

ORIGINAL

Decision No. 67261

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of VALLECITO WATER COMPANY, to sell its water system and assets (other than cash and accounts receivable), to Suburban Water Systems, and

In the Matter of the Application of SUBURBAN WATER SYSTEMS, to purchase Vallecito Water Company's water system and assets, and to render water service under the Vallecito Water Company rate schedules in the area served and presently certificated to Vallecito Water Company.

Application No. 45688
Filed August 19, 1963

William M. Lasseben, Jr., Harold M. Mathisen, and Tom G. Richards, for Vallecito Water Company; and Guy, Smith & Wahl, by Arthur D. Guy, Jr., Walker Hannon, Vern McNeese, and Frank E. Gray, for Suburban Water Systems, applicants.

Brobeck, Phleger & Harrison, by Robert N. Lowry, for San Gabriel Valley Water Company, interested party.

Hugh N. Orr and R. E. Heytens, for the Commission staff.

O P I N I O N

Vallecito Water Company (Vallecito)^{1/} seeks authority to sell its water system and assets to Suburban Water Systems (Suburban)^{2/} for a consideration of \$785,000, subject to stated adjustments to a

^{1/} Formerly Whittier Extension Mutual Water Company, organized in 1914.

^{2/} Formerly Whittier Water Company, organized in 1907, and San Jose Hills Water Company, organized in 1944.

sales price of \$651,471, and Suburban seeks authority to purchase Vallecito's water system and assets and to render water service in Vallecito's service and certificated area under Vallecito's rate schedules, pursuant to the terms of the Agreement for Purchase and Sale of Corporate Assets, dated August 12, 1963, a copy of which is attached to the application as Exhibit B. The adjusted sales price guarantees not less than \$16.10 per share on Vallecito's 38,332 shares of capital stock issued and outstanding.

Public hearings were held before Examiner Warner on November 18, 19 and 20, 1963, at Los Angeles, on which last date the matter was submitted, subject to the receipt on or before November 25, 1963, of late-filed Exhibit No. 10, and subject to the filing of concurrent briefs on or before December 9, 1963. San Gabriel Valley Water Company (San Gabriel)^{3/} participated in the hearings. Eight witnesses were called and presented testimony and 13 exhibits were received. A Motion to Strike San Gabriel's Brief was filed by applicants on December 23, 1963.

The issues to be determined are: 1. Should Vallecito be permitted to sell to Suburban its water source, service and storage facilities and be relieved of its public utility responsibilities; 2. Is Suburban financially able to acquire the assets of Vallecito; and 3. Is Suburban capable of serving the area now served by Vallecito.

The Evidence

Vallecito's president^{4/} testified as follows: He has been a director and officer of Vallecito since its inception in

^{3/} Formerly San Gabriel Valley Water Service, organized in 1937.

^{4/} Witness Mathisen.

October, 1954, and had been a director of Vallecito's predecessor, Whittier Extension Mutual Water Company, a mutual,^{5/} since 1948, and was also secretary and general manager of, and, since 1930, has been associated with La Habra Heights Mutual Water Company, a mutual. Vallecito's present service area as delineated on the map Exhibit No. 1 comprises approximately 3,400 acres.^{6/} Because of lack of finances, Vallecito, in the summer of 1960, determined it to be in the best interests of its stockholders to sell its assets; negotiations for sale to San Gabriel for \$550,000 were conducted, but were tabled in November, 1960. Vallecito's directors then decided to continue to operate and to seek equity capital or long-term financing from principal shareholders or lending institutions. None of the principal shareholders really wanted to be in the water business, and low

^{5/}By Decision No. 53277, dated June 26, 1956, in Application No. 36348 (Amended) filed November 26, 1954, Vallecito was granted a certificate of public convenience and necessity to construct and operate a public utility water system in the area formerly served by Whittier Extension Mutual Water Company, authorized to file schedules of rates, and was authorized to issue 38,332 shares of stock, par value \$383,320, to Whittier Extension for the latter's water system and assets. Said Decision recites that the opening entry on the mutual's books of account was July 1, 1914, to reflect the acquisition by the mutual of the water system assets of Whittier Extension Company, a subdividing company; that Vallecito's service area was situated on the north slopes of the Puente Hills in the central and east section of San Gabriel Valley; that the potential of the area was some 10,000 domestic services; and that Vallecito had been receiving numerous requests from subdividers in the area for water service to subdivisions under construction and proposed to be constructed.

