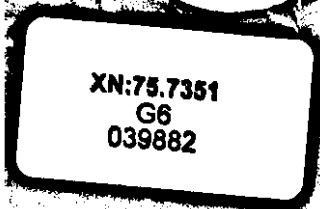
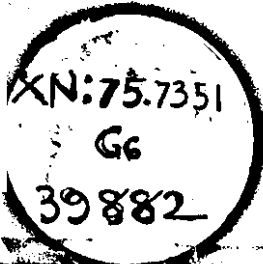


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BY
DUDLEY F. PEGRUM

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INTRODUCTION

THE CONTROL of security issues of the enterprises coming under their jurisdiction is probably the most important single function exercised by public service commissions. Successful regulation is impossible without comprehensive supervision of financial practices, and, in the opinion of the writer, control of security issues must be the starting point of any satisfactory regulatory scheme. Yet, it is only in recent years that this aspect of regulation has received any appreciable attention, and even today this phase of the public utility question is far overshadowed by the controversy over reasonable rates which, in the end, derive their real significance from financial requirements. The California Railroad Commission has achieved outstanding success in the control of public utilities in the State of California, and no small part of that success is attributable to the policy which has been followed in regulating the security issues of the utilities. It is with this phase of regulation in this State that this monograph deals.

Regulation of public utilities, and the legislation pertaining thereto, has had a long and colorful history in California.* Down to 1911, attempts at control were singularly ineffective and it was not until the Public Utilities Act was passed in that year, effective March 23, 1912, that a satisfactory program was put into force. This legislation was the combined result of the accumulation of experience in California and a thoroughgoing study of existing regulatory practices throughout the country. It was designed to deal with public utility control in all aspects necessary to ensure to the public adequate service at reasonable and just rates. In keeping with this aim was the affirmative responsi-

* Superior figures refer to notes on pages 201-222.

bility, imposed upon the commission which was created, of seeing to it that the utilities of the State should receive adequate protection and that public utility development should be fostered. For the first time in California, State authorities were charged with the duty of supervising carefully the financial practices of all utilities under their jurisdiction.

The system of regulation thus set up contemplated that the supervision of public utility finance would be an integral part of the program of public utility control. That the persons responsible for the formulation and early interpretation of the legislation intended this to be so, is evidenced by the remark of Mr. Max Thelen, legislative investigator, member of the first board of commissioners and later president of the commission:

In my opinion, control over the issue of securities and the disposition of their proceeds is the keystone of the entire arch of public utility regulation.³

The Railroad Commission was given very comprehensive powers to carry out the letter and intent of the law, although it is not quite possible to agree with one commentator who said, in 1918, that the California commission had complete and unrestricted powers over security issues.⁴ Numerous amendments and additions to the original act have been necessary, to overcome limitations which experience disclosed and to extend the commission's jurisdiction over types of business not comprehended by the original law. Thus, section 52 of the Public Utilities Act was amended in 1915 so as to permit a utility to issue securities to reimburse the treasury for surplus earnings expended for capital purposes.⁵ In 1917 it became possible for public utility corporations to issue capital stock without par value, when, and as permitted by the commission.⁶ Again, in 1925, section 52 was amended so as to clarify the wording and establish the commission's control over all types of public utility securities.⁷ In the same year, section 52½, forbidding any utility to assume any obligation as guarantor, indorser, surety, or otherwise, when the securities are payable at periods of more than twelve months, without first obtaining the permission of the Railroad Commission, was added.⁸ Similarly, the Auto Truck Transportation Act of 1917 extended jurisdiction to speci-

fied types of automobile transportation and included control over securities of the businesses falling within the purview of the act.⁹ This legislation also has been amended many times so as to strengthen the hands of the commission.¹⁰

The direct jurisdiction of the California Railroad Commission over security issues by steam railroad companies has been limited by federal legislation. By the Federal Railroad Control Bill of 1918 authority over securities issued by railroads coming under the scope of this act was vested exclusively in the hands of the federal government. The Transportation Act of 1920 required the Interstate Commerce Commission to file with the governor of each state in which the railroad operated a copy of the application for the issuance of securities submitted to it by a carrier. Some steam railroads have taken the position that the Interstate Commerce Commission has exclusive jurisdiction and hence have not filed applications with the California Commission. It has been the practice, however, for the governor to refer these applications to the commission for review.¹¹

POWERS OF THE COMMISSION

THE CONTROL of security issues of public utilities by the California Railroad Commission is governed by sections 51, 52, 52½ of the Public Utilities Act and section 6 of the Auto Truck Transportation Act.¹² Section 51 provides that no public utility shall "sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part" of its property necessary or useful in the performance of its duties to the public, nor merge or consolidate its property franchises or permits, either in whole or in part, without first having obtained the consent of the commission.¹³ All contracts made otherwise than in accordance with the orders of the commission are null and void. However, a utility may dispose of property not necessary or useful in the performance of its duty to the public (presumably without application to the commission), but such disposition "shall be conclusively presumed to have been of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value."¹⁴

Section 52 of the act contains extensive and comprehensive provisions with respect to evidences of interest or ownership and of indebtedness. The issuance of such securities against public utility property situated within this State is "a special privilege, the right of supervision, regulation, restriction and control of which is and shall be continued to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe." A utility may issue evidences of ownership or of indebtedness payable at periods of more than twelve months after the date thereof for the following purposes, *and no others*: acquisition of property; construction, completion, extension or improvement of its facilities; improvement or maintenance of its service; discharge or lawful refunding of obligations, reimbursement of moneys actually expended from income, or any other moneys in the treasury not secured by or obtained from security issues. Such securities cannot be issued for maintenance of service³³ and replacements, and the applicant is to keep the record of its expenditures in such a way that the commission can ascertain the purpose for which they were made. The authorities must sanction all such issues and must satisfy themselves that the money, property, or labor to be acquired or paid for is reasonably required for the purposes specified in the order.³⁴ Any conditions deemed reasonable and necessary may be attached to the order, and a public utility corporation may issue evidences of indebtedness greater than its authorized or subscribed capital stock if the commission sees fit.³⁵ Notes, for proper purposes and payable at periods of not more than twelve months from the date thereof, may be issued without the consent of the commission but they cannot be refunded without application. Furthermore, the commission cannot authorize the capitalization of the right to be a corporation, nor of a franchise or permit, nor the right to own or operate such, in excess of the amount (exclusive of tax or annual charge) actually paid to the state or political subdivision thereof. Similarly, contracts for consolidation or lease cannot be capitalized nor can evidences of indebtedness be issued against such contracts. Accounting for proceeds may be required in such manner as seems fit, and all security issues made without authorization by the

commission are null and void." Every public utility which violates the law or the commission's order is subject to a fine of not less than five hundred dollars, nor more than twenty thousand dollars for each offense. Every person who knowingly violates the law, or order, or constitution of the State, or falsifies information is guilty of a felony. The provision is also specifically made that the State of California is in no way obligated to pay or guarantee any of the securities issued under the supervision of the Railroad Commission.

Section 52½ provides, in part: "No public utility shall henceforth assume any obligation or liability as guarantor, indorser, surety or otherwise in respect of the securities of any other person, firm or corporation, when such securities are payable at periods of more than twelve months after the date thereof, without first having secured from the railroad commission an order authorizing it so to do." (Added in 1925).

Sections 6 and 6(c) of the Auto Truck Transportation Act, in effect, apply sections 52, 52½, and 57 of the Public Utilities Act to motor carriers embraced by the Auto Truck Act.

