

DECISIONS

OF THE

RAILROAD COMMISSION

OF THE

STATE OF CALIFORNIA

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222375 ✓

833 Market Street

San Francisco

1914

DECISION No. 568.

IN THE MATTER OF THE APPLICATION OF VALLEY GAS AND FUEL COMPANY AND CALIFORNIA COKE AND GAS COMPANY FOR AN ORDER AUTHORIZING THE TRANSFER AND SALE TO LOS ANGELES GAS AND ELECTRIC CORPORATION OF THEIR GAS PLANT, DISTRIBUTING SYSTEM AND FRANCHISES, AND THE APPLICATION OF LOS ANGELES GAS AND ELECTRIC CORPORATION TO PURCHASE SAID PROPERTY.

Application No. 452.

Decided April 10, 1913.

The properties of the vendor companies are operated in competition with the purchasing company. Application is made for approval of their sale at \$175,000, the properties being valued by the purchasing company at \$189,809.87 and for approval of payment of part of the consideration by the issue of bonds of the purchasing company to the amount of 75 per cent of the purchase price, to wit, \$131,250.00. It appeared that the property to be acquired will be discarded from use to the extent of about one half its present value,

Held, In view of the natural tendency of courts to award a rate at least high enough to pay interest on the outstanding bonded indebtedness, it becomes very important that due consideration be given to the item of bonded indebtedness (*Smyth vs. Ames*, 169 U. S. 466). If a utility desires to buy out its competitor, it cannot expect that the public authorities will permit it to take on additional bonded indebtedness to cover that portion of the property which it will scrap or junk after its acquisition. A utility has no right to expect the public authorities to authorize the capitalization of junk. If a public utility, in order to rid itself of a competitor, desires to purchase its entire property, including that portion which will be scrapped, it must expect to pay for the scrap out of its reserve or in some other way which will not be charged up against the public.

Held, That the purchase and sale of the property be authorized for the sum of \$175,000, and that the purchasing company be authorized to issue bonds against this property in the face value of \$87,500, and that the remaining portion of the purchase price be taken out of surplus accrued to date. It would not be fair to provide that the moneys which are not to be secured from the sale of bonds should be taken out of future earnings, because if that were done, the public would pay for the duplicated property after all, as it would be compelled to pay higher rates in order to meet these obligations. If the property which is not to be used in connection with the supply of gas in the territory here affected is hereafter sold or applied to a beneficial use in the purchaser's plant, the sale price or the value thereof may again be credited to surplus.

Porter & Sutton, for Valley Gas and Fuel Company and California Coke and Gas Company.

Paul Overton, for Los Angeles Gas and Electric Corporation.

REPORT OF THE COMMISSION.

THELEN, *Commissioner*.

This is an application on the part of Valley Gas and Fuel Company and California Coke and Gas Company to sell their gas plant, distribut-

ing system and franchises to Los Angeles Gas and Electric Corporation for the sum of \$175,000, and of the Los Angeles Gas and Electric Corporation to purchase said property. The property to be sold by the California Coke and Gas Company consists of a parcel of real estate in the city of Alhambra, and the gas manufacturing and generating plant located thereon, from which plant gas has been distributed by the Valley Gas and Fuel Company. The property to be sold by the Valley Gas and Fuel Company consists of its entire distributing system and its franchises. The California Coke and Gas Company is the holding company of the Valley Gas and Fuel Company and owns 4,995 of its 5,000 issued shares of capital stock. Neither the Valley Gas and Fuel Company nor the California Coke and Gas Company are selling any of the so-called Lowe patents owned by them.

The Valley Gas and Fuel Company was incorporated in 1901, and started operations in the city of Pasadena and South Pasadena in about January, 1902. At that time the company leased a small gas manufacturing plant near Arroyo Seco and secured its gas from this source. In 1906, the California Coke and Gas Company constructed a plant in Alhambra, from which plant the Valley Gas and Fuel Company has thereafter secured its gas. The Valley Gas and Fuel Company was the pioneer in Alhambra and in South Pasadena, but the city of Pasadena was being partially served by the Pasadena Consolidated Gas Company at the time the Valley Gas and Fuel Company entered that field. At the time the latter company started operations, it charged the sum of \$1.25 per thousand cubic feet of gas. Since that time, gradual reductions have been made, due in part, at least, to the competition of the Los Angeles Gas and Electric Corporation, with the result that the rate at present charged for gas in the entire territory served by the Valley Gas and Fuel Company, including Pasadena, South Pasadena, Alhambra and certain outlying territory is 75 cents per thousand cubic feet of gas. Mr. Thaddeus Lowe, the president of the Valley Gas and Fuel Company, and also of the California Coke and Gas Company, testified that the distributing system of the Valley Gas and Fuel Company had cost \$171,965.34; that the generating and manufacturing plant had cost \$70,000 and that the real estate on which the plant was located had cost \$2,500, and was now worth about \$7,000.

