

DEC. 16 1992

Decision 92-12-047 December 16, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application of SAN JOSE WATER)
 COMPANY (U-168-W) and SJW Corp.,)
 its parent company, seeking)
 Commission authority for SJW Corp.)
 to acquire 9.7% of the outstanding)
 shares of California Water Service)
 Company (U-60-W) through a merger)
 with Roscoe Moss Company.)

ORIGINAL

Application 92-06-027
(Filed June 22, 1992)

O P I N I O N

Statement of Facts

The Parties Involved

San Jose Water Company (SJWC), a California corporation headquartered in San Jose, under authority issued by this Commission provides public utility water service to a population of about three-quarters of a million through just over 200,000 customers in the cities of Campbell, Saratoga, and Monte Sereno, the Town of Los Gatos, and in portions of the cities of San Jose, Cupertino, and Santa Clara and in adjacent territory in the County of Santa Clara.

SJWC is a wholly owned subsidiary of SJW Corp., a holding company, organized and existing since 1985 under the laws of the State of California. SJW Corp. also wholly owns SJW Land Company, formed in 1985 for the purpose of developing real estate. The common stock of SJW Corp. is traded on the American Stock Exchange.

Roscoe Moss Company (RMC), a California holding company incorporated in 1927, has two wholly owned subsidiaries, Roscoe Moss Manufacturing Company (RMM) and Western Precision, Inc. (Western Precision). RMM manufactures water well casings and screens, well monitoring products and water transmission pipes. Western Precision manufactures precision mechanical parts designed

to customer specifications. RMC also owns 31% of the outstanding common stock of SJW Corp. and 9.7% of the outstanding common stock of California Water Service Company (CWS).

CWS, the largest investor-owned water utility in California, provides public utility water service through 21 districts serving 38 cities and communities and adjacent territories in California with an estimated population in excess of 1.4 million. Its common stock is traded in the over-the-counter market. CWS has extensive experience in operating multiple, noncontiguous water districts.

Part I of Appendix A reflects the present respective organization of SJW Corp. and RMC.

The Inception

Early in 1992, concerned with potential estate tax consequences under present arrangements were either he or his brother to die, Roscoe Moss, Jr., RMC Board Chairman and an SJW Corp. director since 1980, met with J. W. Weinhardt, SJW Corp. Chairman and CEO, and raised the possibility of a merger between the companies. A special SJW Corp. Board Committee concluded that a merger could be mutually advantageous. Surrounded as it is by other water utilities, SJW Corp. cannot sustain growth in earnings and dividends unless it goes outside its current service area. A merger with RMC would disperse the RMC 31.1% ownership interest in SJW Corp., enable SJW Corp. to diversify into the business of Western Precision, and enable SJW Corp. to acquire at a discount a block of CWS common stock (making SJW Corp. the largest shareholder in CWS) opening various avenues of a combination or expanded relationship between the two utilities.

The Proposed RMC Merger With SJW Corp.

On May 28, 1992, SJW Corp. and RMC signed a Letter of Intent in which they propose, subject to shareholder and regulatory approval, that RMC would become a wholly owned subsidiary of SJW Corp., and SJW Corp. would thereby acquire RMC's 9.7% interest in

CWS and its Western Precision subsidiary. The transaction proposes that in exchange for the 883,159 shares of SJW Corp. common stock presently held by RMC (which shares would become treasury stock and cease being treated as outstanding for accounting or voting purposes), SJW Corp. would issue approximately 1,305,000 shares of SJW Corp. common stock to the current RMC individual shareholders. Thus, a net of approximately 422,000 new shares would be issued by SJW Corp. The transaction is intended to qualify as a tax-free reorganization for federal and state tax purposes, and a tax ruling to that effect is being sought. Closing would not occur prior to the common stock dividend payment dates of each of SJW Corp. and CWS for the fourth quarter of 1992, but the Exchange Agreement will terminate if the closing has not occurred by March 31, 1993, unless otherwise agreed. Before the closing, RMC would distribute all the capital stock of RMM to the existing RMC shareholders (the "spin-off"), and would cause Western Precision to be liquidated or merged into RMC as a division. At the closing, RMC shareholders would exchange their shares of RMC common stock¹ for shares of SJW Corp. common stock,² and RMC (as Western Precision) would

