

ORIGINAL

Decision No. 53270

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of AZUSA VALLEY WATER COMPANY, a Corporation, for Authority to Issue Stock and Stock Certificates or Other Evidence of Indebtedness

Application No. 37474
(As Amended)

Gibson, Dunn & Crutcher, by Max Eddy Utt and Richard L. Wells, for Applicant; Arthur D. Guy, Jr., for Suburban Water Systems, and Arlyne Lansdale, for Dyke Water Company, interested parties; Harold J. McCarthy, Theodore Stein and Charles W. Drake, for the staff of the Commission.

O P I N I O N

In this application, Azusa Valley Water Company, a corporation seeks authorization to issue \$300,000 par value of its Class A, 5% preferred stock to pay for additions and improvements and \$1,000,000 par value of its Class B, 3% preferred stock in exchange for refund agreements on a dollar-for-dollar basis.

On July 23, 1956, applicant filed an amendment to its application, seeking authority to deviate from its filed Rule No. 15 as shown on Sheets 25-W and 26-W, effective November 1, 1952, and from its Sheets 35-W through 38-W, effective November 7, 1954, for the purpose of offering Class B preferred stock to purchase the refund agreements. Said deviation request is limited to 95 specific contracts under the old rule and to 48 specific contracts under the new rule. Applicant does not seek to modify its present rule as to new subdivision contracts.

A public hearing was held before Commissioner Untereiner and Examiner Coleman in Los Angeles on August 23, 1956, at which time the matter was taken under submission. The Commission has received no protests in the proceeding.

Azusa Valley Water Company was organized January 25, 1952 for the purpose of acquiring and operating, as a public utility, certain domestic water facilities in Los Angeles County then owned and operated by Azusa Irrigating Company, a mutual corporation.

Under authorization granted by Decision No. 47713, dated September 16, 1952, it acquired the properties at their book values, undertook public utility operations and issued 12,000 shares of no par value common stock at a stated value of \$323,308 and a note in the amount of \$210,000.

The following statement, prepared from applicant's filed annual reports, indicates the results of operation and the growth of the business during the operating life of the utility from its inception up to December 31, 1955:

	<u>Operating Revenues</u>	<u>Net Income</u>	<u>Plant Dec. 31</u>	<u>Services Dec. 31</u>
1952 (Oct.6 to Dec.31)	\$ 12,872	\$ (3,846)	\$ 780,107	1,825
1953	113,760	11,609	1,146,194	3,319
1954	199,523	17,195	1,817,957	6,216
1955	356,858	59,837	2,424,185	9,612

(Red figure)

A condensed statement of applicant's assets and liabilities as of December 31, 1955, is as follows:

Assets

Utility plant, less reserve		\$2,210,964
Current assets -		
Cash and deposits	\$ 23,265	
Accounts receivable	35,639	
Materials and supplies	52,256	
Prepayments	<u>12,466</u>	
Total current assets		<u>123,626</u>
Total		<u><u>\$2,334,590</u></u>

Liabilities and Capital

Long-term debt		\$ 210,000
Current liabilities		203,640
Reserves		19,661
Advances for construction		1,451,857
Contributions in aid of construction		41,329
Capital -		
Common stock	\$323,308	
Earned surplus	<u>84,795</u>	
Total capital		<u>408,103</u>
Total		<u><u>\$2,334,590</u></u>

Since December 31, 1955, applicant has issued a \$500,000 long-term note to refinance the outstanding indebtedness and to provide in part the funds needed to finance new construction. The note was issued to Lincoln National Life Insurance Company and is secured by an indenture of mortgage.

The record shows that applicant's service area is being converted rapidly from a rural region to a residential suburban one, that applicant is and has been compelled to make substantial additions to its plant to provide water service and that it has met its capital requirements, in the main, with monies advanced to it under refund agreements.^{1/} The record further shows that such agreements, by their terms, have required substantial cash outlays by the company to make refunds and that such cash outlays have been increasing materially year by year. The refunds amounted to 18.1% of the 1953 gross revenues, to 25.0% of the 1954 gross revenues and to 28.6% of the 1955 gross revenues and are estimated to decline to 27.5% of 1956 revenues. According to Exhibit No. 14, the annual refunds have exceeded the net profits from the operation of the water system, as shown by the following tabulation:

	<u>Net Profits</u>	<u>Refunds</u>
1952	\$ (3,846)	\$ 2,141
1953	11,609	19,392
1954	17,195	46,423
1955	59,837	94,540
1956 (6 months)	28,426	46,335

(Red figure)

The above tabulation does not consider internal sources of funds such as depreciation which latter totaled over \$30,000 in 1955.

It is estimated by witnesses that the refunds will increase when the full impact of recent agreements is felt and that they will aggregate \$120,836 on the basis of the 1956 revenues and from \$140,000 to \$150,000 for 1957.

^{1/} The testimony shows that at the time of the hearing the unpaid advances aggregated \$1,529,323 of which \$910,502 had been incurred under the extension rule in effect prior to November 7, 1954 and \$618,821 under the present rule.