Mr. Luckenbach, the Los Angeles Gas and Electric Corporation's construction engineer, made a detailed estimate of the value of the properties to be acquired from the Valley Gas and Fuel Company and the California Coke and Gas Company. His conclusion was that the total value of these properties in their present condition is \$189,309.67, of which amount the real estate in Alhambra is estimated to be worth \$3,500, the distributing system \$129,444.67, and the remainder is to represent the manufacturing and generating plant in Alhambra, and

an item of \$1,600 for miscellaneous personal property. I am convinced that the sum of \$175,000 is not an excessive amount to pay for the property in its present condition.

Mr. Lowe testified that the Valley Gas and Fuel Company has been losing money at the rate of some \$8,000 or \$9,000 per year, and that it has become impossible longer to meet the competition of its more powerful rival. A comparison of the gross receipts of his company and of his rival for the year 1912 will show the relative strength of the two companies. For the year ending December 31, 1912, the Valley Gas and Fuel Company had total earnings amounting to \$50,374.96, with an alleged loss of \$13,914.04. The latter item, however, includes large items for loss by fire and for depreciated accounts, which are exceptional items and should not properly be charged in their entirety to this one year. For the same period, the total operating revenue of the Los Angeles Gas and Electric Corporation was \$4,284,809.44, and the balance carried forward for the year to the credit of profit and loss was \$1,446,558.64. From this amount, however, should be deducted the depreciation, estimated by the company's engineer at \$721,000, and dividends declared at the average rate of 7.2 per cent on all the common stock, amounting to \$687,000.

The importance of this application grows largely out of the fact that a considerable portion of the property which the Los Angeles Gas and Electric Corporation is to purchase has already been duplicated by that company, and will be scrapped or junked. The Los Angeles Gas and Electric Corporation has already duplicated most of the Valley Gas and Fuel Company's gas mains in the city of Pasadena. There is also some duplication in the remaining portions of the territory served by the Valley Gas and Fuel Company. It is the intention of the Los Angeles Gas and Electric Corporation to dismantle the gas manufacturing and generating plant at Alhambra, utilizing such portions thereof as are fit for further service. About one third of the Valley Gas and Fuel Company's mains are in territory in which no duplication has as yet taken place. The Los Angeles Gas and Electric Corporation expects to permit a portion of the Valley Gas and Fuel Company's mains now duplicated in the streets of Pasadena to remain in service, but it will be necessary to scrap about 25 per cent of the Valley Gas and Fuel Company's mains.

If the public utility desires to buy out a competitor and the public will not suffer from the transaction, this Commission, bearing in mind the greater economies which ought to result from the operations of a larger utility, will not be disposed to deny the right to consolidate, provided that the interests of the public are properly protected. If the consolidation is to be effected, however, it must be done in such a way that the burdens of the public will not be increased. In the present case, the Los Angeles Gas and Electric Corporation desires to pay \$175,000 for

property, a portion of which will be scrapped or junked, and to issue against this property bonds to the amount of 75 per cent of the purchase price, amounting to \$131,250. If these bonds are issued, the company will expect to earn rates sufficiently high to meet the added interest obligations which will result therefrom. At the hearing, counsel for the Los Angeles Gas and Electric Corporation suggested that the amount of bonded indebtedness would not make much difference as affecting the rates to be paid by the public, for the reason that the proper basis of valuation is the fair value of the property used and useful for the public purpose, and not the amount of bonds or stock outstanding. While there is much to be said in favor of this contention, it should be remembered in this connection that the Supreme Court of the United States, in the leading case of *Smyth vs. Ames*, 169 U. S. 466, held that all the elements of the problem should be taken into consideration, including the amount of bonds and capital stock outstanding. In view of this declaration and of the natural tendency of courts to award a rate at least high enough to pay interest on the outstanding bonded indebtedness, it becomes very important that due consideration be given to the item of bonded indebtedness.

If a utility desires to buy out its competitor, it can not expect that the public authorities will permit it to take on additional bonded indebtedness to cover that portion of the property which it will scrap or junk after its acquisition. A utility has no right to expect the public authorities to authorize the capitalization of junk. It may be reasonable to ask that bonded indebtedness be increased for the acquisition of that portion of the plant which will continue to be used or useful for the public service, but certainly not for that portion which is to be discarded. In the present case, the Valley Gas and Fuel Company has no bonds outstanding. If the process of competition were carried to its logical conclusion and the Valley Gas and Fuel Company were put entirely out of business, the public would not have to pay additional rates to cover a bonded indebtedness on this plant.