1 At present, RMC has 1,723 shares of common stock and 7,410 shares of preferred stock outstanding. Immediately prior to a closing on the proposed merger, the preferred stock outstanding would be converted to common, so that after the conversion there would be a total of 2,217 RMC common shares outstanding. After distribution, Roscoe Moss, Jr. and his brother George E. Moss (RMC President) would hold under revocable trusts 893.5 and 695.5 shares (40.3 and 31.4%), respectively, with the remaining 628 shares (28.3%) of RMC common held directly or in trust by or for other Moss family members.

2 An Exchange Agreement was signed on August 20, 1992. It provided that the approximate 1,305,000 "Initial Shares" to be exchanged to the former RMC shareholders (based on valuation by comparison of book values as of December 31, 1991) would be equal

(Footnote continues on next page)

become a wholly owned subsidiary of SJW Corp. Upon the closing, the former shareholders of RMC would own approximately 40% of SJW Corp.

Part II of Appendix A reflects the resulting organization after the closing.

The Exchange Agreement also provides for a 10% holdback of shares to be received in the exchange, with these heldback shares to be deposited in escrow for one year from closing to allow SJW Corp. to recover for liabilities, costs, and expenses incurred above \$50,000 for any misrepresentation or breach of warranty, covenant, or agreement made by RMC or the two Moss brothers in the Exchange Agreement.

In addition, the two Moss brothers agree to indemnify SJW Corp. for all damages incurred (1) by reason of any misrepresentation or breach of warranty, covenant, or agreement made by RMC or the brothers in the Exchange Agreement where such damages exceed \$50,000, (2) in connection with any environmental liability of Western Precision relating to periods prior to the closing,³ and (3) in connection with taxes payable by RMC or any

(Footnote continued from previous page)

to the number of SJW Corp. common owned by RMC on closing date, plus 0.76 of a share of SJW Corp. common for each share of CWS owned by RMC on closing day. In addition, approximately 4,000 "Post Audit" shares of SJW Corp. common stock would be issued to the former RMC shareholders (equal to the net investment in Western Precision after certain adjustments).

3 The Western Precision plant on Commercial Street in Sunnyvale (leased from an individual who was a majority owner of Western Precision before Western Precision was acquired by RMC) is in close proximity to a Superfund cleanup site on the Environmental Protection Agency's National Priorities List. Western Precision

(Footnote continues on next page)

affiliate for period prior to closing in excess of provision therefor or because of the failure of the spin-off to qualify as a tax-free distribution (either subject to applicable claim periods).

The two Moss brothers also guarantee that for three years after closing SJW Corp. will receive no less than a cumulative 15% per annum after-tax return on the tangible book value of Western Precision. And should SJW Corp. decide to sell the CWS shares within three years the Moss brothers will assume the added tax liability for the difference in tax basis, and if SJW Corp. must sell Western Precision within three years, SJW Corp. is guaranteed to recover its investment.

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once used a vapor degreaser that produced Tri Chloro Ethane (TCA), a hazardous waste contaminant. Groundwater monitoring wells found TCA down gradient from the Western Precision facility, but the Regional Water Quality Control Board (RWQCB) in 1987 noted that a clear correlation between Western Precision and the contaminant found was "not apparent." Western Precision no longer uses the degreaser. The Superfund cleanup site near Western Precision ("Operational Unit 1 of the Kifer/101 Study Area") is being cleaned up voluntarily by National Semiconductor Corporation (National) and Advanced Micro Devices (Advanced). In its Draft Non-Binding Allocation of Responsibility document relative to the cleanup, National mentioned Western Precision, and while not proposing allocation of any cleanup responsibility to Western Precision, National did ask RWQCB to order an investigation into the Commercial Street properties. However, no investigation was ordered, and with the passage of time since Western Precision believes that neither National nor Advanced could today pursue legal action for Western Precision contribution for expended cleanup costs. However, it is possible that regulatory agencies may proceed, and for that reason SJW Corp. negotiated indemnification provisions in the merger agreement.