^{6/}Exhibit No. 1 shows that Vallecito furnishes water service largely in unincorporated territory of Los Angeles County and in a small portion of the City of Industry. Said Exhibit also shows the boundaries, delineated by a green line, of a blanket easement owned by Vallecito; the boundaries, delineated by a yellow line, of Suburban's San Jose Hills District service area in the vicinity; and the boundaries, delineated by a blue line, of San Gabriel's Kwis System service area.

earnings did not permit servicing a substantial, long-term loan. An application for a rate increase was filed on July 6, 1961, which resulted in small relief in the irrigation rate, but no increase in general or any other rates was granted.^{7/} Early in 1963, Vallecito's directors determined not to continue to operate, but to sell. Contacts were made with four water service companies (Suburban, San Gabriel, Southern California Water Company, and Consolidated Water Company) from which bids were received on the purchase of the assets. The bid criteria were that 50 per cent of the sales price be deposited either in cash or securities as evidence of good faith, that disclosure be made as to the source of funds for the remaining half of the purchase price, and that all bids be in the same form, that is, be figured in approximately the same way; the management's objective in the bidding procedure being to secure for its shareholders the maximum amount per share that could be had. On April 27, 1963, the directors accepted the highest bid, which was Suburban's at \$785,000 with a minimum price of \$16.10 per share and the next highest bid was San Gabriel's at \$16.06 per share. On May 7, 1963, Suburban deposited \$392,000 in United States Treasury bills and \$500 in a certified check with Vallecito's counsel and a sales agreement with Suburban was negotiated and submitted to and approved at a Vallecito shareholders' meeting on June 4, 1963. On April 23, 1963, Skelton and Entwistle, directors of San Gabriel, were also directors of Vallecito. Between April, 1963 and August, 1963, two other directors of Vallecito were replaced by Dietz and Hannon who were also directors of

^{7/} Decision No. 64323, dated October 2, 1962, in Application No. 43581; rehearing denied by Decision No. 64762, dated January 8, 1963.

Suburban. Thereafter a modified agreement (Exhibit B attached to the application) providing for the return to Suburban of all but \$10,000 of its deposit (but retaining the \$500 check) was approved by a majority of Vallecito's shareholders and its directors, and signed by its officers on August 12, 1963. Although directed by Vallecito's officers to do so, its counsel had not returned said deposit because of a letter written by Skelton and Entwistle to Vallecito's counsel, Exhibit No. 12, threatening him with certain suits if the money was returned.

Vallecito's general manager^{8/} testified as follows: He had been Whittier Extension's superintendent since 1933, and manager of Vallecito since its inception on November 18, 1954. He described Vallecito's water-system facilities as shown on the map, Exhibit No. 1, including wells, pumps, transmission mains, reservoirs and distribution mains, their sizes, dates of installation, location, and condition. Approximately 50 per cent of the lineal footage of pipelines within the service area is asbestos-cement pipe. On November 15, 1963, there were 3,448 general metered and industrial customers, 154 irrigation services, and 408 public fire hydrants. The development in the past five years has been changing very rapidly to residential subdivision; citrus groves, walnut orchards and other crops are being removed for such purpose. Under present zoning, Vallecito would have approximately 7,500 customers when its area is completely subdivided or developed, and there would be in excess of 700 lots with single-family residences if the subdivision maps Vallecito presently has

^{8/}Witness Richards.

on file are implemented. Vallecito's unpaid balance on refund agreements exceeds 50 per cent of its utility plant. Authority was requested by Advice Letter No. 11, dated October 18, 1963, to serve and deliver water to 478 single-family residences within ten different tracts in Los Angeles County, and to exceed the utility's advances to plant 50 per cent ratio. Such authority was granted by Commission Resolution No. W-906, dated November 6, 1963. Vallecito will be requested to deliver water service to approximately 250 additional lots in the near future but does not have sufficient funds with which to effect such service; its cost to install water service within its service area has averaged \$325 per lot.

As shown in Exhibit No. 2,^{9/} an Interim Report on Vallecito's financial condition as of August 31, 1963, refunds on subdividers' advances for construction, due and payable as of December 31, 1962, in the amount of \$56,447.35 for the period 1961-62, remained unpaid as of August 31, 1963. Its liabilities under refund agreements for the year 1963 were estimated to be \$25,000 to \$30,000. Vallecito has issued its promissory note for a period of one year to Neptune Meter Company in the amount of \$24,834.39 with interest rate of 5 per cent payable concurrently with principal at the end of twelve months; said note is due, payable and unpaid. Other accounts totaling \$47,409.73 were due, payable, and unpaid as of August 31, 1963, to Parkson, Incorporated, Johns-Manville Corporation, Western States Engine Service, Hersey-Sparling Meter Company, Brown & Caldwell, Consulting Engineers, and Wintroath Pump Company, for materials delivered on

