

ORIGINAL

Decision No. 57782

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
SUBURBAN WATER SYSTEMS, a California
corporation, for permission to
borrow money and in connection
therewith to issue and sell \$500,000
of its First Mortgage Series D 5-1/4%
Bonds under a Third Supplemental
Trust Indenture dated as of May 15,
1957.

Application No. 40628

Arthur D. Guy and Camille A. Garnier,
for applicant.
Richard R. Entwistle and Donald B. Steger,
for the Commission staff.

O P I N I O N

Public hearing was held in this matter on December 24, 1958, in Los Angeles, at which time evidence was adduced and the matter submitted.

Applicant is a California corporation engaged in the public utility business of distributing water in Los Angeles County. Inasmuch as it now seeks authority to sell the balance of its First Mortgage Series D 5-1/4% Bonds, a review of the prior bond issues of this company is hereinafter set out.

By Decision No. 49423, dated December 15, 1953, in Application No. 34873, this applicant was authorized to issue and sell

its Series A 4-7/8% bonds in the total amount of \$2,000,000. These bonds were secured by a trust indenture covering substantially all of the assets of applicant and were sold to the Northwestern Mutual Life Insurance Company, the Bankers Life Insurance Company of Nebraska, The Lincoln National Life Insurance Company, and the Pacific Mutual Life Insurance Company. These Series A bonds are dated October 1, 1953, and will mature October 1, 1973.

Thereafter, by Decision No. 50656 dated October 19, 1954, in Application No. 35832, this applicant was authorized to issue and sell \$750,000 of its 4-1/8% Series B bonds. These bonds which were sold to the Bankers Life Insurance Company of Nebraska, The Lincoln National Life Insurance Company, and the Pacific Mutual Life Insurance Company were dated October 1, 1954, and will mature October 1, 1974.

On November 14, 1955, by Decision No. 52240 in Application No. 37401, this applicant was authorized to issue and sell \$500,000 worth of its 4-1/4% Series C bonds. These bonds were sold to the Northwestern Mutual Life Insurance Company, Bankers Life Insurance Company of Nebraska, The Lincoln National Life Insurance Company, and the Pacific Mutual Life Insurance Company. On March 6, 1956, by Decision No. 52729, in Application No. 37649, an additional \$600,000 of Series C 4-1/4% bonds were authorized and these bonds were sold to the same four life insurance companies. A third issuance and sale of Series C 4-1/4% bonds was authorized by Decision No. 54084, dated November 19, 1956, in Application No. 38529. These bonds in the amount of \$650,000 were sold to the same insurance companies. All of the Series C bonds have a basic 20-year life.

By Decision No. 55053, dated June 4, 1957, in Application No. 39069, this company was authorized to issue \$1,000,000 of its Series D 5-1/4% bonds. These bonds were issued and sold to The Lincoln National Life Insurance Company, Pacific Mutual Life Insurance Company and Bankers Life Insurance Company of Nebraska. They have a 20-year life and are due in 1977.

In the instant application authority is requested to issue an additional \$500,000 of Series D 5-1/4% bonds due in 1977 and to sell these bonds to the following listed insurance companies in the indicated amounts:

The Lincoln National Life Insurance Company	\$283,000
Pacific Mutual Life Insurance Company	150,000
Bankers Life Insurance Company of Nebraska	67,000

It is alleged by applicant that this additional \$500,000 of Series D bonds is the balance of a planned issue. In other words, by Application No. 39069 authority was requested to issue \$1,500,000 of Series D bonds; however, by Decision No. 55053, supra, the Commission limited the authority to \$1,000,000.