Supplementing the general legislation are two items of significance, issued by the commission, namely, General Order No. 24, and Rules of Procedure of the Railroad Commission. The rules of procedure, compiled in accordance with section 53 of the Public Utilities Act, set forth in detail the procedure to be followed in formal proceedings before the commission. General Order No. 24 prescribes in detail the formalities to be complied with in regard to the issuance of securities." Strict adherence to the rules laid down is required before authority to issue securities is given. Frequently, applications to issue securities are made when the technicalities, for some reason or other, have not first been met; and the commission usually gives its authorization subject to the fulfillment of all requirements. Sometimes, when the failure to conform is more fundamental, the application is denied, without prejudice, until the necessary conditions have been complied with.

It should be noted here that the commission has ruled that it is not necessary for companies to obtain permission to issue qualifying shares of stock to directors."

GUARANTEE OF SECURITY ISSUES

THE FOREGOING brief outline of the law which governs the issuance of public utility securities in California indicates that the statutory basis upon which the commission operates in this state is broad indeed. Furthermore, a considerable number of precise rules are contained in the legislation and from time to time these are augmented by new statutes. Security regulation evidently rests on a firm legal basis for, so far as the writer has been able to ascertain, no case concerned with the issue of securities has been taken to the courts. The administrative detail involved in applying the law has been enormous and a tremendous volume of decisions has been handed down. Consequently, a large body of principles has been evolved and it is with the enunciation and analysis of these that the major part of this study deals.

Although the law specifically provides that the State of California in no way guarantees any securities issued under the authority of the Public Utilities Act, yet the commission has deemed it necessary, time and again, to reiterate this fact. In regulation, the dividing line between the responsibility of management and that of the administrative authorities is, frequently, very difficult to draw. A commission possessed of broad powers is faced with the necessity not only of safeguarding the public but also of following a policy which will encourage the development of public utilities under its jurisdiction. Hence, satisfactory evidence must be offered that an applicant for a security issue has reasonable prospects for success and will be able to pay returns on the money invested, unless there is some valid reason why these conditions need not be fulfilled. Thus, in *Central California Gas Co.*, the applicant, engaged in the construction of new properties and in the acquisition of the Home Gas Company of Porterville, requested a certificate of public convenience and necessity as well as permission to issue securities. In dealing with the application the commission said:

It should be clearly understood in these three applications and in all other cases of issuance of certificates of public convenience and necessity and approval of franchise rights, secured or to be secured, and of issues

of stocks, bonds or other securities, that the Commission does not and cannot guarantee the financial success of the enterprise. People who finance public utilities in this State must continue to take the risk of success of the venture just as they have always done in the past. The Public Utilities Act is no magic talisman insuring public utilities against failure in case good judgment is not exercised in the financing and construction thereof. Under the Public Utilities Act, the projectors of public service enterprises may rest assured that in so far as the Commission has jurisdiction, the utility will be permitted to collect rates sufficient to yield a fair return on the money wisely and sanely expended in serving the public, but more than this they have no right to expect.²⁹

In this same connection it should be noted, as we shall see later, that the authorities have been aware of the statement in *Smyth vs. Ames* relative to securities and hence have, to a degree, correlated security control with rate regulations.

Although no guaranty is established, nevertheless there is a presumption that when an application for the issuance of securities is granted it has passed a test, which at the time of the hearing establishes reasonable ground for belief that prospects for the success of the enterprise are good, unless reasons to the contrary are given in the opinion.

While this Commission has repeatedly pointed out that it cannot guarantee the success of a public utility to which it has given authority to issue stocks and bonds, the Commission cannot escape the conclusion that purchasers of public utility securities have at times invested their money at least partly in reliance on this Commission's authorization, without making the independent investigation which they ought to make.³⁰

When, however, the success of an enterprise or the return upon securities is in doubt, the commission, if for some reason it grants the authorization, demands that the purchasers be given full information. Thus, in *Marin County Electric Railways* the authorities felt that the application should be granted. However, there was some doubt concerning the investment nature of the securities to be issued and there was a possibility that losses might ensue. For this reason the company was required to give prospective purchasers of the stock complete information about the nature of the enterprise. The order in the case

provided that the utility submit to the commission for the latter's approval the prospectus which was to be used in the sale of the securities.²⁸

In short, the commission's attitude is that legally it assumes no responsibility for the value of the securities issued, nor for the future success of any project, but it does take all possible precautions to see that public interest shall be served and that the securities shall rest on a business undertaking which reasonably warrants their issuance.²⁹

TECHNICAL CONDITIONS OF ISSUANCE

WHEN APPLICATION to issue securities is made to the commission, conformity to many technical matters is required as well as compliance with conditions considered requisite to sound financial procedure. In the first place,

The Commission has ruled that securities are issued only when exchanged in good faith for value. A conference was called on this and related subjects, and after views of all interested parties had been presented, the Commission held that once a bond returned to the obligator's hands it was extinguished, and that when it went out again there was a reissue.³⁰

Then, too, it has been held that consent is not required when a corporation authorizes a bond issue; action is necessary only on the issuance of bonds authorized by the utility.³¹ There is also, in this connection, a distinction between issuance and sale. A utility is frequently authorized to issue more securities than are deemed necessary for immediate use. When this is done, permission may be given to sell the entire amount authorized at the time and use such of the proceeds as is specified in the order, for the purpose prescribed, or, the order may stipulate that a certain amount may be sold at once and the remainder as need arises. In either alternative the money obtained may be used only for the purposes stipulated.³² Moreover, the commission has interpreted issue to mean execution and delivery of the instrument.³³ Thus, supplemental opinions are frequently rendered; these deal with modifications or continuations of the original cases.

The consent of the State Commissioner of Corporations is necessary when securities are to be issued or when provisions of the charter with regard to capitalization are to be changed, but these proceedings are

apart from the jurisdiction of the Railroad Commission and it is not concerned with them.²⁷ The authority exercised by the two agencies is distinct and applicants must be prepared to satisfy both. If this is not done the security issue involved is void.²⁸

Before a utility can obtain permission to issue securities, it must establish proof that it has the legal right to exist and operate as a public utility. Thus, in *San Diego, Riverside and Los Angeles Railway Company* the commission found that the franchises under which the applicant proposed to operate were subject to forfeiture because the conditions pertaining thereto had not been complied with, and there was quite a possibility that the disputes would not be settled in a manner satisfactory to the utility. Consequently, the company was required to supply evidence that it had composed its franchise difficulties before any of the bonds authorized in the order could be issued. The authorities stated that they would be unwilling to sanction, in the future, the issuance of securities, especially if a large amount was involved, unless the applicant manifested good intentions in its formation and with regard to its franchise rights. A clear title to legal existence and compliance with the ordinary dictates of good faith is the *sine qua non* to the privilege of the sale of stocks and bonds.²⁹

Similarly, when bonds are involved, the corporate life of the issuing company must extend beyond the maturity date of the obligations. The *Nevada County Narrow Gauge Railroad Company* applied for an order authorizing the issuance of \$500,000 of thirty-year bonds. The corporate life of the company terminated in 1924, eleven years after the date of the application and nineteen years before the maturity date of the bonds. The railroad proposed to extend its existence by appropriate proceedings to January 1, 1963. The commissioner in charge recommended that the application be granted "upon the condition precedent that the proceedings to lengthen the corporate life of applicant be completed so as to extend beyond the maturity of the bonds herein asked to be authorized."³⁰

Where a substantial proportion of a utility's property is involved in litigation, the outcome of which is uncertain, as is often the situation in disputes over water rights, the sanction for the issuance of bonds

will not be given.²⁴ If the controversy covers a relatively small part of the property of the applicant, conditions may be attached to the authorization. Thus, the *Southern Sierras Power Company* wished to issue bonds to finance a project, but the city of Los Angeles had instituted condemnation proceedings against part of the land. The properties involved in the suit constituted a relatively small proportion of the entire properties of the applicant. As a protection to bondholders against the eventuality that the company should lose the suit, the commission stipulated that any loss arising therefrom should be properly recorded. Then the amount of bonds outstanding was to be reduced accordingly or surplus earnings were to be plowed back to cover the loss.²⁵

Stock appears to be treated in a slightly different manner, but when it is to be sold to the investing public the commission insists that the purchasers be given adequate protection. In application of *Sierra Valley Water Co.*,²⁶ the utility agreed to require subscribers to sign a consent and waiver agreeing to abide by the results of the litigation before the certificates were issued.