The Present Application

By this application, SJW Corp. asks for an ex parte order authorizing it to acquire 9.7% of the outstanding shares of CWS through SJW Corp.'s merger with RMC; that the Commission order submission of the final form of the Merger Agreement(s) and proxy materials as submitted to SJW Corp.'s shareholders to the Commission within 30 days after execution of the Agreement(s); and that the Commission authorize the merger under both Public Utilities (PU) Code §§ 852 and 854.

Notice of the filing of this application appeared in the Commission's Daily Calendar of July 1, 1992. There have been no protests. SJW Corp. has cooperated fully with the several requests of Administrative Law Judge John B. Weiss for supplemental information.

Discussion

PU Code § 854 prohibits any person or corporation from acquiring or controlling, either directly or indirectly, any California public utility without first securing authorization to do so from this Commission. The first issue thus presented by this proposed merger of RMC and SJW Corp. is whether or not the present RMC shareholders, by exchanging their RMC stock for SJW Corp. stock (which each thereafter will hold as an individual), will, by virtue of SJWC being a wholly owned subsidiary of SJW Corp., be acquiring control, either singularly or collectively, of SJWC, a regulated California water public utility.

At present RMC, in its corporate capacity and name, holds approximately 31.1% of the present (or pre-merger) outstanding common stock of SJW Corp. The two Moss brothers (RMC Chairman Roscoe Moss, Jr. and RMC President George Moss) now share voting and investment powers with respect to all the SJW Corp. shares held by RMC. This 31.1% interest in SJW Corp., far and away the largest block of SJW Corp. stock, has given RMC and the two Moss brothers considerable influence over SJW Corp. as well as two seats on the

eight-director board of SJW Corp. Consummation of a merger would reduce RMC holdings of SJW Corp. to zero. But thereafter the former RMC shareholders, meaning the two Moss brothers and certain members of the Moss family, would individually hold SJW Corp. shares in the aggregate amount of 40% of the post-merger outstanding shares of SJW Corp. While no individual Moss family member would hold as large an interest as is presently pre-merger represented by RMC, the post-merger combined interests of the two Moss brothers alone would increase to 32.92% of the outstanding SJW Corp. shares. In Gale v Teal (1977) 81 CPUC 817, we held that the acquisition of a 50% interest constituted control, either directly or indirectly, for purposes of PU Code § 854. In the proposed merger, the Moss family even if acting in concert would not be acquiring control by the merger. Of course, if allied with other SJW Corp. shareholders, there exists a real potential for taking control of SJW Corp., and thus control of SJWC. But in WUI, Inc. v Cont. Tel. Corp. (1979) 1 CPUC 2d 579, 586, we noted that it is of primary importance that PU Code § 854 does not speak of power to control, or potential to control, but of "control," which we interpreted to mean actual or working control. And negative control does not equal "control" either (Pacific Telesis Group (1986) 20 CPUC 2d 585, rehearing denied (1986) 231 CPUC 2d 98). Thus, while the potential for obtaining control of SJW Corp. and through it of SJWC, would actually be increased by the proposed merger, the rationale of WUI, Inc. supra, applies, and absent a combination with other shareholders, we find that the proposed merger would not within the context of PU Code § 854 result in RMC or the Moss family (individually or collectively), either directly or indirectly, acquiring or controlling SJWC.

The issue of acquisition of control does not rise to any relevant level under PU Code § 854 in considering SJW Corp.'s proposed acquisition of the 9.7% of CWS shares presently held by RMC. CWS's common stock is relatively thinly held. While RMC is

the largest shareholder, a French water company holds the next largest block (4.5%); the CWS employee-pension group holds 4%; a nominee shareholder holds 2%; and family trust holds 1/2 of 1%. The balance is held in smaller segments.

We next turn to the question whether or not, through the proposed merger of RMC and SJW Corp., the latter should be authorized to acquire the 9.7% of the capital stock of CWS presently held by RMC.