The record discloses that Suburban Water Systems has experienced a very substantial growth in plant and number of consumers in a relatively short period of time; for example, as of December 31, 1954, there were 23,822 consumers, a gross plant of \$7,672,868 and operating revenues of \$903,795. As of October 31, 1958, the number of consumers totaled 39,175, the gross plant \$14,695,028. Percentagewise this means that as of this latter date the number of consumers was approximately 65 percent in excess of those served on December 31, 1954, and the utility plant investment

had increased approximately 92 percent. Likewise operating revenues for the year 1957 were \$813,346 in excess of those realized in the year 1954, or an increase of 90 percent. For the year 1958 it is obvious that the operating revenues will even exceed this amount.

The financial condition of the company has been set out in each of the six decisions authorizing the issuance of bonds hereinabove mentioned. In a balance sheet as of October 31, 1958, attached to the application, the following information is shown:

Assets

Fixed capital		
Tangible capital	\$13,799,317	
Less: Depreciation reserve	1,565,138	
Net tangible capital	<u>12,234,179</u>	
Intangible capital - Net	895,711	
Total fixed capital		\$13,129,890
Current assets		334,529
Deferred charges and other assets		243,985
Total assets		<u>\$13,708,404</u>

Liabilities

Capital stock and surplus		
Common stock	\$ 433,550	
Preferred stock		
Class A 5½% cumulative	\$1,206,084	
Class B 3% cumulative	<u>1,867,660</u>	3,073,744
Capital surplus		543,260
Paid in surplus		247,369
Earned surplus		<u>367,430</u>
Total capital stock and surplus		\$ 4,665,353
First Mortgage bonds		
Series A 4-7/8%	1,910,000	
Series B 4-1/8%	728,000	
Series C 4-1/4%	1,724,000	
Series D 5-1/4%	<u>1,000,000</u>	
Total first mortgage bonds		5,362,000
Current liabilities		983,418
U. S. Army advance on condemnation		93,850
Consumers advances for construction		2,069,795
Contributions in aid of construction		533,988
Total liabilities		<u>\$13,708,404</u>

For the first ten months of 1958 applicant's income statement shows gross operating revenues of \$1,658,387, expenses of \$1,383,313 and net profit before Federal income taxes of \$275,074. For the entire year of 1957 the company had a total gross operating revenue of \$1,717,141 and a net profit before Federal income taxes of \$291,189.

The record discloses that to finance its capital requirements Suburban Water Systems has for the most part issued capital stock and entered into long term debt arrangements. As of December 31, 1952, there was outstanding \$210,000 of common stock, \$175,000 of Class A preferred stock, and \$270,050 of Class B preferred stock. During the years 1953 and 1954 there was issued \$223,550 of common stock, \$35,000 of which was issued in exchange for the acquisition of properties of other water companies and the balance in exchange for the company's Class B preferred stock. There has been no common stock issued since December 31, 1954.

As to the Class A preferred stock, \$614,550 par value of this class of stock was issued during the period January 1, 1955 to December 31, 1957. Of this amount \$483,450 was issued for cash. These sales of Class A preferred stock include rather substantial sales to subscribers who had their subdivisions piped in without being required to make an advance to the utility. In other words, the subdivider was given the opportunity of purchasing stock in lieu of making an advance to the utility. The Class B preferred stock issued between January 1, 1955 and December 31, 1957 amounted to \$1,053,290. This stock was issued in exchange for contracts for advances for construction of extensions to the water system. Of this amount, \$30,740 was repurchased for cash.

The bonds currently outstanding total \$5,362,000 and constitute the unredeemed balance remaining from the original issue totalling \$5,500,000.

By Decision No. 52240, dated November 14, 1955, this Commission in its decision authorizing the issuance of \$500,000 of Series C 4-1/4% bonds, noted that this would result in a ratio of:

Bonds	40%
Advances for construction	27%
Preferred stock	18%
Common stock equity	15%

The Commission stated:

"The capital ratios shown in the above tabulation indicate that the company's capital structure is becoming unbalanced due to its construction having been primarily financed through issues of long term debt and by consumers' advances. Even if consumers' advances for construction are eliminated from the computation the capital ratios as of August 31, 1955, and on a pro forma basis including the proposed issue of \$1,000,000 of bonds, the long term debt represents 48% and 55% respectively of the company's capital structure. It is the Commission's opinion that applicant should give prompt consideration to the issuance of equity securities as the means of financing its future construction requirements."