3/ Exhibit No. 2 also shows Vallecito's utility plant in service as of August 31, 1963 to be \$1,953,142.95, with related depreciation reserve of \$372,545.61; current and accrued assets of \$99,629.27; current and accrued liabilities of \$269,438.29; and advances for construction of \$948,113.64.

terms not to exceed one year. An "on demand" note, dated August 14, 1963, had been given Security First National Bank-Whittier Branch (Bank), for \$125,000, payable August 14, 1964, or if no demand, at 5 per cent interest rate. A long-term note in the amount of \$50,000, secured by a deed of trust, dated November 29, 1962, had been given Sunset International Petroleum Corporation (Sunset), bearing interest at the rate of 5-3/8 per cent on the unpaid principal, payable annually in installments of \$2,500, or more, on the first day of each year, the balance of which, on August 31, 1963, was \$47,500. Vallecito finds itself in a growing area where a continued demand is placed upon it for water services it could render, except that it finds itself financially unable to do so. Vallecito's witness testified that its deep-well, natural-gas-engine pumps are obsolete and, although maintained in operating condition, sometimes with difficulty to secure spare parts, cannot be automated. He estimated that replacement of present equipment with electrical motors and telemetering would cost about \$175,000, over a three-year period. He stated that, as Vallecito's plant is modernized, direct labor expense for the operation and maintenance of wells, pumps, and other facilities would decline, but Vallecito has not and cannot secure the necessary funds to modernize.^{10/}

Suburban's vice president in charge of operations^{11/} and a director, who has been associated with Suburban for the past eight

^{10/} Exhibit No. 5 is a Five Year Study of Source and Application of Funds, dated April, 1962, prepared for Vallecito by consulting engineers to illustrate the need for outside financing in the immediate future if Vallecito were to meet the requirements of service and the consequent financial obligations.

^{11/} Witness Hannon.

years, and who is also a director of Vallecito, testified as follows: In his opinion acquisition of Vallecito by Suburban would be a natural and logical expansion of Suburban's system adjacent to Vallecito's service area for the reason that there are several interconnections of the two systems in the South Puente area, as shown on the map of a portion of Suburban's San Jose Hills system in the vicinity of Vallecito's system, Exhibit No. 3.^{12/} Such expansion and acquisition would be advantageous to customers of both Vallecito and Suburban inasmuch as Vallecito's well field is located in Suburban's present certificated area, and the elevations of Vallecito's reservoirs are compatible to the present zone areas in Suburban's area. Vallecito's water rights are worth in excess of \$600,000, but such amount was not included in his estimate of \$700,000, the approximate worth of Vallecito. Suburban was negotiating with the City of Santa Fe Springs (City) for the taking, under threat of a condemnation action commenced by City two years ago, of Suburban's water system within City's limits, and possibly all of Suburban's water system in the Cities of Pico-Rivera, Downey, and Norwalk, and in County area adjacent to City. Negotiations with City were in the engineering phase, that is, the properties to be condemned or negotiated were being inventoried by engineers employed by City. The maximum payment authorized under City's bond issue and condemnation proceedings could exceed \$2,500,000, but Suburban estimates that \$2,000,000 is a relatively conservative expectation. The proceeds

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The instant application shows that Suburban furnishes water service to nearly 46,000 customers located in two areas, generally referred to as the San Jose Hills and Whittier-Pico Rivera Districts.

from such an acquisition would be used to acquire additional service areas, such as Vallecito, to replace those taken by City and such proceeds could lawfully be permitted to be reinvested within a year without tax consequence. At the time Vallecito's directors declared Suburban to be the high bidder and awarded the sale of the assets to Suburban, Vallecito's directors were Crosby (Chairman), Mathisen, Svenson, Skelton, and Entwistle. No formal demand had ever been made by Suburban upon Vallecito's counsel for the return or the drawing down of the deposit of 50 per cent of the bid price. Suburban proposed to assume Vallecito's refund agreement obligations, and to assume the payment on the \$50,000 debt on the reservoir constructed by Sunset. As a director of Vallecito he had voted in favor of a resolution which was approved by Vallecito's directors to request a rate increase. Suburban's proposal to pay the difference between the net book value of Vallecito's stock of \$11.87 and Suburban's guaranteed \$16.10 per share to shareholders was justified on the basis that, in addition to the book value of the company, there are additional assets including the proximity to the existing Suburban area making it readily adaptable to becoming a part of Suburban's service area, the blanket easement owned by Vallecito which is an asset not included in the book value, the fact that Vallecito is a going concern, and Vallecito's water rights. Although he was not a director at the time of sale, after he became a director certain terms and conditions of the sale were modified to provide for the return to Suburban of \$382,000 of the deposit as the directors then thought that it was unnecessary for Suburban to expend interest on money that would be on deposit pending the conclusion of the

hearings before this Commission. He stated that the proposed sale of Suburban's Santa Fe Springs system facilities to City would have no effect on Suburban's operations in its San Jose Hills system since these two Suburban systems are completely separate in their operations.