In addition to making the cash refunds, applicant reports that if it is to provide adequate service it is required to make cash expenditures of some magnitude which cannot be provided by refund agreements. It proposes to construct a purification system at a cost of \$400,000 and to develop a new well, install mains and purchase some 3,000 meters at an estimated cost of \$270,000. It also intends to acquire from the mutual company an existing reservoir at its depreciated value of \$142,371 and to issue 5,285 shares of no par value common stock in payment.

From a review of the record it is apparent that applicant does not have sufficient internal resources to meet its obligations under its refund agreements and to maintain its service and facilities and that with such a preponderance of refundable advances in its capital structure it is unable to borrow money or engage in equity financing to provide the capital costs of the additions and improvements it now must make. The testimony of applicant's witnesses shows that under its indenture of mortgage its borrowing capacity is measured or limited by its assets which are available for rate-making purposes, that is, its utility plant less the consumers' advances, and that with its present balances of refundable advances it is unable to qualify for additional loans. With no dividend record, equity financing is not feasible except possibly through its parent, the Azusa Irrigating Company.

Thus, the record is clear and unequivocal that applicant must reorganize its financial structure and reduce its cash outlays for refunds if it is to meet its obligations to serve the public. Applicant must make provision for a larger proportion of permanent capital than it now has, as it seems obvious that the operation of a water utility under reasonable rates cannot produce the gross revenue necessary to meet the obligations which have been incurred by applicant to repay

advances, and at the same time keep the service up to the standards expected of an expanding concern. As stated, this utility was required to utilize 28.6% of its 1955 gross revenues to pay refunds, leaving a balance of only 71.4% to pay operation and maintenance costs, to provide the income needed to service long-term debt and the over-all coverage necessary for additional debt and equity financing, and to make prudent provision for working capital and surplus. It is of record that from October 6, 1952, when operations were commenced, to December 31, 1955, applicant's net working capital was decreased \$135,155 resulting in a deficit in its current position on the latter date of \$80,014. This deficit condition has been temporarily alleviated in 1956 by the funding of \$85,000 of short-term notes.

It is to improve its adverse financial position that applicant now proposes to issue its 3% preferred stock in exchange, at dollar for dollar, for the unpaid advances now on its books. If successfully carried to completion the program will result in releasing internal funds for construction and improvements and will increase applicant's borrowing capacity by about \$600,000 and thereby place it in a position where it can go forward with the orderly and proper development of its plant to meet the needs of its present customers and the demands arising from the growth in its territory.

In reviewing the record in this particular proceeding we are impressed with these facts:

1. The extremely fast growth of applicant's plant investment, it having tripled in the past three years.
2. The heavy drain on the company's available funds caused by the refunding payments of the presently existing contracts.
3. The attitude of the applicant in not seeking a revision of its extension rule for the future, but limiting its request to presently outstanding contracts.

Under the special conditions set forth in this application, we find the proposed offering to be not adverse to the public interest and will authorize it.

Attention is called to the fact that applicant has not followed its tariffs in regard to the contracts in failing to adjust the advance deposits to actual cost. It appears that substantial variations exist, both over and under collections; and to avoid discrimination applicant must adjust all such contracts to actual cost prior to offering the stock in exchange.

Applicant, in offering the stock to contract holders, must make it clear that the option of acceptance rests with the contract holder. The offer must be made uniformly to all contract holders as listed in Exhibits Nos. 7 and 10 herein.

In addition to the proposed issue of stock in exchange for advances, applicant desires to sell \$300,000 of its 5% preferred stock, for cash, to finance the cost of the additions and improvements which are not covered by refund agreements. It does not intend to make a public offering but reports that certain individuals associated with the company are willing to acquire the stock if authority for its issue can be obtained. The request to issue this stock will be granted.

The authorization herein granted is for the issue of stock only and is not to be taken as indicative of amounts to be included in a future rate base for the purpose of determining just and reasonable rates.

O R D E R

A public hearing having been held on the above-entitled matter and the Commission being of the opinion that the application should be granted, that the money, property or labor to be procured or paid for by the issue of the stock herein authorized is reasonably required for

the purposes specified herein and that such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income; therefore,

IT IS HEREBY ORDERED as follows:

1. Azusa Valley Water Company may issue not to exceed \$1,000,000 par value of its Class B, 3% preferred stock on or before June 30, 1957, in exchange at dollar for dollar, for presently unrefunded amounts of subdivider advance contracts as listed in Exhibits Nos. 7 and 10 herein, after first adjusting said contract amounts to the actual cost basis in harmony with the terms of the applicable main extension rule.

2. Azusa Valley Water Company may issue and sell, at not less than par for cash, not to exceed \$300,000 of its Class A, 5% preferred stock, on or before June 30, 1957, to finance the cost of capital additions and improvements.

3. Azusa Valley Water Company shall file with the Commission monthly reports as required by General Order No. 24-A, which order, insofar as applicable, is made a part of this order.

4. The authority herein granted will become effective on the date hereof.

Dated at Los Angeles, California, this 23rd day of OCTOBER, 1956.

[Signature] President
[Signature]
[Signature]
[Signature]
[Signature] Commissioners