In Decision No. 52729, dated March 6, 1956, authorizing the issuance of an additional \$600,000 of Series C 4-1/4% bonds, the Commission quoted this same language and further pointed out that the issuance of bonds would result in a ratio of:

Bonds	40%
Advances for construction	28%
Preferred stock	18%
Common stock equity	14%

By Decision No. 54084, dated November 19, 1956, approving the issuance of \$650,000 of Series C 4-1/4% bonds, the Commission used the following language:

"...In making our order we are in no way approving applicant's capital structure and we reiterate our opinion that the company should undertake to obtain funds from equity securities in order to improve its debt position."

By the issuance of the \$650,000 of bonds approved by that decision the following ratio resulted:

Bonds	41%
Advances for construction	24%
Preferred stock	21%
Common stock equity	14%

By Decision No. 55053, dated June 4, 1957, approving the issuance of \$1,000,000 of Series D 5-1/4% bonds, the Commission pointed out that the issuance of that amount of bonds would result in the following ratio:

Bonds	46%
Advances for construction	21%
Preferred stock	21%
Common stock equity	12%

In commenting upon this ratio the Commission stated:

"It is thus apparent that applicant is continuing its practice of using debt capital and consumers' advances for construction as the primary sources of money with which to finance its construction program. Applicant's attention is again directed to the fact that it is the Commission's opinion that prompt consideration should be given to the issuance of equity securities as a means of financing future construction requirements. ..."

If the instant request to issue an additional \$500,000 of Series D bonds is authorized it will result in the following ratio:

Bonds	48.24%
Advances for construction	17.03%
Preferred stock	25.29%
Common stock equity *	9.44%

Excluding advances for construction from the computations of the capital ratios as of October 31, 1958, and on a pro forma

* Excluding \$444,711 balance in capital surplus which represents arbitrary valuation of water rights.

basis including the proposed issue of \$500,000 of bonds, the long-term debt represents 55.95% and 58.14%, respectively, of the capital structure. It is thus apparent that applicant has continued to finance itself primarily through the use of debt capital.

According to the October 31, 1958 balance sheet attached to the application, this company has current liabilities of \$983,418 and current assets of \$334,529, or a negative current ratio of 2.94 to 1. The current liabilities include notes payable to bankers in the amount of \$500,000 and it is for the purpose of paying these notes that the company now proposes to issue \$500,000 of Series D bonds. The applicant has a purchase agreement with the insurance companies covering its Series D 5-1/4% bonds which expires on December 31, 1958.

In this connection it is noted that by Application No. 39069, filed on May 13, 1957, Suburban Water Systems requested authority to issue \$1,500,000 of its Series D 5-1/4% bonds, to execute a purchase agreement covering the sale of such bonds and to execute a "third supplemental indenture". By Decision No. 55053, dated June 4, 1957, the Commission authorized the execution of the purchase agreement and the third supplemental indenture, but limited the authorization for the issue of bonds to \$1,000,000. Applicant now requests that issuance of the remaining \$500,000 of bonds be authorized, and that such bond issue be approved prior to December 31, 1958.

Exhibit No. 6 attached to the application is a tabulation which shows the improvements to applicant's water system which have

been financed by the short-term bank loans which applicant proposes to refund with the proceeds from the issue and sale of the \$500,000 of bonds.