PU Code § 852 provides, as relevant in this proceeding, that no corporation holding a controlling interest in a public utility shall acquire any part of the capital stock of any other public utility organized and existing under or by virtue of the laws of California, without prior authorization by this Commission, unless the acquisition falls within a category of stock acquisition which the Commission has determined will not be harmful to the public interest and is therefore exempt.

While SJWC, the wholly owned regulated water public utility subsidiary of SJW Corp., itself would be acquiring no part of the capital stock of CWS, under the terms of the proposed merger between SJW Corp. and RMC, SJWC's holding company parent would acquire a 9.7% interest in CWS, and thereby become the largest shareholder in CWS. Pursuant to provisions of PU Code § 852, such an acquisition requires prior authorization by this Commission in that it falls within no category of stock acquisition automatically exempted by the Commission.

Several principal motivating factors have led to this merger proposal. A merger with exchange of stock means that the death of either Moss brothers, both principal RMC shareholders, would have far less impact on the market for SJW Corp. stock in that under individual rather than a corporate holding of the RMC block of SJW Corp. stock, fewer SJW Corp. shares would have to be sold to provide estate liquidity for tax purposes. Thus, there would be less potential for resulting disruptive impacts to SJW

Corp., and to SJWC. Another factor lies in the fact that SJWC cannot expand its present service area because it is surrounded by other public and private water utilities. Growth can only be attained by going outside its current service area. A merger with RMC would result in giving SJW Corp. a strategic position in CWS at a substantial discount compared to market acquisition, and under terms that do not present substantial financial risk and would allow SJW Corp. to evaluate the benefits of strengthening a relationship with CWS, including a possible merger or other business combination. SJWC will not assume any obligations of any party to the merger, and no negative impacts to SJWC operations or financial integrity would result from the merger. Consummation of the merger would not adversely affect SJWC or its customers, SJW Corp.'s shareholders, CWS or its shareholders or customers, RMC and its shareholders or customers, or any other person. Accordingly, we perceive the merger as not being harmful to the public interest and will authorize it.

SJW Corp.'s effective acquisition of CWS stock through the proposed merger would have no adverse environmental effect, and thus no Environmental Impact Report is necessary pursuant to Rule 17.1 of the Commission's Rules of Practice and Procedure.

As no person or entity has expressed any opposition to the proposed merger, a public hearing is not necessary. In that the parties desire to close the merger before the end of 1992, the order which follows should be made effective immediately.

Findings of Fact

1. SJW Corp. and RMC are California holding companies and by the captioned application for good business reasons they propose to merge the two corporations through the medium of a capital stock exchange, and seek Commission authorization to do so.
2. SJWC is a wholly owned subsidiary of SJW Corp.
3. RMC holds 9.7% of the outstanding capital stock of CWS.

4. Both SJWC and CWS are California water public utilities within the jurisdiction of this Commission.

5. Under the terms of the proposed SJW Corp.-RMC merger, neither RMC nor its shareholders, individually or collectively, would through their augmented SJW Corp. stock holdings obtain either actual or working control of either SJW Corp. or SJWC.

6. In the context of PU Code § 852, it would not be adverse to the public interest were SJW Corp. to be authorized by means of the proposed RMC-SJW Corp. merger to acquire the 9.7% of CWS's outstanding capital shares presently held by RMC.

7. A public hearing is not necessary.

8. To permit prompt consummation of the proposed merger, the application should be granted to become effective immediately.

Conclusions of Law

1. In that control is not being acquired by the proposed merger, Commission authorization is not required pursuant to PU Code § 854; however, in that acquisition of part of the capital stock of a public utility is involved, Commission authorization for the proposed merger is required pursuant to PU Code § 852.

2. The proposed merger between RMC and SJW Corp. as set forth in the captioned application should be approved.

ORDER

IT IS ORDERED that:

1. The joint application of San Jose Water Company and SJW Corp., its parent company, seeking authority from this Commission for SJW Corp. to acquire the 9.7% of the outstanding shares of California Water Service Company common stock presently held by Roscoe Moss Company through a merger with the latter is approved.

2. The final form of the Merger Agreement(s) and proxy materials as submitted to the SJW Corp.'s shareholders shall be

submitted to the Commission within 30 days after any such execution(s).