Suburban's assistant treasurer^{13/} testified as follows: He has been associated with Suburban a little over eight years and had been made assistant treasurer a little over a year ago. His experience has been in the accounting and financial end, forecasting, and budgeting. Suburban's comparative financial statements as of August 31, 1963 and 1962, Exhibit No. 6, show its financial condition at those dates and its earnings for the first eight months of 1962 and 1963.^{14/} Exhibit No. 7, based on reasonable estimates and judgment figures arrived at by various members of management, and adopted by him as being reasonable, is a schedule of Suburban's estimated Available and Use of Funds for 1964; "Available Funds" would be: Proceeds from the City of Santa Fe Springs, \$2,000,000; Net Income (after operating expenses and taxes), \$232,600; Depreciation, \$412,000; Contributions, \$25,000; Bank Loan, \$200,000; Advance for Construction, \$320,000; and Sales of Preferred Stock to Institutions, \$500,000, totaling \$3,689,600. Suburban's present bank line of credit is \$1,000,000 of which it has borrowed \$600,000 and of which it would propose to use \$200,000 of the balance in 1964. It

^{13/} Witness McNeese.

^{14/} Exhibit No. 6 shows Suburban's total utility plant as of August 31, 1963, to be \$18,641,975, with related depreciation reserve of \$3,118,180; total current assets of \$1,648,721; total current liabilities of \$1,457,340; and advances for construction of \$1,977,428.

presently has authority to issue preferred stock in the amount of approximately \$250,000, and it would require additional authority from this Commission to issue and sell the proposed total of \$500,000 to institutions. "Use of Funds" would be for: Bond Retirement, \$113,000, representing the amount of bonds to be retired during 1964 under the provisions of Suburban's indenture, Dividends on Preferred Stock, \$176,000, representing the amount to be paid on Suburban's preferred stock presently outstanding and covering some of the dividends that would be paid institutions if sale of stock to institutions were necessary; Refunds on Advances for Construction amounting to \$160,000, representing Suburban's best estimate of the amounts that would be due under its Main Extension Rule; Dividends on Common Stock, \$45,000, representing Suburban's endeavor to make a customary declaration in order to establish a dividend practice so that its stock would be attractive to investors; Refund Notes, \$16,000, representing the amount due on notes issued pursuant to Commission authority; Purchase of Mutual Stocks, \$10,000, representing an average figure which Suburban would use to purchase mutual water company stocks should they be available for purchase and should they be needed; Completion of Work in Process, \$64,800, representing the amount of work expected to be paid for but not completed at the end of 1963; Unforeseen, \$60,000, which would be used for items that Suburban cannot foresee, such as installation of plant, replacement of some equipment that may go out unexpectedly, or the like; Tracts and Main Extensions, \$340,000, representing the amount to be used to put in in-tract facilities within subdivisions for which subdividers already had advanced the money; New Plant Improvements, \$404,800, representing the items of plant that

Suburban would put in during 1964, based upon a management figure; and Vinnell Development, \$53,000, representing Suburban's best estimate of the amount that would be required in the Vinnell development for the year 1964,^{15/} totaling \$1,442,600 and making \$2,247,000 available for payment of bank loans on the Vallecito purchase and improvements in Vallecito.

Exhibit No. 8 contains a condensed balance sheet as of August 31, 1963, recorded, and a pro forma condensed balance sheet as of December 31, 1964. It shows Suburban's financial position at the end of August, 1963, and its financial position at the end of December, 1964, on a pro forma basis after purchasing Vallecito and after carrying out the financial program shown on Exhibit No. 7, except that the bank loan, shown on Exhibit No. 7, would not have been incurred and preferred stock would not have been sold; its purpose was to show, on a pro forma basis, that Suburban would be able to carry out the purchase of Vallecito and have ample funds left over.

