are as follows:

March 31, 1912	Hotaling Estate.....	\$ 60,000	issued at 83-1/3
July 30, 1912	Economic Gas App. Co..	30,000	" " 83-1/3
Aug. 31, 1912	D. O. Druffel.....	15,000	" " 83-1/3
Aug. 31, 1912	S. W. Coleman.....	4,000	" " 83-1/3
Sept. 30, 1912	W. F. Detert.....	30,000	" " 83-1/3
Nov. 30, 1912	W. H. Chickering.....	6,000	" " 83-1/3
Jan. 31, 1913	J. D. Grant.....	60,000	" " 83-1/3
March 21, 1913	L. P. Lowe.....	60,000	" " 83-1/3

Of course this Commission has nothing to say nor authority over the right of action of the parties who bought these bonds in good faith, but the bonds are absolutely void under the law and these parties will either be compelled to make other arrangements with this company or to pursue whatever action they have for the return of the purchase money. As has already been said, the attitude of this company since the matter was brought formally before this Commission has been quite proper, and it has been because of this fact that the Commission has been disposed to be as lenient as it has in this regard, but we call attention to the fact that this Commission has no authority to excuse from prosecution even a technical violation of the law and the proper law officers will have the right at any time to take such steps as they may deem necessary in this regard, and the action of this Commission shall not be taken in any wise as an approval of the actions of this company or as an excuse for such actions. We merely allow certain bonds to be issued which may be substituted for certain obligations paid for by bonds that were attempted to be issued and refuse to allow other bonds to be issued to pay for obligations heretofore assumed and purported to be satisfied by bonds illegally issued. This should be made very clear and any provision of the order should be construed in contemplation of what is here said.

It is apparent that this company will be required to raise money from some source. I have already suggested that the proper source is from stock. If it can make arrangements with the purchasers of these void bonds to settle in the amount paid for said bonds it will be required to raise a little over \$304,000, assuming that these purchasers are in fact purchasers in good faith. As a matter of fact it is clear from the evidence that a considerable

portion of these bonds are held for the purposes of sale to avoid the jurisdiction of this Commission, which accounts for the large book account to which I have already referred. Under all the circumstances I do not believe it will be very difficult for this company to arrange with the companies and individuals holding these bonds for their surrender, and in those cases where this cannot be done it will be necessary, as I have already said, for this company to get the money for these purposes from its stockholders.

I submit the following order:

O R D E R -

ECONOMIC GAS COMPANY having applied to this Commission for an order authorizing the issue of 5 per cent 30-year bonds of the face value of \$930,000 out of an authorized issue of \$1,500,000 and for permission to apply the proceeds thereof to the payment of certain obligations heretofore incurred and attempted to be paid for from bonds heretofore attempted to be issued but in fact void; and a hearing having been held and being fully apprised in the premises,

THE COMMISSION HEREBY FINDS AS A FACT that the applicant issued before March 23, 1912, \$295,000 of bonds and as a matter of law it follows that this Commission's approval to such issue is not required;

THE COMMISSION FURTHER FINDS AS A FACT that this applicant since March 23, 1912, has attempted to issue bonds of the par value of \$635,000 and has attempted to make such issue without the permission of this Commission, and that the permission of this Commission has never been secured to the issuance of said \$635,000 of bonds;

THE COMMISSION FURTHER FINDS AS A FACT that this applicant has given over these void bonds to various parties, which said transactions are discussed in the opinion hereto;

THE COMMISSION FURTHER FINDS AS A FACT that this applicant purported to pay \$233,792.05 of indebtedness by an attempted issue of \$270,000 of bonds on November 30, 1912.

THE COMMISSION FURTHER FINDS AS A FACT that the proceeds from \$270,000 par value of bonds is reasonably necessary for proper capital purposes of applicant for refunding outstanding indebtedness,

And basing its order on the foregoing findings of fact and the further findings in the opinion hereto,

IT IS HEREBY ORDERED:

1. That this applicant be permitted to issue \$270,000 par value of its 5 per cent 30-year first mortgage bonds and sell the same at 83-1/3 and use the proceeds thereof in the payment of \$233,792.05 subsisting indebtedness heretofore incurred for purposes other than income and operating expenses; representing a note to Geo. H. Hayes and other indebtedness incurred at the time of the purchase of the property of the Peoples Gas and Coke Company by the applicant. This provision of this order is contingent upon the following conditions precedent:

a. This company shall rescind the action whereby it attempted to issue bonds of the par value of \$60,000 on March 31, 1912, sold to Hotaling Estate; bonds of the par value of \$30,000 on July 30, 1912, sold to Economic Gas Appliance Company; bonds of the par value of \$100,000 on July 30, 1912 sold to California Light and Fuel Company; bonds of the par value of \$15,000 on August 31, 1912, sold to D. O. Druffel; bonds of the par value of \$4,000 on August 31, 1912 sold to S. W. Coleman; bonds of the par value of \$30,000 on September 30, 1912 sold to W. F. Detert; bonds of the par value of \$270,000 on November 30, 1912 sold to Geo. H. Hayes; bonds of the par value of \$6,000 on November 30, 1912 sold to W. E. Chickering; bonds of the par value of \$60,000 on January 31, 1913 sold to J. D. Grant; bonds of the par value of \$60,000 on March 21, 1913 sold to L. P. Lowe; and the applicant shall further notify the present holders of said bonds of this action and of the fact that such bonds are void.

2. The applicant shall notify this Commission within thirty (30) days from the date of this order of the compliance therewith and of the issuance and acceptance by the holders in lieu of the \$270,000 of void bonds heretofore referred to, of the \$270,000 of bonds herein authorized, and the turning in by said holders of said void bonds, and shall further notify this Commission of its compliance in every respect with the provisions of this opinion and order.

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 10th day of July, 1913.

John M. Cibleman  
Max F. Ebel  
Max F. Ebel

Commissioners.