CORRECTION OF PAST ABUSES

BECAUSE the public utility industry was quite well advanced in this State when effective legislation was established, the commission necessarily was faced with many conditions which it would not have sanctioned in the first instance. Although the provisions of the legislation could not be made retroactive, nevertheless the sweeping powers contained in the Public Utilities Act made it possible for the authorities to correct, or at least materially to improve over a period of time, evils which they found. At the very beginning, the policy to be followed on this score was announced:

Particularly intricate and involved is the problem of securing a true relation between outstanding capitalization and capital assets. The financial operations of public utilities, unregulated and unrestricted for years and contaminated with practices no longer permissible in law and fundamentally unsound, have resulted in many instances in gross overcapitalization. And this in turn has led to fictitious entries upon the assets side of the balance sheet. . . . Not only because past corporate practices have led

to claims of right to earn returns upon securities unrepresented by values but as well because new securities are sold to purchasers who repose faith in the correctness of corporate accounts, is the Commission engaged in the highly important task of not allowing new securities to be put upon the market until inquiry first has been made into the affairs of the company and an earnest endeavor, where conditions demand it, to bring about a sound and healthy basis for the issue.²⁸

This statement emphasizes the fact that, while the commission may lack positive powers to prevent or to undo certain acts, yet the negative power of being able to refuse sanction to new security issues may prove to be controlling. The authorities have not hesitated to take a definite stand on this matter. In *Reorganization of People's Water Company* a considerable difference of opinion arose over the question, What form shall the new capitalization take? To this the commissioner in charge replied:

Hence, while the authorization of this Commission may be persuasive, it cannot be enforced upon anybody. The various bondholders, creditors and stockholders of this corporation must determine for themselves whether or not they will proceed under the authorization of the Commission. But attention is called to the fact that the action of this Commission will finally be controlling, because whether this company be reorganized by agreement or whether it go through foreclosure, no stocks or bonds can be finally issued without its authorization.²⁹

In actual practice, this attitude has brought decisive results.

Positive steps have been taken on a number of occasions, to correct evils which arose prior to the date on which the Public Utilities Act took effect, by attaching conditions to orders or by refusing applications until financial structures have been improved. In *Central Gas Company of California* the applicant asked permission to issue bonds for acquisition and extension of facilities.³⁰ The company had unquestionably followed financial practices, prior to the effective date of the Public Utilities Act, which the commission would not have sanctioned, for the par value of the outstanding securities so far exceeded any reasonable valuation of the property that the common stock was admittedly all water. Public convenience and necessity demanded the developments proposed, and the suggestions for these steps alone

would have met with approval. For the construction of one part of the work the gas company had entered into an arrangement with its affiliate, the General Operating and Construction Company, whereby it had issued to the latter all its common stock of the par value of \$50,000 and preferred stock of the par value of \$15,000. It now asked permission to issue bonds of the par value of \$40,000 in return for which the construction company was to build a plant costing approximately \$40,948. Bonds of \$33,000 were authorized (80 per cent of cost of plant) and the construction company was required to turn over to the commission the 360 shares of common stock which it still retained, to be stamped "Issued for control only and not to be transferred without the consent of the Railroad Commission."¹⁷

For another part of the construction the applicant proposed to issue bonds to the amount of 125 per cent of the cost of the property to be acquired. The commission refused this request because there was no other property not already covered by other outstanding securities, to serve as additional security. Instead, authorization was given to issue bonds to 80 per cent of the cost. This left the problem of raising other money to which the suggestion was made,

As the applicant's entire common stock has already been issued, and as the preferred stock will be taken up . . . it will be necessary for the applicant to derive the additional funds needed . . . by assessment on the stockholders or in some other manner.¹⁸

In *Application of the Oro Electric Company* for a certificate of public convenience and necessity authorizing it to do business in certain territories, the commission found that the financial relations between the applicant and its affiliates, particularly a construction company, were such as to leave in doubt the utility's ability to render adequate service at the rates specified. The certificate was granted only on condition that the obligations arising from the bond transactions already consummated with the affiliates be thenceforth entirely at the discretion of the commission. In taking this position the authorities disavowed any intention of trying to exercise indirect control over securities lawfully issued prior to the effective date of the Public Utilities Act. If the financial position of an applicant is such that there is

strong likelihood that it will be unable to render adequate service at reasonable rates, a certificate of public convenience and necessity will be denied. If, on the contrary, financial improvement is possible and assurance of reasonable service is also given, a certificate will be granted on the stipulation that requirements for financial success be fully satisfied.⁴⁰

¶ A similar stand has been taken on the refunding of present outstanding indebtedness. The mere fact that new securities do not add to already existing obligations is insufficient grounds for granting an application. The entire financial structure must be considered and the request granted or denied accordingly.⁴¹

Positive refusal to grant applications for security issues, until existing evils have been corrected satisfactorily, has also been resorted to. Thus, the application of the *Economic Gas Company*⁴² was refused, except with respect to \$270,000 of bonds used to pay a legitimate capital indebtedness, because of financial malpractices. Bonds of \$365,000 had to be settled for because of illegal issue. Many of these were held for sale merely to avoid the jurisdiction of the commission. In any event, the company needed to raise a rather large amount of money, but it was found that the entire capital stock had been issued for practically no consideration. The opinion stated that it would be necessary to raise the additional funds from the stockholders (the promoters), although the order did not contain this stipulation.

VALUATION OF PROPERTY

THE FOUNDATION upon which the entire security regulation program of the California Railroad Commission has been erected is the valuation of the property. In determining "fair value" the commission in this state has used historical cost.⁴³ This is simply the estimate of the investment in a utility deemed reasonably necessary to erect it into a going concern.⁴⁴ This does not mean that "fair value" and the rate-base are the same thing, for a utility may have items of property which are excluded for rate-making purposes.

In decisions on applications for security issues the authorities have constantly resorted to the value of the property as a means of testing

the validity of the application. Thus in *Angels' Flight Railway Company*, it was stated:

It is obvious that the earning basis is not the proper one upon which to base capitalization, for the reason that public utilities being subject to rate-fixing, capitalization based on earnings would have entirely different security and probability of payment were these rates changed by a rate-fixing body tomorrow. Hence, the Commission has long since determined that a safe basis for determining what capitalization should be permitted on a given property, is the value of such property.⁴⁵

How that value is to be determined is not indicated and, in the majority of decisions rendered, the statements on valuation are as indefinite as the one quoted, but the figures arrived at and the methods used in ascertaining them indicate that consistency has been maintained. Furthermore, the writer has discovered no decision in which reproduction cost has been allowed as a basis of valuation for security issues. On the contrary, it has been condemned many times as being unsuitable for such purpose. In *Application of People's Water Company*⁴⁶ for reorganization, the commission presented an extensive analysis of valuation for new security issues. This utility had got into financial difficulties and found it necessary to reorganize. It was felt that it would be to the public interest to avoid foreclosure if satisfactory arrangements could be made. The engineer of the applicant urged that reproduction new, less depreciation, should be used as the basis for determining the value of the plant. The commission did not feel that this was proper and then indicated that the method to be used was similar to that employed in rate-making cases. It pointed out that capitalization of earnings is appropriate in finding the value of commercial property. Public utility earnings, however, are fixed by the rate-making body. Hence, an independent basis must be found and this is the valuation of the property upon which the return is calculated. This in turn determines the earning power of the plant.⁴⁷

An estimate by the applicant of \$900,000 for the reproduction cost of paving over mains was rejected because this item admittedly cost the company nothing. The amount allowed on this score was only the cost of the paving which the company had actually paid for. Similarly,

going-concern value was limited to an approximation of cost. When proof is established that reasonable expenditures have been made by a utility in obtaining its business, these may be capitalized in a manner similar to any other legitimate item of investment."