Exhibit No. 9 shows comparative capital ratios, recorded and pro forma, as of August 31, 1963, and December 31, 1964. However, the amounts of advances for construction, totaling \$1,977,428 as of August 31, 1963, recorded, and \$3,066,123, pro forma, December 31, 1964, shown in Exhibit No. 8, have not been reflected in the ratios set forth in Exhibit No. 9. Exhibit No. 10 shows the make-up of

15/ In Application No. 45465, filed May 23, 1963, Suburban sought a certificate to extend its Covina Knolls system to serve approximately 2,900 acres to be developed by Vinnell Constructors, Forest Lawn Company, D.G. & H. Development Company and others in the Cities of San Dimas and Covina, and in unincorporated territory of Los Angeles County north and south of the San Bernardino Freeway. By Decision No. 66739, dated February 4, 1964, Suburban was denied a certificate to serve Vinnell and Forest Lawn.

the purchase price stated in the sales agreement, Exhibit B attached to the application, of \$785,000, and shows that it would require Suburban to put in an additional \$40,000 to be able to meet the requirement of a guarantee of \$16.10 a share, and the utility plant acquisition adjustment would be \$143,000 instead of \$180,000. By reviewing Exhibit No. 2, and taking into consideration the capital stock, shown thereon in the liability section, in the amount of \$383,320, and adding to it contributions in aid of construction in the amount of \$114,826 and the surplus in the amount of \$90,300 for a total of \$588,046, and dividing this sum by 38,332 shares, the book value per share would be in excess of \$15.30 per share. Bank loans on the Vallecito purchase in the amount of \$392,000 are unsecured.

In Exhibit No. 6, special deposits of \$455,276, as of August 31, 1963, include the amount of \$392,000 borrowed from Bank and deposited with Vallecito, and an additional amount on deposit with Suburban's trustee under its indenture. Accounts receivable of \$397,792 include \$271,000 advanced to Cal Fin, a wholly owned subsidiary of Suburban. Cal Fin acquired Vallecito stock with such advance. Notes payable of \$716,289 include funds borrowed by Suburban for advance to Cal Fin to acquire Vallecito stock.

Exhibit No. 10 does not represent the required criteria for bidding as described by Vallecito's president. As shown in Exhibit No. 8, notes payable, as of August 31, 1963, would decline from \$716,289 to \$289, as of December 31, 1964, upon the supposition that \$716,000 of notes payable would be discharged during that period from sources shown on Exhibit No. 7. Advances for construction, also shown on Exhibit No. 8, would increase from \$1,977,000 as of August 31, 1963, to \$3,066,000 as of December 31, 1964, due to the

proposed acquisition of Vallecito. If advances for construction had been included in debt and contributions in aid of construction had been excluded from equity, the relationship of total stockholders' equity to total capitalization of the company, shown in Exhibit No. 9, would be somewhat less. The increase in earned surplus, shown on Exhibit No. 9, between August 31, 1963 and December 31, 1964, from \$688,887 to \$1,613,487 carries forward the assumption that \$2,000,000 would be received from City during the year 1964. According to Exhibit No. 7, if the proceeds from City do not become available during the year 1964, there would be a balance of only \$247,000 to take care of the repayment of bank loans on Vallecito purchase and improvements of Vallecito. Suburban could also engage in additional interim financing and the sale of debentures and perhaps some bonds; the matter of selling bonds and debentures has been discussed with various financial institutions, but any further commitments would be premature in view of the fact that negotiations with City for the purchase of Suburban's assets have entered final phases of negotiations. No application to the Commission has been filed asking authorization to issue and sell preferred stock in an amount to bring such authorization up to the amount of \$500,000, indicated on Exhibit No. 7.

Suburban's president^{16/} and director testified as follows: He has been its president since about 1949, but had not been president of its predecessor Whittier Water Company. His principal responsibility is to arrange for Suburban's financing. Accounts receivable

16/ Witness Garnier.

of \$397,792 as of August of 1963 include an amount of \$279,600 loaned to Cal Fin. Notes payable of \$716,000 as of said date include \$700,000 due to Bank and \$16,000 due to subdividers in the form of notes given in the payment of refund contracts. The principal reason that notes payable reflect a substantially larger balance in August of 1963 as compared with August of 1962 was the \$392,000 deposit made with Vallecito's counsel for the acquisition of Vallecito's assets.

