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Decision 88 05 010 MAY 11 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY)
(U 60 W), a corporation, for an)
order authorizing it to acquire)
all the outstanding shares of stock)
of Water West Corporation in)
exchange for the issuance to such)
shareholders of shares of common)
stock of California Water Service)
Company.)

Application 87-12-014
(Filed December 7, 1987)

McCutchen, Doyle, Brown & Enersen, by A.
Crawford Greene, Attorney at Law, for
California Water Service Company, and
Anthony T. Karachale, Attorney at Law, for
Water West Corporation and Shareholders of
Water West Corporation, and Gilbert Neill,
for himself and Water West Corporation,
applicants.
Martin Bragen, for the Water Utilities Branch
of the Commission Advisory and Compliance
Division.

OPINION

By this application, California Water Service Company
(Cal Water) joined by Water West Corporation (Water West) and all
of the shareholders of Water West (Water West Shareholders), seeks
an authorization for Cal Water to acquire all outstanding shares of
Water West stock in consideration of the issuance to such
shareholders by Cal Water of 70,000 shares of Cal Water common
stock.

Notice of the application was published in the
Commission's Daily Calendar of December 10, 1987; no inquiries or
protests were received respecting the application.

Cal Water requested a hearing on the fairness of the
transaction under Public Utilities (PU) Code § 822. This statute

is designed to allow California utilities to invoke the exemption from Federal securities regulation provided by § 3(a)(10) of the Securities Act of 1933 (Title 15 USCA § 77c(a)(10)). § 3(a)(10) provides that certain transactions, including an exchange of stock, are exempt from registration requirements, if a state tribunal finds that they are fair. There must be a hearing on the issue and the affected shareholders must have the right to appear.

Notice of hearing was provided to Cal Water, Water West, Water West ratepayers, and all Water West shareholders. The hearing was held before Administrative Law Judge Gilman on February 22, 1988 and submitted that day.

Gilbert Neill, vice-president and a principal shareholder of Water West, Donald Houck, executive vice-president of Cal Water, and Harold Ulrich, vice-president and chief financial officer of Cal Water, testified concerning the proposed transaction. The staff representative sponsored an exhibit which supported the transaction without taking a position on the § 822 issue. The exhibit recommended that approval be conditioned on a requirement that Cal Water adopt Water West's tariffs. The exhibit also noted that Water West had entered into a non-standard main extension contract with the City of Salinas.

The Agreement

The Stock Exchange Agreement and Plan of Reorganization executed by Cal Water, Water West and Water West Shareholders was filed with the Commission as an exhibit to the application. Under that agreement, Cal Water will acquire control of Water West by an exchange of all of the outstanding shares of Water West for 70,000 shares of Cal Water no par common stock. The exchange ratio is one share of Cal Water stock for 5.38376 shares of Water West Stock.

It is anticipated that Cal Water will replace the existing Board of Directors with its own nominees. Its personnel will take over the responsibility of managing the corporation.

Discussion

Water West serves approximately 3,300 customers in four physically isolated districts, all located in Monterey County. Its Bolsa Knolls district with 1,800 customers is the largest of the four and is contiguous to Cal Water's Salinas district. Water West has eight employees. The undepreciated cost of the Water West properties exceeded \$3,400,000 as of June 30, 1987. The depreciated cost of those properties exceeded \$2,600,000 on that date. Water West currently has outstanding 376,863 shares of stock. ✓

Water West is family-owned and operated, but, as its vice-president Gilbert Neill testified, it is no longer a "mom and pop" operation. If the operation is to finance and replace plant as needed to comply with all regulatory requirements, especially those affecting water quality, it needs a wide range of management skills.

There is also reason to be concerned about continuity of management. Water West is now managed by Gilbert Neill, his brother, and their father. However, the father, who founded and built up the system, is now in his 80s; Gilbert has no children; and his brother has no children interested in operating the utility.