The theory of reproduction cost as the correct basis for determining valuation for security issues came definitely to the fore in the years just preceding the depression. Applications for consolidation of properties were very numerous and holding-company activities in the acquisition of operating utilities called for special attention. It was under these circumstances that the California Railroad Commission took the unequivocal stand that valuation for security issues, capitalization, or purchase must be determined by precisely the same principles as valuation for rate-making.

The most extensive discussion of this issue was given in *California Water Service Company*,⁴ a Foshay affiliate. On two previous occasions the commission had passed on this case and had reaffirmed its stand on valuation. However, on the theory, apparently, that perseverance brings success, the company made a petition for rehearing in which the policy of the California authorities was directly challenged. First of all, the commission reiterated the previous decision, in which it had said:

In authorizing the issue of stocks and bonds the Commission has heretofore held that the actual cost of constructing public utility properties, or if such cost is not known, the estimated original cost giving due regard to the earnings thereof, is the proper basis for the capitalization of the properties. In case of refinancing existing properties, consideration must be given to depreciation. To deviate from this policy merely because someone has acquired operating public utility property and for some reason has seen fit to pay for the property more than its actual or estimated cost depreciated, is in our opinion neither sound finance nor in the public interest. We believe that when we are called upon to authorize the issue of stock and bonds to refinance public utility properties, we should adhere in general to the same principles as are followed by us when authorizing the issue of securities to finance properties to be constructed anew. An estimate of what it would cost to reproduce the properties now, whether depreciated or not, an alleged sound value or even what a purchaser may have or has agreed to pay for the properties, are too fanciful to warrant serious consideration."

The authorities pointed out that their policies had been satisfactory both to the utilities of the State and to the public and that they saw no reason for changing their attitude merely because persons from outside California wished to invest in its utilities. They also emphasized the effect of slight variations in prices on common stock equities if "reproduction cost new were used."⁴⁶

In *Coast Counties Gas and Electric Corp.*, application was made to recall stock in exchange for a new issue based on revaluation. To this the commission replied that it had never allowed a utility to refinance because the reproduction cost new exceeded the investment against which securities had previously been issued. In the present case, the original cost of all the property was not available. The authorities felt, however, that rate bases already established, plus additions, betterments, and net current assets gave the maximum figures that could be used for capitalization purposes.⁴⁷

The foregoing discussion does not warrant the conclusion that valuation and capitalization are synonymous; quantitatively, nor does it mean that the value of the property is the sole basis upon which an application to issue securities is appraised. Other factors, as will be pointed out below, must be given due weight, but the commission does not authorize securities where the "fair value" of the property is less than the money or equivalent which is received in return.⁴⁸

The principles which govern the determination of the fair value of public utility property also set the standard for reasonably capitalizable items. Anything which is rejected as being inappropriate for inclusion in the valuation figure is also excluded from the purposes for which securities may legitimately be issued. Much detail is involved in this connection and the commission constantly has to decide whether a particular item adds to the investment in the property and, if so, what the precise amount is.

Expenses connected with promoters' services and the organization of an enterprise are legitimate for capitalization if they are honestly and wisely incurred. On numerous occasions it has been stated that reasonable promotion and organization expenses are as necessary to the success of a utility as is investment in physical plant and may just

as legitimately be capitalized. Whenever possible, actual expenditures are ascertained and inquiry is made, with respect to the time given to organization by the promoter. In estimating the value of promoters' services the commission has been liberal in order to attract ability and to assist in the development of the utilities of the State. Additional remuneration is frequently allowed also, in order to compensate for risk of failure and for money invested by organizers.¹⁰ Thus, in the application of *Central California Gas Co.*, careful examination of the facts convinced the authorities that \$22,000 was a fair figure for promotion and organization expenses. Against this figure the commission allowed \$27,500 par value six per cent preferred stock because it was expected that the stock would sell at 80. The corporation, however, had legally issued \$15,000 of this stock before the effective date of the Public Utilities Act, so it was now authorized to issue \$12,500 to make up the total.¹¹

When, however, individuals take stock without having rendered an equivalent in return, the commission voices its disapproval and takes such steps as it can to correct the resulting evils. This was the stand taken in *Economic Gas Company*, in which case it was found that \$1,500,000 of stock had been issued to the promoters, the corporation having received no benefits therefrom. It was recognized that the promoters held legal title to the stock but the authorities registered strenuous objection to the practice whereby utility corporations issued such stock when nothing had been paid into the treasury for it. The constitution and laws of California intend that payment shall be made into the treasury and this intent is not altered by the fact that the promoters take the stock as their own property, sell it to the public, and pocket the proceeds.¹²

In practically the same category as promoters' profits is the item of intercompany profits. The *Southern Sierras Power Company*¹³ made application for an issue of bonds. An analysis of the company's affairs disclosed that the properties of the applicant had been constructed by affiliates and that intercompany profits appeared in the construction costs. The Southern Sierras Company also purchased power from the Nevada-California Power Company and the latter guaranteed the

bonds of the former. The commission disapproved the practice with respect to intercompany profits, demanded an elimination thereof, and also ordered an accurate accounting for all the operating relations between the Southern Sierras and its affiliates before the final order was given for the bond issue.¹⁰

This same question came to the fore again in *Pickwick Stages System*. The authorities found that the prices which the company was to pay for its equipment were excessive because of arrangements with the parent company to construct the equipment. The commission reiterated its refusal to permit a construction company to profit at the expense of a public utility when the former controlled the latter.¹¹

Pickwick Stages, subsequently, protested the ruling on the ground, among others, that the order was unconstitutional, *ultra vires*, and took property without due process of law. To this the commission replied that the authority granted could not deprive the applicant of the right to earn a reasonable return upon its investment. Rate cases and applications to issue securities present two distinct situations; valuation in a rate proceeding is not limited by securities outstanding nor by the figures contained in fixed capital accounts. As a matter of fact, the logical and actual approach is really the reverse of this.¹² Consequently, the manufacturer's profit was not allowed although recognition was given to overhead costs and depreciation on equipment used in the construction of the properties.

Mention was made earlier¹³ of the fact that the law is somewhat ambiguous on the question, Are expenditures for the maintenance of service properly capitalizable? This was dealt with in *Oakland, Antioch and Eastern Ry. Co.*¹⁴ The applicant was in financial difficulties and asked permission to issue notes and bonds to meet certain requirements. Protestants argued that the proceeds were to be used for items not properly capitalizable and contended that the commission had no power to authorize the issuance of bonds, stock, or other evidences of indebtedness, the proceeds of which were to be used for operating expenses or to care for a deficit caused by the operation of a utility. Commissioner Edgerton replied that the legislature had placed wide discretion in the commission to pass upon proposed capitali-

zation of public utilities and that the regulatory agency had the power to approve such a capitalization as the applicant requested. The commissioner, however, objected on principle to such a procedure, maintaining that expenses could be capitalized only in extraordinary cases. He said:

I am not here contending the operating expenses or the cost of maintaining service should ordinarily be capitalized. In fact, I believe only in extraordinary cases should this be permitted, but I do contend that the Commission has the power in proper cases to make such authorization.⁶²

The company was granted permission to issue bonds for payment of bond interest where it had been earned but spent for capital purposes; the commission refused, however, to allow the capitalization of bond interest expended on noncapitalizable items. In another case⁶³ the capitalization of interest on the money being used for construction purposes was rejected because the concern was in operation. This differed from the preceding situation since, in the latter case, income, which might have been used for paying interest, was not expended for capital purposes.