He is also president and a director of Cal Fin. Cal Fin was incorporated about 1955 or 1956, for the principal purpose of buying and selling securities and also for the purpose of acquiring and selling real estate. It has made a market in Suburban stock from time to time by acquiring big blocks and then merchandizing them over a period of time, and doing things to assist its principal stockholder, which is Suburban, that Suburban could not do for itself. Cal Fin's directors were very much interested in seeing Suburban acquire Vallecito's assets, and they were interested in doing everything possible to assist it in that task. After establishment of a price of \$16.10 a share for Vallecito's stock as the result of the bidding of the four utilities, many of the stockholders were interested in selling their stock; this was after the determination of the shareholders as to who would be entitled to purchase Vallecito's assets and was about the first part of May, 1963. About ten days after San Gabriel filed its application^{17/} offers of stock started

^{17/} Application No. 45443 of San Gabriel for authority to acquire Vallecito's stock was filed May 17, 1963. By Decision No. 66140, dated October 15, 1963, San Gabriel was authorized to acquire 11,118 shares of Vallecito's capital stock from R.H. Nicholson at a price not to exceed \$12.15 per share and to purchase from others not more than 27,214 shares of Vallecito's capital stock at a price not to exceed \$16.10 per share.

coming in. He went to Bank and told them of Cal Fin's interest in acquiring the stock that was available and asked to borrow about \$300,000 or \$400,000 so that anyone who wished to sell at that time would have a market. He also talked to people who might be interested in acquiring the stock and who were friendly to Suburban. Bank indicated that it would be very glad to lend Cal Fin the money but under the terms of the trust indenture it would be necessary to "pipeline" the funds through Suburban in order to meet the requirements of the trust indenture; so that was done. Cal Fin borrowed funds from Suburban from time to time and acquired the stock, had the stock directly transferred from the owner to Bank, and Bank holds the stock and is the owner of it at the present time. The stock serves as security for the bank loan. It is Cal Fin's intention that, in the event of Commission approval of Suburban's acquisition of Vallecito's assets and the liquidation of Vallecito, the amounts of \$16.10, or more, per share will be paid to Bank to pay off the bank obligations. The reason for Cal Fin's acquiring Vallecito's stock, when it was Suburban's objective to acquire Vallecito's assets, was that, knowing that the president of San Gabriel, Nicholson, had already acquired 11,000 shares of Vallecito's stock, it was evident that the available stock should be purchased by someone friendly to Suburban or the matter of the acquisition of Vallecito's assets would never get to this Commission by application, or otherwise, if control was acquired by Nicholson or his group. Therefore, it was necessary for Cal Fin and others to acquire shares when they were available. Cal Fin's directors are John Bodger, Ruskin Gardner, C. H. Deitz, Walker Hannon, and Camille Garnier.

Dietz is Suburban's secretary, Hannon is Suburban's executive vice president, Bodger and Gardner are directors of Suburban.^{18/}

Bank is the legal owner of the stock, is the one who would vote it, and it is in its name; it was from Bank funds that the stock was purchased. Bank has loaned in excess of \$150,000 to Vallecito, and he thought Bank's only hope of being repaid was to get someone financially strong in charge of the company. Upon the repayment to Bank of the money loaned, the stock will be turned over to Cal Fin. The stock is being held as security for the loan to Cal Fin. Bank loaned the funds to Suburban and Suburban made the funds available to Cal Fin; Cal Fin borrowed the money from Suburban; with that money Cal Fin purchased Vallecito's stock and caused it to be transferred to Bank. Bank holds this stock as collateral for the funds advanced to Suburban until such time as the loans are repaid. The bank notes are demand notes, and Suburban's loan to Cal Fin is a 6 per cent demand note.

A vice president^{19/} and director of San Gabriel, who is also a director of Vallecito, testified as follows: San Gabriel's offer on April 23, 1963, provided for adjustment in the purchase price as a result of changes in utility plant taking place after December 31, 1962, as did Suburban's bid. Subsequent to the acceptance by Vallecito's directors of Suburban's offer of \$16.10, the terms and conditions of that offer were tendered to the shareholders of Vallecito for their approval and were approved. Subsequently, and on August 8, 1963, the make-up of Vallecito's directors

^{18/} Commission records show that Dietz, Hannon, and Gardner are also directors of Suburban.

^{19/} Witness Entwistle.

changed when Deitz and Hannon became directors, and on August 12, 1963, the sales agreement, Exhibit B attached to the application, was executed on behalf of Vallecito; the agreement makes no provision for adjustment in the purchase price as a result of the additions (net, after retirements and depreciation) to plant made by Vallecito, either subsequent to December 31, 1962, or subsequent to the closing. Based on Vallecito's balance sheet as of August 31, 1963, Exhibit No. 2, the San Gabriel bid figure at August 31, 1963, would be approximately \$31,750 greater than that indicated by Exhibit No. 10, which would be approximately 90 cents more per share, and San Gabriel's purchase price would equate somewhere close to \$17 a share.

One of Suburban's counsel testified regarding the status of negotiations with City, and corroborated other testimony thereon.