The \$500,000 of bonds are to be sold at par plus accrued interest to The Lincoln National Life Insurance Company, Pacific Mutual Life Insurance Company, and Bankers Life Insurance Company of Nebraska under the terms and conditions set forth in a purchase agreement between the applicant and purchasers, approved by this Commission in Decision No. 55053. The bonds to be issued will be secured by a deed of trust and will be redeemable at par, plus accrued interest, plus a premium of 5-1/4% if redeemed prior to June 1, 1964, and thereafter reducing four-tenths of 1% each year until June 1, 1977, except that no Series D bonds may be redeemed prior to June 1, 1963, if the funds to be used for that purpose have been obtained from the issue and sale by applicant of securities having an interest rate of less than 5-1/4% per annum. The deed of trust applicable to the proposed issue of bonds is an open-end indenture in the form of a third supplemental to the trust indenture dated October 1, 1953, which trust indenture applicant executed under authorization granted by this Commission in Decision No. 49423, dated December 15, 1953, in Application No. 34873. The third supplemental indenture was approved by this Commission in Decision No. 55053, dated June 4, 1957, in Application No. 39069.

In considering this record we now find that applicant's common stock equity position has continued to deteriorate the past four years despite repeated warnings from this Commission, and it currently has a very unbalanced capital structure. Under the terms of Section 818 of the Public Utilities Code, a utility may indulge in short term borrowing (indebtedness payable at periods of twelve months or less) without securing the prior approval of this Commission. We are faced with a situation where a company has engaged in this practice and now desires approval of this Commission of a bond issue in order to secure the money to pay its short term notes.

On the other hand, a review of all of the evidence indicates that applicant has a present need for the funds to be procured from the issue of its securities as herein proposed, and it is the Commission's finding in this proceeding that the funds to be secured from the proposed sale of securities are required by the company for the purposes indicated herein; that the money, property or labor to be procured or paid for by the issue of the bonds herein proposed to be issued is reasonably required by Suburban Water Systems for the purposes specified herein and that such purposes, except as otherwise authorized, are not in whole or in part reasonably chargeable to operating expense or to income.

Therefore, as to the present issuance, we are faced with a fait accompli. The applicant has committed itself to the short term notes which now must be repaid. If the purchase agreement with the insurance companies covering the Series D 5½% bonds is permitted to lapse on December 31, 1958, the over-all cost of money to applicant on future borrowings will probably increase, thus tending towards a situation which may result in higher rates to the ratepayer. Therefore, the requested authority to issue \$500,000 Series D 5½% bonds will be approved only upon compliance by applicant with a condition

precedent that it submit to this Commission a resolution of its Board of Directors to the effect that it will not in the future engage in any borrowing in excess of \$200,000 in any calendar year for the purposes of financing its expansions, without prior approval of this Commission.

The authority herein granted is for the issuance of securities only and is not to be construed as a finding by the Commission as to the amounts which will be included in any future rate base for the purpose of determining just and reasonable rates.

O R D E R

Application as above entitled having been filed, a public hearing having been held thereon, the Commission being fully advised in the premises and hereby finding it to be not adverse to the public interest, and good cause appearing,

IT IS ORDERED that:

1. Suburban Water Systems, on and after the effective date herein, and on or before March 31, 1959, and only after compliance with the following condition and not before, may issue and sell not to exceed \$500,000 in principal amount of its First Mortgage Series D: 5-1/4% bonds at par, plus accrued interest, and may use the proceeds for the purposes set forth in its application. The accrued interest from the sale of the bonds may be used for such purposes or for general corporate purposes.

2. Prior to the issuance and/or sale of the bonds authorized in Paragraph 1 hereinabove, Suburban Water Systems shall file with this Commission a certified copy of a resolution of its Board of Directors to the effect that it will not engage in any borrowing in excess of \$200,000 in any calendar year whether it be short term, or otherwise, for the

purpose of financing future construction requirements, without first securing the approval of this Commission.

3. Suburban Water Systems shall file with the Commission a report, or 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 when Suburban Water Systems has paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is \$500.

Dated at San Francisco, California,
this 30th day of DECEMBER, 1958.

E. L. Fox
President

W. E. ...

Paul ...

...

Theodore ...
Commissioners