Past deficits are normally not capitalizable⁶⁴ since fair return is fixed as of the time of the inquiry. However, the amount by which a utility has failed to earn a fair return during a reasonable developmental period (usually about five years), provided that the amounts were not counterbalanced by earnings in excess of a fair return at a later date, may be capitalized.⁶⁵

Discount and premiums on securities issued have been handled in a way similar to that of dealing with other items. Ordinarily, these are connected with the cost of capital and must be amortized out of fair return. When, however, this has not been done because the earnings have been expended on property appropriately chargeable to investment, securities may be authorized against such discount or premium. This is merely another way of authorizing the reimbursement of the treasury for capital expenditures.⁶⁶

The rulings in regard to the capitalization of bond sinking funds and depreciation funds have been made on the same basis. The purpose of sinking funds, ordinarily, is to reduce indebtedness. This must

be done by the stockholders and may be accomplished either by the sale of stock or by the accumulation of a surplus. When the objective of the sinking fund is to reduce outstanding indebtedness, this fund must be accumulated either from earnings or from some source which does not create new obligations. To permit the capitalization of such money would be to defeat the purpose for which the appropriation was made. On the other hand, if the sinking fund arrangement is merely designed to protect the bondholders and the financial position of the utility is such that the continuation of the existing amount of outstanding indebtedness is warranted, then the capitalization of the fund will be allowed.⁷⁶

When the reserves for sinking funds appear in surplus out of which dividends may be declared, the application will be refused.⁷⁷ Nor is it possible to treat these items as an operating expense,⁷⁸ but when the funds have been invested in appropriately capitalizable investments or it is desired to increase the property, and this is in the public interest, reimbursement is possible.⁷⁹

Depreciation funds are not capitalizable, because they can, under no circumstances, represent additional investment in property. Depreciation is an operating expense, covered by rates prescribed, and in all cases involving security issues where it is necessary to examine the property as a whole, the commission demands that adequate allowance for depreciation be made. Thus, in the application of the *Valley Natural Gas Co.* to declare a stock dividend, it was found that the company had made an inadequate allowance for depreciation. Since the property of this utility had a short-term life, the function of the depreciation reserve was to return the investment to the investors. However, no matter what the circumstances may be, depreciation accumulations cannot be capitalized. Consequently, the commission ordered that the surplus be adjusted before the securities were authorized.⁸⁰

Although the law specifically provides that franchises, contracts for merger, lease, or consolidation, operating rights, and so forth, shall not be capitalized at more than the amount paid to the governmental agency granting them, nevertheless, the commission has been forced,

time and again, to reject applications made under various pretenses to do so. This, of course, conforms to the rulings in regard to valuation.¹¹

Motor-transport companies have continually appeared before the state body seeking permission to cover alleged costs of securing franchises and operating rights. Thus, the *United Stages Co.* applied for authority to issue stock to acquire the Morgan Motor Co., and said that \$24,500 represented the cost of various franchises. Nothing had been paid for these, and the testimony showed that this really was claimed for the cost of developing the business. The request was denied.¹²

EARNING CAPACITY AND FINANCIAL STRUCTURES

THE PROSPECTIVE earning capacity of a utility is a factor which is given thorough consideration by the commission when it is passing on applications for security issues. Before the authorization is made, it is necessary to show that there are reasonable prospects of providing for fixed charges together with a margin that will accrue to stockholders. The moral responsibility the authorities have assumed in regard to the authorization of security issues necessitates a careful examination of prospective earnings. Furthermore, in its rate-making capacity the commission assures the utilities of an income adequate to make them financially successful if this is possible, and if the financial structure is sound. Hence, when new securities are applied for, steps are taken to ensure sound finance, or at least to see that there are reasonable prospects for the success of the enterprise. Thus, rate-making and security regulation are definitely integrated although the decisions clearly indicate that the former is primary.

In *Los Gatos Telephone Co.*, the utility applied for permission to issue capital stock of par value of \$15,000 to be sold at par. Of the money derived, \$12,000 was to be used to secure a lot and erect a building thereon. It was evident that the applicant would have to look for new business if it was going to pay the usual dividends on its present outstanding and additional capital stock. This presented some uncertainty. The commissioner in charge was unwilling to say that the company should not make the proposed expenditures, but he drew at-

tention to the necessity of conserving resources for future expansion. He also stated emphatically that a utility's first duty is to serve its public adequately and at reasonable rates, regardless of the expansion program it undertakes.⁷²

Again, in *San Francisco-Richmond Ferry Co.*,⁷³ the oft-repeated statement was reiterated that regulation does not ensure public utilities against failure in the event that good judgment is not used in financing and construction, but that rates will be fixed with the objective of providing a reasonable return on money wisely expended in serving the public. In the application of *Pacific Gas & Electric Co.*, for an increase in rates it was found that the company was not earning a fair return and that the cost of new capital was rising.

The evidence introduced showing the increased cost of money shows that while certain securities cost approximately 6 to 6½ per cent prior to the war, the financing during the past year and one-half has been at a rate of between 7 and 9 per cent, and the money which has been borrowed by the Pacific Gas & Electric Company to carry on the development it is now commencing, according to the evidence, is costing 8.88 per cent. It is apparent that the former rate of return cannot apply to additions and betterments of applicant when the present money is costing it from 1 to 2 per cent in excess of moneys previously obtained.⁷⁴

In fixing the fair return, 9 per cent on the new capital was allowed.

A great deal of leeway is granted to management in financial matters, especially where it is demonstrated that an applicant's financial position will be improved. If doubt exists, the issue is resolved in favor of the utility. In *Stockton-Terminal & Eastern Railway Co.*, the corporation sought permission to issue bonds for extensions and improvements. The company was operating at a deficit, but it was expected that this would be corrected by the new constructions. The evidence presented left some doubt that the concern would earn the revenue it anticipated. It was felt, however, that the doubt should be resolved in favor of the railway. The commission cannot say that an enterprise will succeed. The best it can do is to obtain reasonable assurance of success and to see that money obtained from the sale of securities is invested in the property.⁷⁵

Nevertheless, the authorities are very cautious when bonds are applied for and take every care to see that there is little prospect that the bonds will not be adequately protected.