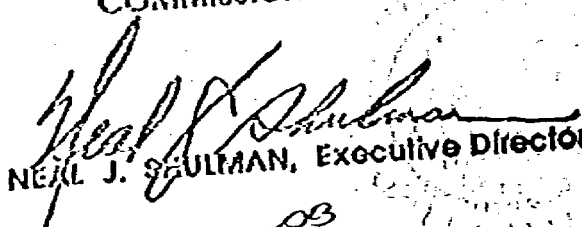
3. A merger between Roscoe Moss Company and SJW Corp. as set forth in the application, and the amendment thereto dated July 13, 1992, is authorized pursuant to provisions of Public Utilities Code § 852.

This order is effective today.

Dated December 16, 1992, at San Francisco, California.

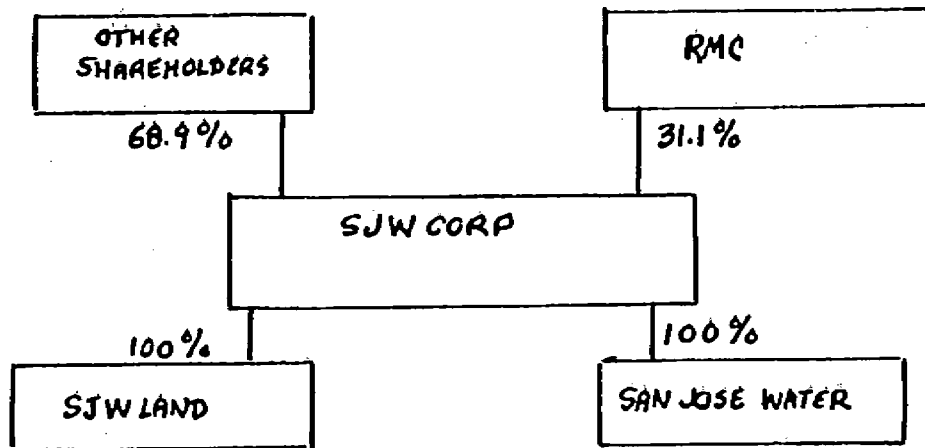
DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

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


NEAL J. SCHULMAN, Executive Director

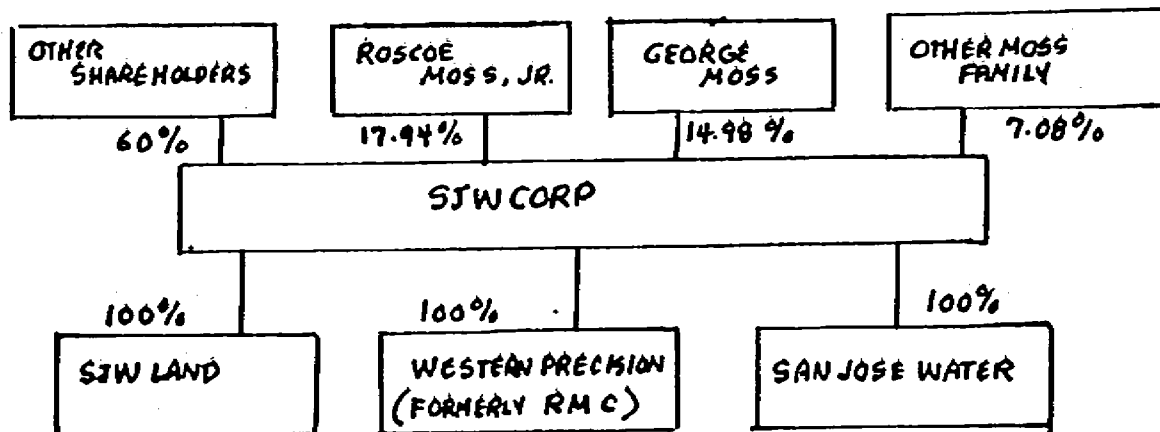
PART I:

SJW CORP - BEFORE THE EXCHANGE



PART II:

SJW CORP - AFTER THE EXCHANGE



(END OF APPENDIX A)