If a public utility, in order to rid itself of a competitor, desires to purchase its entire property, including that portion which will be scrapped, it must expect to pay for the scrap out of its reserve or in some other way which will not be charged up against the public.

In the present proceeding, the testimony shows that of the total of \$189,309.67, being the value of the property to be acquired, as estimated by the purchaser's construction engineer, the sum of \$58,265 represents the real estate in Alhambra and the gas manufacturing or generating plant thereon, which property is no longer to be used in the gas business. The testimony also shows that about 25 per cent of the Valley Gas and Fuel Company's gas mains will be scrapped. Twenty-five per cent of the sum of \$129,444.67, representing the estimated present value of

the Valley Gas and Fuel Company's distributing system, is \$32,361.17. It thus appears that property representing about one half of the value of the property to be acquired will be scrapped or no longer used in the gas business.

I accordingly recommend that the purchase and sale of the property be authorized for the sum of \$175,000, and that the Los Angeles Gas and Electric Corporation be authorized to issue bonds against this property in the face value of \$87,500, and that the remaining portion of the purchase price be taken out of surplus accrued to date. It would not be fair to provide that the moneys which are not to be secured from the sale of bonds should be taken out of future earnings, because if that were done, the public would pay for the duplicated property after all, as it would be compelled to pay higher rates in order to meet these obligations if the property which is not to be used in connection with the supply of gas in the territory here affected is hereafter sold or applied to a beneficial use in the purchaser's plant, the sale price or the value thereof may again be credited to surplus.

The city of Pasadena was represented at the hearing by its city attorney, who drew the attention of the commission to a condition existing in that portion of Pasadena which is known as Oak Knoll, where the gas service of the Valley Gas and Fuel Company has not been adequate to supply the needs of the inhabitants. The city attorney asked that the commission take some action in order to make sure that the residents of that section of the city would secure an adequate gas supply in case the contemplated purchase is consummated. The Los Angeles Gas and Electric Corporation gave assurance at the hearing that as soon as the order authorizing the purchase were made, it would immediately take steps to see to it that the inhabitants of Oak Knoll received adequate and sufficient service. This assurance may be deemed sufficient for the present. In case the plans of the Los Angeles Gas and Electric Corporation in this connection, as they will be presented to the city authorities at Pasadena, be not satisfactory to them, this Commission will be glad to go into this question further upon having its attention drawn to it.

I submit herewith the following form of order :

ORDER.

Valley Gas and Fuel Company and California Coke and Gas Company having applied to this Commission for an order authorizing the sale to Los Angeles Gas and Electric Corporation for the sum of one hundred and seventy-five thousand (\$175,000) dollars of the real property and gas manufacturing and generating plant located thereon, situated in the city of Alhambra and belonging to California Coke and Gas Company, and of the entire distributing system and franchises of

the Valley Gas and Fuel Company, as appears in contract between Los Angeles Gas and Electric Corporation and Valley Gas and Fuel Company and California Coke and Gas Company, dated February 21, 1913, a copy whereof is attached as "Exhibit D" to the petition in this case, and Los Angeles Gas and Electric Corporation having applied for an order authorizing the purchase by it of said property at said price, and a public hearing having been held on said application, and it appearing to the Commission that the application should be granted, subject to the conditions hereafter specified.

It is hereby ordered that said application be and the same is hereby granted, subject to the following express conditions:

1. The amount of one hundred and seventy-five thousand (\$175,000) dollars which Los Angeles Gas and Electric Corporation is authorized to pay for the property which it is to acquire from the Valley Gas and Fuel Company and the California Coke and Gas Company shall not be taken before this Commission or any other public authority to represent for rate fixing purposes the value of the property to be acquired.

2. In order to secure said purchase price of one hundred and seventy-five thousand (\$175,000) dollars, Los Angeles Gas and Electric Corporation may issue its bonds in the face value of eighty-seven thousand five hundred (\$87,500) dollars, as authorized by this Commission's order in Application No. 453, and the remaining portion of the purchase price shall be charged against surplus of said Los Angeles Gas and Electric Corporation.

3. Los Angeles Gas and Electric Corporation agrees that it will not use the purchase of the property of its competitor in the territory affected or the conditions arising out of the competition or resulting from the purchase of said property for the purpose of increasing gas rates in the territory affected. It is the intention of this Commission that gas rates in the territory affected shall not be increased above those now in effect.

4. The Los Angeles Gas and Electric Corporation shall take immediate steps to supply to the inhabitants of Oak Knoll an adequate and sufficient gas supply.

The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 10th day of April, 1913.