I think where the whole enterprise is to be financed upon the sale of bonds, that this Commission should be put upon information showing the feasibility of the enterprise. A different situation would be created if the promoters proposed to expend their own money to finance this enterprise because being on full information, people should not be restrained from investing their money in enterprises calculated to develop the country even where considerable risk may be entailed on making such investments. But we are asked to authorize the issuance of bonds which will be sold to the public, to some extent on faith of the Commission's authorization.⁷⁷

It should not be concluded from the foregoing remarks that the California Commission passes upon security issues and then in subsequent rate proceedings fixes a fair return designed to pay interest and reasonable dividends on the securities outstanding. The reverse is nearer the truth. Rates are designed to yield a fair return on money reasonably and wisely invested, which means, of course, that, normally, the securities of a soundly financed utility will be a good investment. The opinions on applications for security issues indicate clearly that the estimates of future earnings are based on independent calculations and that authorizations are designed to fall within the rate-making formula. The authorities are aware of the implications, however, and always take steps to protect themselves on this matter.⁷⁸ A utility must see to it that its financial structure is such that reasonable financing is possible. Thus, in *Southern Sierras and San Francisco Power Co.*, it was found that the company required applicants for service to advance the total amount for extensions costing more than \$50. The company paid 6 per cent interest on this and returned the amount by a 20 per cent deduction from monthly bills. The reason given for this procedure was that financial difficulties made it impossible to borrow the necessary funds because the utility could not sell its bonds; and lack of revenue prevented it from making the necessary extensions. The commission drew attention to the fact that any utility which wishes to continue its existence and maintain its monopoly must put itself in a financial position which will enable it to meet the demands of its

territory. If reasonable financing is impossible, the situation must be remedied promptly, even if this requires drastic action."⁷

As a matter of general policy, the California commission during the early years of its jurisdiction held to the principle that a public utility should not encumber its property for more than 80 per cent of its value.⁸ This, of course, meant that the authorities looked with disfavor upon any application for obligations of indebtedness which resulted in a long-term debt structure exceeding 80 per cent of the value of the property. As a rule this stand has also applied to the acquisition of new property and extensions, although in exceptional instances bonds have been authorized up to the full amount of the property to be purchased. Where an unusually large unbonded equity existed, wisdom might dictate the issuance of bonds for the full amount of the new construction. If this were not the situation, both stocks and bonds should be used.⁹ The public has a direct interest in the capitalization of a public utility corporation because the absence of conservative financing means inevitably that consumers suffer from lack of service.¹⁰

An interesting exception to the rule was provided in *Citrus Belt Gas Company*.¹¹ This involved the transfer of properties approximating \$550,000, which was less than the indebtedness against them. The commission authorized the assumption of a mortgage of \$350,200, issuance of a note of \$25,000 to cover minor obligations, and \$200,000 par value of stock for general creditors. The stock, however, was unsatisfactory to banking institutions who were creditors. This was adjusted by authorizing certificates of indebtedness of \$200,000 bearing interest not to exceed 5 per cent and variable at the option of the company. The case was decided on May 5, 1915, and it provided that the certificates must be converted into stock before January 1, 1918, at the ratio of one and one-quarter shares of stock for each \$100 certificate. The certificates were to be placed in escrow pending the exchange.

In the years following the war the commission adopted the policy that bond issues should not exceed 60 per cent of the depreciated historical cost of public utility properties.¹² Thus, in *Southwestern Gas and Fuel Company*,¹³ the authorities stated that it was their policy not to allow bonds to exceed 60 per cent of the cost or reasonable value of

property to be acquired except under extraordinary conditions. The writer has not been able to discover in any decision the reason for this change in policy, but it seems to have become a permanent one.

Decisions have been rendered which indicate that preferred stock is considered to be in practically the same category as bonds because of the implications arising from the dividend contract.

While the holder of preferred stock occupies no different relation to the public than does the holder of common stock, yet the buyer of such stock purporting to bear interest at a certain rate expects that the interest will be paid. When this Commission authorizes the issuance of bonds at 6 per cent and preferred stock at 6 per cent, in an aggregate sum in excess of the value of the property to be acquired from the proceeds thereof, and thereafter fixes rates on the fair value of the property devoted to the public service, it may follow that the purchaser of the preferred stock cannot receive from the legitimate income which is the result of reasonable rates the interest which his preferred stock specifies."

In agreement with this attitude was the decision made in *Northern California Power Company*, a request to sell preferred stock to stockholders at 80. The commission stated that an issue of preferred stock calls into question the entire condition of the property involved." An appraisal of the utility had not been made nor had the equities been determined. Hence, the order was rendered with the stipulation that the present stockholders of the company should supply any deficiency, that might be discovered, between the obligations of the applicant and its preferred stockholders on the one hand and the value of the property as fixed by the commission on the other."

In authorizing bonds against property the commission scrutinizes the relation existing between the par value of the bonds and the value of the property. When bonds are sold at a discount it is not permissible to sell bonds enough to provide all the money to be raised. Only in exceptional circumstances do the authorities allow bonds to be issued at the par value of the purchase to be made. Under any circumstances, if the bonds cannot be disposed of at par, it is evident that the difference between the par value of the bonds and the value of the property must be supplied in some way by the stockholders. In this manner, overcapitalization by bond issues is generally prevented."

Where the conditions mentioned above do not obtain, other steps are taken by the authorities to assure the position of the bondholders. Thus, in the application of the *Tonopah and Tidewater Railroad Company*⁸⁰ to issue \$364,000 of bonds it was found that the value of the property did not equal the outstanding indebtedness of the applicant and that, furthermore, the company was unable to pay all its existing bond interest out of earnings. The Borax Consolidated, Limited, of London had made up the deficit. The application was denied because insufficient proof had been furnished of the value of the guaranty of the London company in the present application. Again, in the case of the *Coast Valleys Gas and Electric Company*⁸¹ application was made to issue \$100,000 of 6 per cent bonds for the purpose of retiring certain notes and financing additions and betterments. The purposes for which the bonds were to be issued were quite valid, but a question arose with respect to the applicant's liability as guarantor of principal and interest of the bonds of the Monterey and Pacific Grove Railway Company, which had defaulted on its interest payments. The commission recommended that the difficulties be adjusted and that the company do nothing to weaken the position of the bondholders in question. Consequently, only \$10,000 of bonds were authorized for extensions, which it was estimated would strengthen the position of the utility by bringing in revenues many times the interest charges incurred.

When the situation seems to warrant the authorization of bonds, but the future of the business is somewhat uncertain, other steps may be taken to avoid financial embarrassment. In *Oakland, Antioch and Eastern Railway*⁸² it was felt that the authorization of the bond issue applied for was warranted, but that earnings for a few years were an uncertain quantity. As a condition of its sanction the commission required that the railroad raise by stock assessment, if so ordered by the commission, the amount necessary to extinguish any deficit that might accrue from operation, maintenance, repairs, taxes, and bond interest during the first three years of the life of the bonds. A similar stand was taken in *Clear Lake Railroad Company*.⁸³ This involved the construction of a new railroad for which it was necessary to raise \$661,705.30.

For this purpose the authorities sanctioned a \$500,000 bond issue to be sold at 80 and ordered that the remaining \$261,705.30 be raised from the sale of stock at par, all of which was to be subscribed for and sold before the bonds were issued. The company also had to present a plan "of either securing from the purchasers of the bonds a waiver of the interest during say the first five years or a guarantee from responsible parties satisfactory to the Commission that such interest as was not waived would be paid."¹⁰⁴

Overcapitalization can obviously arise in connection with stock issues. A great deal of the time, the sale of these at less than par has been sanctioned. This, coupled with the fact that stock is frequently authorized to supply funds needed, over and above that realized from the sale of bonds, continually presents a situation of technical overcapitalization. Evidence with respect to the commission's attitude on this point is decidedly obscure. There have been indications that the authorities regard the par value feature as objectionable, since common stock in the end is only a residual claimant.¹⁰⁵ However, stock can be disposed of only for authorized purposes, and below 80 per cent of par only in exceptional instances. The problem of future financing is always given careful attention when applications for the issuance of securities are acted upon and in view of the fact that the commission requires that stocks as well as bonds be used in raising capital, overcapitalization is necessarily discouraged. Stock assessments have frequently been resorted to in order to protect future financing. When reimbursement for expenditures made out of earnings is requested, the genuineness of the accumulated surplus, as we shall see below, must be established. Finally, the commission has on occasion criticized dividend policies on the ground that disbursements have been made when surpluses should have been accumulated to increase financial strength.¹⁰⁶ Overcapitalization in regard to new securities does not arise, because such securities cannot be issued except for value received, and the conclusion seems warranted that the elimination of even technical overcapitalization is encouraged by relating security issues to earnings so as to make possible accumulations of surplus.¹⁰⁷ The correction of financial structures, unsatisfactory because of conditions

obtaining prior to the commission's jurisdiction, presented obstacles, but even here the same objectives obtained. Securities authorized, whether for refunding or new acquisitions, have been designed to improve financial structures deemed to be unsatisfactory.¹⁰⁹

CONDITIONS OF SALE OF SECURITIES

WHEN APPLICATIONS for the authorization of securities have met the tests required by valuation, prospective earnings, and public interest, it is still necessary to impose conditions upon their sale. From the beginning the commission has avoided arbitrary procedure and has endeavored to safeguard both the utility and the public. In all cases the minimum sale price is fixed and that price is determined by what the authorities believe to be the best market price obtainable at the time of the application.