A Commission staff accountant^{20/} testified regarding Exhibit No. 13, the Commission staff's financial report on the application. Said exhibit shows that: Total estimated cost of construction for plant expansion for the purpose of rendering water service to an area developed by Sunset International Petroleum Corporation was \$888,000, of which Suburban will provide \$220,100; the cost of financing the development of the area, requested in Application No. 45465 (Footnote 15 herein), to be provided by Suburban is \$678,130.^{21/} The sales agreement, Exhibit B attached to the application, provides that Suburban assume a promissory note in the amount of \$47,500 payable to Sunset. If paragraph 4 of the

^{20/} Witness Hendricks.

^{21/} Any conclusion to be drawn from this statement would be altered by the effects of the denial of the main portion of Application No. 45645 (supra).

sales agreement were strictly interpreted and adhered to, the utility plant acquisition adjustment could amount to \$268,213, representing the amount by which the adjusted sales price would exceed the amount of net assets. Suburban's adjusted purchase price for Vallecito's assets is \$651,471. Although Suburban has consistently stated that the possible sale of its Santa Fe Springs water system is the primary source of these funds, as of October 21, 1963, the sale had not been consummated nor had the final engineering figures of the sale been prepared. As of December 31, 1962, common stock equity constituted about 10 per cent and preferred stock about 26 per cent of Suburban's total capital structure, and total stockholders' equity of that date was about 36 per cent; these ratios decrease to 9 per cent, 22 per cent and 31 per cent, respectively, on a pro forma basis assuming the inclusion of items pertaining to the Sunset Development and of items pertaining to the Vallecito acquisition. Long term debt and advances for construction constituted 64 per cent of the capital structure at December 31, 1962, and would increase to 69 per cent upon such pro forma basis and combined stockholders' equity would decrease to 31 per cent. Advances for construction would remain well below 50 per cent of net depreciated utility plant even when projected on a pro forma basis. This witness concluded at page 6 of said Exhibit No. 13, with respect to applicant Suburban as follows:

- "1. Applicant's common stock and total equity capital ratios do not compare favorably with other Class A water utilities operating in California, and no means of improving its capital structure has been advanced by applicant in its current proposals. The average mean ratio of common stock equity for

the other Class A water utilities shown in a Commission study entitled "Comparative Statistical Data," dated July 26, 1963, is 33.46%, compared with 10.36% and 7.57% 22/ for the applicant at December 31, 1962, and on a pro forma basis, respectively.

- "2. Applicant's present capital structure appears to be weak and may further deteriorate if the current application is granted.
- "3. It appears that applicant's dividend requirements consume most of its net operating revenues; that internally generated funds to finance expansion are limited, and that financing of the expansion proposed must rely principally on debt and advances for construction.

"In view of the Commission's past and continuing concern over applicant's unbalanced capital structure* which will be further unbalanced as a result of proposed expansion without additional equity capital, it is recommended that approval of applicant's request, if granted, be conditioned upon development and maintenance of a capital structure containing at least 40% total preferred and common stock equity, and no more than 60% debt and advances for construction combined.

*Decision No. 52240, dated November 14, 1955, in Application No. 37401.
Decision No. 52729, dated March 6, 1956, in Application No. 37649.
Decision No. 54084, dated November 19, 1956, in Application No. 38529.
Decision No. 55053, dated June 4, 1957, in Application No. 39069.
Decision No. 57782, dated December 30, 1958, in Application No. 40628.
Decision No. 58716, dated July 7, 1959, in Application No. 40954.

"Decision No. 58716 comments upon Suburban's unbalanced capital structure and prohibits contiguous extension without Commission's authority."

22/ This ratio would be 8.92% excluding the Vinnell and Forest Lawn developments denied by Decision No. 66739 (supra).

Findings

Upon consideration of the evidence, the Commission finds that:

1. Applicants' Motion to Strike San Gabriel's Brief should be denied.

2. Vallecito Water Company is a public utility water corporation under the jurisdiction of this Commission, and has been since its inception on November 18, 1954; the operations of its predecessor as a mutual were largely in connection with agriculture since about the year 1914; its present operations are preponderantly the furnishing of domestic water service to subdivisions in unincorporated territory of Los Angeles County and in a small portion of the City of Industry. Demands on Vallecito for water service to ten subdivisions, comprising at least 750 lots, have been made by subdividers. Its current and accrued liabilities exceed its current and accrued assets in the ratio of almost three to one; it is in default not only on its refunds payable to subdividers on main extension contracts, but also on notes with suppliers of services; its financial condition is poor, and its water system cannot be modernized because of lack of funds. Its directors have voted to apply for a rate increase. Because of its poor financial condition and its inability to secure additional financing, its directors, in January, 1963, determined to sell its assets; and on April 27, 1963, Vallecito's directors accepted the highest bid for its assets, which was the \$16.10 per share bid of Suburban Water Systems.

