

Decision No. 58334**ORIGINAL**

## BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of  
SOUTHWEST WATER COMPANY, a corporation,  
for authority to issue and sell  
\$400,000 of Class B, 3% preferred stock  
for cash.

Application No. 40509

In the Matter of the Application of  
SOUTHWEST WATER COMPANY, a corporation,  
for authority to issue Class B, 3%  
Preferred Stock in Exchange for Refund  
Contracts.

Application No. 40510

Arthur D. Guy, Jr., for applicant.

William Roche, Walter Cavagnaro and  
A. L. Gielegem, for the Commission  
staff.

O P I N I O N

Southwest Water Company, by these applications filed October 16, 1958, requests authority to issue not to exceed 18,000 shares of its Class B 3% preferred stock of the par value of \$50.00 per share to finance construction of water facilities for industrial developments in its La Mirada and Etiwanda Districts (A.40509) and to convert certain existing and future subdivision water main extension refund agreements (A.40510). In addition applicant requests that the Commission approve in principle certain standby contracts which will produce revenue from industrial developments. In Application No. 40510 applicant requests permission to deviate from the main extension rule, both as to existing contracts and future contracts.

The applications were heard before Examiner John M. Gregory at Los Angeles on December 29 and 30, 1958 and submitted on a consolidated record.

The evidence shows that applicant has experienced rapid growth during the past few years, as indicated below.

<u>Year</u>	<u>No. of Customers (Year End)</u>	<u>Gross Sales</u>	<u>Fixed Capital (Year End)</u>	<u>Outstanding Consumers' Advances for Construction (Year End)</u>
1955	1,585	\$ 68,817	\$ 762,330	\$304,755
1956	6,140	165,840	1,791,807	493,057
1957	7,277	353,866	2,345,712	518,172
1958	7,536 <sup>a</sup>	381,998 <sup>b</sup>	2,554,512 <sup>b</sup>	592,825 <sup>b</sup>

<sup>a</sup> To Aug. 31, 1958

<sup>b</sup> To Nov. 30, 1958

Applicant, with a present bondable capacity of only about \$38,000, is finding it increasingly difficult to generate internally the funds needed to repay outstanding water main extension contract refunds and to construct large capacity grid systems for water service to existing and projected industrial developments. An industrial development of about 450 acres of rail-served property owned by Central Manufacturing District, a subsidiary of the Santa Fe Railway, in the company's La Mirada District will require some 7,750 gallons of water per minute, including water for fire protection, the facilities for which are estimated to cost from \$457,800 to \$500,700, depending on which one of three proposed methods of construction is used. Central Manufacturing District has indicated a willingness to purchase the company's 3% preferred stock, pursuant to arrangements currently under negotiation, in order to finance construction of necessary distribution and backup facilities.

The Vina Vista Development Company's project, in the utility's Etiwanda District, comprises about 3,500 acres marked for various industrial and residential installations. Discussions have also been had by the utility with other large industrial landholders concerning future development of another three or four thousand acres in that area.

Applicant alleges that initial financing of these developments for industrial water service, or for those which contemplate both industrial and residential projects, by the sale of stock rather than by refundable advances under the main extension rule, offers certain advantages both to the utility and to the developers. Among these, from the utility's viewpoint, are the greater flexibility of planning and constructing large capacity grid systems, when indicated, and the immediate inclusion in the rate base of the installed facilities under agreements, now being negotiated, which provide built-in revenue features for meeting depreciation expense and ad valorem taxes during development.

The following tabulation indicates the principle involved in standby arrangements currently under consideration by the utility and Central Manufacturing District, as compared with results under an extension rule refund contract, assuming the cost of the installed facilities to amount to \$400,000 (Exhibits 3 and 4). The figures are in thousands of dollars.

Year	Revenue		Extension		Operating Expenses (Both)	Property Taxes (Both)	Depreciation (Both)	Net Income		
	From Operations	Standby Charge	Rule Refund	Contract				Stock Sale	Refund Contract	
1	0	14.0	14.0	0	-	4	8	2.0	(12.0)	
2	10	12.5	22.5	10	3.5	4	8	7.0	(5.5)	
3	20	10.9	30.9	20	7.0	4	8	11.9	1.0	
4	30	9.3	39.9	30	10.5	4	8	17.4	7.5	
5	40	7.8	47.8	40	14.0	4	8	21.8	14.0	
6	55	5.5	60.5	55	19.3	4	8	29.2	23.7	
7	70	3.1	73.1	70	24.5	4	8	36.6	33.5	
8	90	-	90.0	90	31.5	4	8	46.5	46.5	
Total									172.4	108.7

(Denotes minus)

The exhibits relating to economic feasibility do not consider either the dividends payable on the 3% preferred stock or

the cost of the capital required to refund the customer advances under the main extension rule. Nor do the exhibits demonstrate the differences or effect on the level of water rates of the two alternatives. In determining the revenues to be produced by these industrial developments, no estimated water consumption figures were used nor were these related to any existing or proposed rate schedule.

Applicant did not introduce any contracts embodying the principles illustrated by the above chart, nor was any evidence of parties other than applicant introduced to show that the proposed contract provisions were acceptable to them. It was the applicant's proposal to have the developer finance all facilities including wells, storage and transmission mains, and the utility was assuming no independent portion of the financial responsibility. Testimony also indicated that the instant request was only for the initial industrial developments and that these same developments would require later additional Commission authorizations.

With respect to conversion of refund contracts by sale of 3% preferred stock applicant stated that it would be the utility's general policy, for subdivisions, to offer to all holders of such agreements, when the covered development has achieved 85% of revenue-producing capacity, the privilege of converting such contracts, now and in the future, to stock on a dollar-for-dollar basis after adjustment to actual cost of the facilities installed pursuant to the agreement.