An illustration of this attitude was given in the request by the *Southern California Gas Company* for permission to sell \$1,000,000 of first and refunding bonds at 93½. On September 26, 1921, the utility had entered into a contract, subject to the commission's approval, for the sale of these bonds at that price. The application for authorization was not filed until October 10, and the matter was finally submitted on October 28. In the meantime, conditions of the market had changed. The authorities refused to be governed by the contract. They felt that market quotations, at the time the application is passed upon, should be controlling. Hence they ordered a minimum price of 95 and accrued interest, without the payment of any commission or brokerage fee whatsoever.¹¹⁰

As a general rule a sale price below 80 per cent of par is frowned upon although it may occasionally be permitted.¹¹¹ In *Pacific Gas and Electric Company*,¹¹² the utility had arranged to give capital stock at \$65 a share for property. The commission approved the entire transaction, of which this was a part, but stated that it would estimate that at least \$80 had been received from each share of stock and that any excessive amount paid for the property would have to be written out of surplus. Somewhat the reverse of this situation was presented in *Mill Valley Railway Company*.¹¹³ The company wished to sell new

stock but could not get more than par for it. The value of the property appreciably exceeded capitalization. To protect themselves the stockholders proposed to organize a new corporation, issue new stock to themselves on a 3 for 2 basis, and then raise the necessary funds by the sale of new stock at par. To this plan the authorities assented.

In the application of the *Standard Oil Company*, the commission evidenced its disapproval of the sale of stock to stockholders at par when the market price is appreciably higher.¹⁰⁰ The stock was selling at \$277 a share. It was felt that as a general policy such a procedure was unwise. It was pointed out that a utility's ability to raise new capital is a matter of consequence to the public, and especially so to the company's patrons. Capital stock is an important means of raising new money. Sale of that stock at less than market value deprives a utility of part of its opportunity to do so and to that degree the public is injured.¹⁰¹

Sanction was given to this particular application because the Standard Oil had always followed the policy of selling stock to its stockholders at par and there was no doubt that the company would be able at all times to finance that part of its business which fell into the category of public utility. Departure from the customary method of financing used by the Standard Oil might be a matter of serious embarrassment. The commission was not concerned, of course, with the effect of the authorization on the nonutility part of the business.

A similar situation was encountered in a number of applications presented in 1929,¹⁰² in which the companies all sought permission to issue stock to stockholders at par, although earnings and market price showed a much higher value. The commission did not seem to regard these requests with favor, although in each application authorization was granted. The attitude on this matter was expressed by the following statement:

It is urged that we should continue to permit the company to issue its common stock at par regardless of what the market price of such stock might be. We do not agree with this general conclusion for the reason that we believe that the public has an interest in the price which the company receives for its stock. However, the relation between applicant's rate-base,

as disclosed by previous decisions of the Commission, and reports filed by applicant, and its outstanding securities, is such as to warrant the granting of this application. It should be understood that if the Commission is hereafter called upon to fix applicant's rates or any of them, it will not regard the dividends paid on common stock issued by applicant at par when the market value of such stock is substantially above par, as representing the cost of money obtained through the issue of such stock.¹⁰⁸

Reclassification of common stock by the reduction of par value has received the sanction of the authorities on the ground that a better market price could be obtained and hence the public would be benefited.¹⁰⁷ In *Modern Warehouse, Inc.*,¹⁰⁸ however, application was made to transfer properties to a new corporation, to reduce the outstanding capital stock, and to distribute the stock of the new corporation to the present stockholders in proportion to their holdings. The commission ruled that it had no jurisdiction over the diminution of outstanding stock nor over the distribution of the stock received in payment for the properties. In connection with no-par stock it has ruled that this should not be sold for less than \$25 a share.¹⁰⁹

The price at which bonds should be sold to a holding company was determined by market comparison in *Southern Sierras Power Company*.¹¹⁰ The applicant wished to sell these to the controlling concern at a yield of about 6.9 per cent. The market price of the bonds of other utilities indicated, however, that they could have been marketed on a 5¾ per cent basis. Consequently, it was ordered that this price or better should be obtained.

Excessive commissions on the sale of securities are forbidden and the authorities require that these commissions be paid only on the actual cash received. Thus, in *Big Four Railway Company*,¹¹¹ it was found that the Avery Investment Company was to sell all the stocks and bonds which the applicant might issue at a commission of 15 per cent. Furthermore, the investment company had been a party to a transaction whereby 6,000 shares of stock of the applicant had been exchanged for 4,000 shares of stock of the Tidewater and Southern Railroad Company and a similar commission had been paid on this. The Railroad Commission disapproved of the 15 per cent as being ex-

cessive, severely criticized the contract with the investment company, and forbade the practice of paying commissions on stock sales except for actual cash received. Similarly, it disapproved of the 15 per cent commissions proposed by the *Golden Gate Ferry Company* and also of the proposal that the applicant's management be paid as salesmen on the ground that "they should receive a reasonable compensation for their services rendered and such compensation should not be dependent upon their success of selling securities."¹²⁸

The matter of profits which may legitimately be allowed to promoters has received an appreciable amount of attention by the California Commission. The attitude which has been maintained consistently on this point is that promoters are entitled to reasonable compensation for their services, and that their work is useful and to be encouraged. Before they are allowed to receive their rewards, however, the fruits of their work must be established, and whether they benefit or not depends upon the success of the enterprise which they foster. The payment of the promoter's fee must be in the manner and at the time designated by the commission. In *C. A. Irwin and Winters Gas Company* a fee of \$2000 was allowed and common stock of the par value was authorized to be issued as payment. The value of a promoter's services to a community depend upon the completion of a project and its subsequent successful operation. Hence, the order provided for the immediate issuance to Mr. Irwin of stock of the par value of \$500. The remaining \$1500 was to be turned over to him after the plant had been completed and placed in operation and only upon a specific order of the commission.¹²⁹

The fact that stock may have been issued legally to promoters but without the commission's consent does not prevent steps from being taken to compel restitution. When the *Economic Gas Company* made application to issue securities it was found that all the common stock had been issued to the promoters before the passage of the Public Utilities Act. In answer to the request under consideration, the commission gave only a modified order for the issuance of bonds and pointed out that it would be necessary for the company to raise some money from stockholders. Because stock had been issued to the pro-

moters from whom no compensation had been received by the treasury, this order stipulated that no more money could be realized from bonds until the utility had raised something from the stock which the promoters held.²³⁴

The authorities also refuse to allow the issuance of stock, even without par value, for control purposes only. Thus in the application of *Western Warehouse and Transfer Co.*²³⁵ to issue stock, attention of the company was drawn to the fact that requests, by utilities, to issue stock for control purposes had been denied repeatedly. The policy in this State has been to see to it that control of a corporation rests in those individuals who purchase stock and pay cash therefor. The mere fact that no par stock was involved in this request was of no consequence. The intention was to give control to one George F. Schneider who had supplied less than 20 per cent of the tangible capital. The request was denied.²³⁶