Financing is another area of concern. In order to keep operating plant in acceptable condition, Water West needs a continual infusion of debt capital. However, in recent years it has been unable to find lending institutions willing to furnish the long term capital needed. As a result, family members have been impelled to lend large sums to the utility. Currently, the lack of sufficient loan capital has led Water West to postpone some projects. While the plant is currently capable of maintaining good service, the long-term prospects are not encouraging.

Neill testified that the decision was made to look for a buyer of the Water West stock. Accordingly, an approach was made

to Cal Water. The result was the Stock Exchange Agreement and Plan of Reorganization.

Cal Water has more than 337,000 customers in 21 districts throughout the State. Its Salinas district has approximately 17,600 customers, is served by 19 employees, and is contiguous to Water West's Bolsa Knolls system. The undepreciated cost of all Cal Water properties exceeded \$357,000,000 as of June 30, 1987. The depreciated cost of those properties was almost \$264,000,000 on that date. Because of its size, it has management employees who specialize in operations, regulatory affairs, financing, taxes and accounting. These skills will be immediately made available to Water West; the cost of this management will be shared by a larger number of customers. Cal Water has ready access to sources of long-term debt capital and can obtain such financing at attractive rates.

Water West, for the immediate future, will remain a separate corporation, dealing with both its customers and with this Commission as a separate entity. Ultimately, the Bolsa Knolls system will be physically and operationally consolidated with Cal Water's Salinas district. Since the two systems are contiguous, physical integration can be achieved relatively easily and inexpensively. The other three Water West systems will be operated as physically separate systems by Cal Water. All four will be operated out of Cal Water's Salinas office. In the long run, Water West will lose its separate identity and these systems will become part of Cal Water's district organization, most likely to be operated as part of its Salinas District.

Effects of the Transaction

The Water West Shareholders will benefit from the transaction. The Cal Water stock they will receive is actively traded whereas there presently is no market for the Water West shares. The new Cal Water shares will provide a dividend, whereas

Water West does not pay dividends. The new Cal Water shares will be a less risky investment than the Water West shares.

Cal Water, generally speaking, provides good service throughout all of its divisions. There is no reason to doubt that the same high standards will be observed by the new management of the Water West system. Customers will also benefit from Cal Water's professional management skills.

There will be operating economies, even in the short run, since some utility functions will be taken over by Cal Water; for example, billing will be handled by Cal Water's central office.

Cal Water expects that there will be no dilution in its earnings. There would thus be no significant effect on Cal Water shareholders. Aside from a small reduction in per customer costs, there will be no noticeable impact on Cal Water's existing ratepayers. On a short term basis, Cal Water will keep the Water West rates in effect for service furnished after the closing.

The Water West systems are in good condition and provide good service to their customers. However, it should be noted that some of the Water West plant may be overdue for replacement or major rework because of recent capital shortages.

Exchange Ratio

The evidence demonstrated that the 5.38376 exchange ratio of Water West stock for the Cal Water common was reached in arms'-length negotiations between representatives of the Water West Shareholders and Cal Water after consideration of relative book values, earnings and other relevant factors.

Effect on Tariffs, Accounting, Rate
Base and Utility Obligations

Staff's concern over adoption of tariffs is premature. This transaction will not cause any change in Water West's tariffs. They will continue in effect, as a matter of law, regardless of who owns its stock or sits on its Board of Directors. For this same reason, there is no need to be concerned, at this juncture, over either the accounting or rate base treatment of any Water West property, including that acquired under the non-standard extension contract. Property owned by the corporation will continue to be accounted for in the same manner as before, no matter who owns the stock or sits on the Board. Likewise, a change in control or in stock ownership would not justify any change in the ratemaking treatment for items currently in rate base.

Orders dealing with the obligation of main extension contracts or the effect of new tariffs may well be necessary when (or if) Cal Water decides to merge with Water West, or otherwise acquire its property and assume its public utility obligations. However, this decision does not approve any such transaction. We can therefore defer consideration of the Staff's concerns until such an application is before us.

