

ORIGINAL

Decision No. 70525

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

APPLICATION of LEROY J. LAFRENTZ, d.b.a.,)
DESCANSO PARK WATER COMPANY to transfer)
assets to DESCANSO PARK WATER CO., A)
California Corporation and to ISSUE)
SECURITIES. }

Application No. 47992
(Filed October 21, 1965)
(Amended November 29, 1965)

W. Paul Payne, for LeRoy J. LaFrentz and Emma Lee
LaFrentz, applicant sellers.
Raymond E. Heytens, for the Commission staff.

O P I N I O N

LeRoy J. LaFrentz and Emma Lee LaFrentz (sellers), husband and wife, doing business as Descanso Park Water Company, and Descanso Park Water Co. (buyer) a corporation, seek authority for the transfer of a water system. Buyer also requests authority to issue securities.

Public hearing on this application was held before Examiner Catey in San Diego on January 25, 1966. Notice of hearing had been published in accordance with this Commission's instructions and rules of procedure. Testimony was presented by one of the sellers, who is also president of buyer, and by sellers' accountant. The matter was submitted on January 25, 1966.

Sellers and Buyer

Sellers are the owners of a public utility water system serving an area adjacent to the community of Descanso in San Diego County. They acquired jointly from the former owner the portion of the system supplying the Descanso Park area, pursuant to authority granted by Decision No. 50835, dated December 7, 1954, in Application No. 35838. Mr. LaFrentz acquired from the former owner the portion of the system supplying the Descanso Park Terrace area, pursuant to authority granted by Decision No. 61725, dated March 28, 1961, in Application No. 41951.

Buyer is a corporation formed by sellers who are officers and directors of buyer. The securities which buyer proposes to issue would, at least initially, be held by sellers and members of their immediate family.

Proposed Securities

In the application filed October 21, 1965, buyer proposed to issue certain securities in exchange for sellers' water system and to sell other securities to provide working cash:

In Exchange for Water System @ \$68,495.80

To Sellers.....	24 sh. of \$100/sh. common stock.
To Sellers' daughter...	6 sh. of \$100/sh. common stock.
To Sellers' daughter...	\$19,247.90 unsecured note.
To one of Sellers.....	\$19,247.90 unsecured note.

For Working Cash of \$5,000

To Sellers..... 5 sh. of \$100/sh. common stock.

Inasmuch as sellers' daughter is not a part owner of the water system, it is presumed that the securities actually would be issued to sellers, who would then transfer some of them to their daughter, with or without compensation.

As is indicated by the foregoing tabulation, buyer proposes to assign a "value" of \$1,000 per share to the common stock in determining the number of shares to be issued for the water system and working cash. The \$900 per share in excess of the par value would be shown on buyer's books as paid-in surplus.

The purchase price of \$68,495.80 for the water system is based upon the net assets of the system as of December 31, 1964, as shown in Exhibit A attached to the application. On that basis, sellers now propose to reduce the \$5,000 working cash they originally would have provided as of December 31, 1964, to reflect some \$2,000 in cash they have provided the utility operation since that date. One of the sellers testified further that even the reduced amount of working cash would not necessarily be made available to buyer because the

stock requested for that purpose may not be sold initially. He first testified that he had no one in mind who might purchase the stock to provide working cash, but later testified that he would accept stock for about \$3,000 of working cash.

Potential Future Transfers

Section 851 of the Public Utilities Code prohibits the transfer by a public utility of its property necessary or useful in the performance of its duties to the public, without first having obtained Commission authorization. The Commission may thus determine in advance whether or not any proposed transfer would be adverse to the public interest. This regulatory protection to the public can be circumvented, however, in the case of a closely held corporation, by transfer of all of the utility's common stock, rather than the utility plant, to a new owner. If a corporate utility is well-established and financially strong and is capable of carrying out its public obligations regardless of changes in its management, there may be no need for surveillance over subsequent transfer of shares of stock issued originally with Commission authorization. That would not necessarily be the case with the proposed corporate buyer of the Descanso Park water system.

One of the sellers testified that he has no present intention of disposing of his interest in the corporation today, but could not guarantee his plans for tomorrow. For example, he declined to enter into a stipulation, suggested by the Commission staff, that he would not dispose of the securities to officers of a specific utility which has managed and operated water systems nearby in San Diego County.

The Commission staff representative pointed out that the shares of common stock could be placed in escrow, subject to transfer only upon Commission authorization. He did not recommend that procedure as a general solution to the problem of uncontrollable transfers but, under the circumstances herein, suggested such escrowing as a suitable alternative to the type of stipulations declined by sellers.

Discussion

The requisite for authority to transfer a public utility water system, regardless of the affiliation or lack of affiliation of sellers and buyer, is a showing that the transfer is not adverse to the public interest. Such showing must include, among other things, evidence that buyer is financially capable of acquiring the system and operating it in a satisfactory manner.

Requests for authority to transfer a utility from a proprietorship to a corporation are often for the purpose of making more funds available for the utility operation; in this proceeding, the purpose appears to be to make less funds available. One of the sellers testified that the reason for the incorporation is to make the water system "stand on its own two feet" and to avoid providing outside funds from his other enterprises. He indicated that the corporation would do whatever it could with whatever funds it had available but that, with his limited liability as a stockholder of the corporation, he would no longer have the obligation of a proprietor to provide funds when needed.

Buyer's proposal to issue notes would create an added drain on the cash available solely from system operations. At the present time, the water system is unencumbered. If buyer were a well-established entity with reasonable availability of additional funds,

the proposed capital structure of about one-half equity and one-half debt would be acceptable. In fact, the lower income taxes resulting from the interest deduction on the debt could benefit the utility's customers in the form of lower water rates than would otherwise be appropriate. The short-term benefits would be more than offset in this case, however, by the utility's precarious financial position resulting from the proposed capital structure. In Exhibit No. 2, sellers state that the Commission staff's recommendation for issuance of all stock, instead of part stock and part notes, is not acceptable to them.

Finding and Conclusion

The Commission finds that the proposed sale and transfer would be adverse to the public interest and concludes that the application should be denied.

O R D E R

IT IS ORDERED that the application of LeRoy J. LaFrentz and Emma Lee LaFrentz (sellers) and Descanso Park Water Co. (buyer), for (1) authority to transfer a water system, and (2) authority to issue securities, is denied.

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

Dated at San Francisco, California, this 5th day of APRIL, 1966.

Fredrick B. Holboell
President
George J. Prover
Augustin

Commissioner Peter E. Mitchell, being necessarily absent, did not participate in the disposition of this proceeding.

William B. Bennett
Commissioners