Testimony elicited on cross-examination shows that, in addition to the 85% test to be used to determine when refund contracts were to be converted to preferred stock, additional subjective tests were to be imposed by the company management. These tests appeared to be of most significance with regard to nonsubdivision refund contracts.

The record indicates that such a plan may have tax consequences that would make it attractive to the holders of refund contracts who might qualify for the conversion privilege. From the utility's standpoint, the servicing of dividends would be an easier burden than the annual payment of refunds.

The record also shows that prior to the date of the instant hearing applicant had financed facilities in new subdivisions by issuance of 5½% preferred stock to the subdivider, instead of required advances, without the Commission's specific authority. Exhibit No. 10 discloses that applicant has unpaid balances existing on many of its refund contracts and has failed to make adjustments as between estimated and actual costs as required by the main extension rule.

According to applicant's balance sheet, as of August 31, 1958, it had outstanding the following securities:

CAPITAL STOCK:

Common:

Authorized 20,000 shares @ \$50 Par Value	
Issued and Outstanding 8,520 shares	\$426,000

Preferred:

Class A, 5½% Cumulative	
Authorized 20,000 shares @ \$50 Par Value	
Issued and Outstanding 5,894-3/8 shares	<u>294,719</u>
	\$720,719

LONG-TERM DEBT:

Series A - 5½% Bonds due 11/1/75	\$350,000
Series B - 5% Bonds due 8/1/76	<u>500,000</u>
	\$850,000

Applicant was authorized by Decision No. 55798 in Application No. 39404 (November 12, 1957) to sell 3,000 shares of its common stock at par and \$350,000 of preferred stock for cash on a 5½% dividend basis. During the period of about 13 months following

that authorization applicant has been able to sell only \$28,250 of the common stock and only \$97,137.50 of the preferred stock.

A previous application to convert refund contracts into 3% preferred stock was dismissed without hearing (54 Cal. P.U.C. 493) as being in conflict with Rule A-12 of the Water Main Extension Rule, which reads as follows (53 Cal. P.U.C. 490, @ p. 498):

"Contracts entered into under the percentage of revenue method of refund under this extension rule may be terminated any time after two years following completion of the extension upon the mutual agreement of the parties by payment to the individual, individuals or subdivider of the present worth of an annuity of equal annual payments of the unpaid balance of the advance calculated at 6% interest as of the termination date of the contract."

Applicant now requests authority to deviate from Rule A-12 by the issuance of \$500,000 of its Class B, 3% preferred stock in exchange for certain refund contracts on a dollar-for-dollar basis. Exhibit 10, introduced by the staff in this proceeding, lists the utility's advances and other methods of financing construction costs as of November 30, 1958, under several categories, and also includes cost data. The following table indicates the utility's position on November 30, 1958, with respect to equity capital, long-term debt and advances in aid of construction:

## EQUITY CAPITAL:

## Common Stock:

Authorized 20,000 shares \$50 Par			
Issued and Outstanding 8,520 shares	\$426,000		
Surplus balances	<u>96,422</u>	\$ 522,422	22.88%

## Preferred Stock - Class A, 5½%

## Cumulative:

Authorized 20,000 shares \$50 Par			
Issued and Outstanding 6,370-3/8 shares		<u>318,519</u>	<u>13.94%</u>
Total Equity Capital		\$ 840,941	36.82%

## LONG-TERM DEBT:

Series A - 5½% Bonds due 11/1/75	\$350,000		
Series B - 5% Bonds due 8/1/76	<u>500,000</u>		
Total Long-Term Debt		850,000	37.22

## ADVANCES IN AID OF CONSTRUCTION

		<u>592,824</u>	<u>25.96</u>
Total Capitalization		<u>\$2,283,765</u>	<u>100.00%</u>

The record makes plain that applicant does not have adequate internal resources with which to meet its refund obligations and at the same time maintain its credit, attract outside capital and extend and improve its service and facilities.

The record is also clear that in Application No. 37413 applicant's president, who testified herein to the above stringent financial situation, had previously testified that there was a well-established financial group who had the ability to purchase all necessary common stock for company growth to the amount of millions of dollars.

Applicant asserts that the plans it proposed in these applications, if carried to completion, should develop additional funds internally for use in improving its plant and operating standards and, at the same time, should improve its credit position by broadening the base of permanent low cost equity capital in its structure, thereby facilitating debt financing should that be required.

#### Findings and Conclusions

It is the Commission's opinion that the absence of definitive contracts and a full showing as to the economic impact upon the water system of the proposed industrial development financing makes it impossible, at this time, to conclude that the sought authority would be in the public interest. Therefore, Application No. 40509 will be dismissed without prejudice.

The Commission finds and concludes that applicant's request for a blanket unrestricted authority to deviate from the main extension rule and to refund existing and future customer advances by the exchange of 3% preferred stock is not in the public interest. In the instant proceedings and under the facts adduced

therein, it is the Commission's opinion that concrete proposals assented to by all affected parties are required before it is justified in making an exception to a rule enacted for the protection of both customers and the utility.

ORDER

Public hearing having been held herein,

IT IS HEREBY ORDERED that:

1. Application No. 40509 is hereby dismissed without prejudice.
2. Application No. 40510 is denied.

The effective date of this order shall be the date hereof.

Dated at Los Angeles, California, this 29th day of April, 1959.

E. Lynn Fox  
President

Walter E. Ditchell

Theodore Jenner

Commissioners

Commissioner Everett C. McKee, being necessarily absent, did not participate in the disposition of this proceeding.