Waiver, 30 Day Rule

As amended in 1987, PU Code § 311 now permits all parties to a Commission proceeding to stipulate that the Commission may issue its decision sooner than 30 days after hearing. Such a stipulation was entered into this record at hearing. It appears particularly appropriate to act on this stipulation, since there was no dispute to be resolved. Accordingly, the Administrative Law Judge's Proposed Decision was placed on the agenda for the next scheduled meeting following its issuance. The Proposed Decision is accepted with only minor editorial changes.

Summary

After careful review of the record in this proceeding, the Commission has determined that the acquisition of control by Cal Water of Water West is sound and reasonable economically and operationally, and that it will not be adverse to the public interest. Therefore, the Commission will grant all authorizations sought in Application 87-12-014. There is also evidence to support a finding of fairness under PU Code § 822.

Findings of Fact

1. The terms and conditions of the Stock Exchange Agreement and Plan of Reorganization among Cal Water, Water West, and the Water West Shareholders attached to the application are fair.

2. Issuance by Cal Water of 70,000 shares of its common stock in exchange for the 376,863 shares of Water West is fair. The shareholders of Water West will benefit from the transaction. There will be no significant dilution in earnings for Cal Water shareholders.

3. The transaction will benefit the existing customers of Cal Water, since the administrative and managerial costs will be shared by a larger number of customers. There will be no adverse effects.

4. The transaction will benefit the customers of Water West, by providing access to debt capital at reasonable rates and under favorable conditions; the transaction will also assure that the utility serving them is well-managed.

5. The proposed transaction will not be adverse to the public interest.

6. The authority requested should be granted.

7. The money, property, or labor to be procured or paid for by the issuance of common stock herein authorized is reasonably required for the purposes specified herein, which purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

8. All parties have stipulated that the Commission may issue its decision less than thirty days after the issuance of the Proposed Decision herein. Since there are no disputes to be resolved by this decision, it is appropriate to act on the stipulation.

Conclusions of Law

1. The application should be granted to the extent set forth in the order which follows.

2. There is no need for any order requiring adoption of tariffs, or for accounting or ratemaking treatment of property, or assigning responsibility for main extension obligations.

The number of shares outstanding, the total par value of the shares, and the dividends paid do not determine allowable return on plant investment. This authorization is not a finding of the value of the utility's stock or property, nor does it indicate the amounts to be included in ratesetting proceedings.

ORDER

IT IS ORDERED that:

1. California Water Service Company (Cal Water), Water West Corporation (Water West), and Water West Shareholders are authorized to carry out the terms and conditions of the Stock Exchange Agreement and Plan of Reorganization as set forth in the application, and Cal Water may acquire control of Water West in accordance with the provisions of said Agreement.

2. Cal Water may issue 70,000 shares of its common stock to Water West Shareholders in the proportion of one share of Cal Water common stock for each 5.38376 shares of Water West stock.

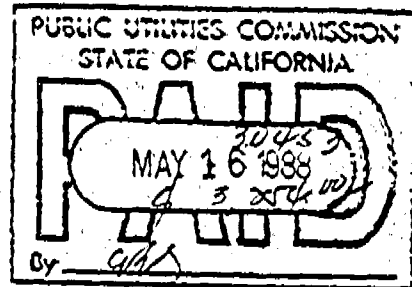
3. Cal Water shall file with the Commission the report required by General Order 24-B, which order, insofar as applicable, is hereby made a part of this order.

4. Within 30 days after consummating the transaction herein authorized, Cal Water shall notify the Commission in writing of that fact.

5. This order shall become effective when Cal Water has paid the fee prescribed by PU Code § 1904(b), which fee is \$3,254. Unless exercised, any authority herein granted will expire on July 31, 1988.

Dated MAY 11 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners



I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.

Victor Weisner
Victor Weisner, Executive Director

Discussion

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