3. Suburban Water Systems, or its predecessors, have been furnishing water service in Suburban's San Jose Hills District since

1944, and in its Whittier, Pico-Rivera District since 1907; it now furnishes water service to approximately 46,000 customers.

4. Suburban's financial capabilities to purchase Vallecito's assets are based on its estimate of the availability of funds as set forth in Exhibit No. 7. Such estimate of the available funds usable for purchase of Vallecito is conjectural, incomplete, does not extend beyond the year 1964, and is primarily dependent on proceeds from the sale of its properties to the City of Santa Fe Springs. The prospect of such sale being consummated between the City of Santa Fe Springs and Suburban is uncertain and the time within which such proceeds might be made available to Suburban is indefinite.

5. Notwithstanding the denial of Suburban's application to serve the Vinnell and Forest Lawn developments and the resultant exclusion of financial requirements therefor, the ratio of Suburban's equity capital to total capital has been and is unsatisfactorily low, and if this application were granted would be more so.

6. Had the sales agreement, Exhibit B attached to the application, been executed pursuant to the criteria of bidding for the sale of properties, the bid of San Gabriel Valley Water Company, guaranteeing a price to Vallecito's shareholders of not less than \$16.06 per share, would have equated to approximately \$17 per share as of August 31, 1963.

7. Vallecito and Suburban have failed to show that the granting of the application is in the best interest of Vallecito's consumers and proprietors, and have also failed to show that the granting of the application is in the best interest of Suburban's consumers.

8. Suburban has failed to show its financial ability to carry out the terms of the Agreement for Purchase and Sale of Corporate Assets, dated August 12, 1963, a copy of which is attached to the application as Exhibit B.

9. Neither Vallecito nor Suburban has established that the granting of the application would not be adverse to the public interest.

10. Suburban obtained a loan from Security First National Bank-Whittier Branch, in May, 1963; at least \$279,600 of the proceeds of said loan were then loaned to Cal Fin, a wholly owned subsidiary of Suburban; Cal Fin's officers and directors are interlocking and for the purposes of this proceeding Cal Fin is the alter ego of Suburban. Cal Fin purchased or caused to be purchased Vallecito stock with said funds for the purpose of preventing the majority of Vallecito stock from being sold to San Gabriel Water Company's president, which said latter company had applied for authority to purchase Vallecito stock, and which said authority was granted in October, 1963. Suburban has gained control of and does control Vallecito by means of Cal Fin's purchase of Vallecito stock or by means of Cal Fin's having caused the purchase of Vallecito stock enabled by Suburban's loan to Cal Fin.

11. Cal Fin was unable to acquire Vallecito stock or cause Vallecito's stock to be acquired without Suburban's loan, and Suburban's loan enabled Cal Fin to acquire Vallecito stock or cause it to be acquired.

12. No application, pursuant to Section 852 of the Public Utilities Code, to acquire Vallecito stock or to cause Vallecito stock to be acquired was made by Suburban or its alter ego Cal Fin or granted by the Commission. The purchase of Vallecito stock by Cal Fin in the manner described herein is tantamount to the purchase of said stock by Suburban and is in violation of Section 852 of the Public Utilities Code and is therefore void.

13. Vallecito transferred shares of its capital stock to Cal Fin or to Security First National Bank-Whittier Branch.

14. No application, pursuant to Section 852 of the Public Utilities Code, to transfer its stock to either Cal Fin, the alter ego of Suburban, or Bank, as holder, was made by Vallecito or granted by the Commission.

Conclusions

Based on the foregoing findings, the Commission concludes that:

1. Applicant's Motion to Strike San Gabriel's Brief should be denied.
2. This application should be denied.

O R D E R

IT IS ORDERED that:

1. The Motion to Strike San Gabriel's Brief is denied.
2. Application No. 45688 is denied.
3. Suburban Water Systems and Cal Fin shall, within ten days after the effective date hereof, report to the Commission in writing their action regarding their unlawful acquisition or their causing of the unlawful acquisition of the stock of Vallecito Water Company.

4. Vallecito Water Company shall, within ten days after the effective date hereof, report to the Commission in writing its action regarding its unlawful transfer of its stock to Cal Fin or to Security First National Bank-Whittier Branch, as holder.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 26th day of May, 1964.

Hallam L. Beard
President

[Signature]

[Signature]

George L. Brewer

Fredrick B. Hallock
Commissioners