Because of its determination to see that enterprises applying for authorization of security issues have reasonable assurance of success, the commission has found it necessary to safeguard investors against purchasing securities in a business which is unable to raise capital adequate to embark upon the undertaking. The usual procedure in this event is, to quote:

In the case of new utility enterprises the Railroad Commission in various instances has required that the proceeds obtained from the sale of stock and bonds be deposited in a bank with some trustee until such time as the promoters have sold a sufficient amount of securities to carry their enterprise to a successful completion. If unable to comply with the terms and conditions of the Railroad Commission's order, the money is returned to the subscribers or purchasers of the stocks and bonds.²³⁷

In agreement with this view was the ruling in the *Big Four Electric Ry. Company.*²³⁸ The applicant did not have money enough to assure the completion of the enterprise, so it was required to impound all money received from the past or future sales of stock and had to obtain the consent of the authorities before it could use any of these funds. This order did not apply to the expenditures arising in connection with a grading contract nor to the necessary current office expenditures. Simi-

larly, in *San Rafael and San Anselmo Valley Railway Company*,¹²⁸ in order to safeguard the investors, it was required that construction should not begin until 90 per cent of the bonds authorized and 90 per cent of the stock had been subscribed by responsible parties and until the sum of \$50,000 in cash had been paid into a separate bank account. Later on, it was discovered that these conditions could not be met. Permission was sought to return the money to the subscribers, less deductions for expenses incurred. The commission fixed the reasonable expenses and ordered that the balance be paid ratably to the subscribers.¹²⁹

Finally, the issuance of assessable stock is not allowed and stock cannot be turned over to subscribers until it is fully paid for. Thus, the application of the *Alameda Belt Line*¹³⁰ to sell all its stock on the condition of an initial payment of 10 per cent of the par value, and the balance of the subscription to be paid when called for, was refused. The commission stated that it had not been its policy to authorize the issuance of assessable stock and that neither stock nor stock certificates should be issued until they were fully paid for. It should also be noted that the authorities object to the sale of noncallable long-term bonds, although they gave permission to the *San Joaquin Light and Power Company* to issue thirty-year noncallable bonds because of exceptional circumstances.¹³¹

SHORT-TERM FINANCING

THE PUBLIC UTILITIES ACT states that utility corporations may issue notes for proper purposes, if such notes are payable at periods of not more than twelve months after the date of issuance, without the consent of the commission. These may not be refunded, however, without due application. This part of the legislation and the reason for its enactment was discussed by Commissioner Thelen in *Pacific Gas and Electric Company*.¹³² He pointed out that it was the intent of the law to enable utilities to obtain short-term loans on promissory notes and to take care of emergency matters without the necessity of applying for an order of authorization. The purpose of requiring commission sanction for refunding, if the final date of payment was more than

twelve months from the date of original issue, was to prevent utilities from taking their financial operations out of the jurisdiction of the commission.¹²⁹ The word "refund" was interpreted to mean: "... that no note issued for a period of not more than twelve months without the consent of the Commission shall be refunded or taken up by any note 'of any term or character,' whether running to the same payee or another payee."¹³⁰

The fact that the law was designed to allow flexibility in short-term financing has led the authorities to regard with disfavor the use of short-term notes for the financing of additions and betterments. Money for these must be provided by more permanent means.¹³¹ When the market for long-term securities is unfavorable notes may be allowed. In *Antioch and Eastern Ry. Company*,¹³² the applicant sought to execute notes to pay off a part of the floating debt and to pledge bonds in a 2 to 1 ratio as security. The commission gave its sanction because the bond market was not favorable at the time.

Demand notes must receive the approval of the authorities because it is possible that they may not be called within twelve months. Collateral trust notes of any maturity must be authorized because the securities pledged require sanction.¹³³ Similarly, interest coupons attached to bonds have been designated as "notes" and "evidences of indebtedness" and must be sanctioned in so far as they are payable at periods of more than twelve months from the date of issue.¹³⁴

HYBRID CORPORATIONS

BECAUSE THE COMMISSION has jurisdiction over the financing of all public utilities, enterprises doing both a utility and a nonutility business find it necessary to seek permission to issue securities. This matter first came to the attention of the authorities in *Farmers' Warehouse Company*,¹³⁵ an application to issue capital stock. It was pointed out by Commissioner Eshleman that hybrid organizations present a difficulty in the disposition of the proceeds of security sales. The language of the statute contemplates a public utility business, and a strict construction of the law, he believed, would prevent dual activities. He felt that, in many businesses, joint operations are desirable and, therefore that the

law should be interpreted as embracing them. It was necessary, however, to keep careful records of the different businesses, to see that the utility activities were not burdened with an unreasonable part of the expense of the entire enterprise, and to see that any of the proceeds of the securities devoted to the utility part of the business should be strictly in accordance with the Act. Although authorization was necessary, irrespective of the purpose for which the funds were to be used, the commission had no jurisdiction over the disposition of that part of the proceeds devoted to the nonutility part of the business. It was emphasized that it was desirable to separate the activities into distinct corporations whenever possible.¹⁰⁰

Subsequent decisions have been precisely the same as the one stated above, and in the application of the *Winterburn Improvement Company*,¹⁰¹ authorization was denied because the affairs of the two businesses which the company conducted were so inextricably interwoven as to make the separation of records impossible. The commission ordered a readjustment so as to limit the petitioner's business to public utility. In the same connection the authorities have ruled that they have no power to allow the encumbrance of public utility property for nonutility purposes.¹⁰² Jurisdiction has even been exercised over the securities of a corporation which was not engaged in public utility business, but which was permitted, by its articles of incorporation, to participate in such business. *Los Angeles Terminals Inc.*,¹⁰³ was in this category and it sought authorization to issue securities in order to remove all doubt of their legality. The case was passed upon in the usual manner.

REIMBURSEMENTS AND STOCK DIVIDENDS

WHEN UTILITIES make application to issue securities to reimburse the treasury, it is necessary to satisfy the authorities, first, that the money was spent on properly capitalizable items, and second, that the funds so disbursed were contributed by the stockholders or out of surplus earnings which might have been distributed to the stockholders.¹⁰⁴ In *Mill Valley and Mt. Tamalpais Scenic Ry.*,¹⁰⁵ it was pointed out that it was necessary to show not only that the expenditures could appropri-

ately be refunded, but also that the capitalization would be reasonable after this was done.

This stand has been reaffirmed many times. When *Haines Canyon Water Company* applied for authorization to issue bonds to reimburse its treasury on the theory that it was entitled to do so, because \$24,633.94 had been expended on additions and betterments, the commission said:

Such a conclusion does not necessarily follow. Section 52 of the public utilities act requires the Commission to make a finding that the money, property and labor to be procured and paid for through the issue of securities is reasonably required for the purposes stated in the Commission's order, and further provides that a public utility may issue stocks, bonds, notes or other evidences of indebtedness if authorized by the Commission for the reimbursement of moneys actually expended from income or from any other moneys in the treasury of the public utility not secured by or obtained from the issue of stocks, bonds, notes or other evidences of indebtedness.¹³⁶

When permission is sought to reimburse the treasury for expenditures from surplus, it is necessary to show that the accumulations are legitimate.¹³⁷ On the same basis disbursements spent from depreciation funds on items legitimately capitalizable may be used as the basis for security issues.¹³⁸ Similar treatment is accorded sinking funds if the money could legitimately and wisely have been disbursed as dividends.¹³⁹

Akin to the question of reimbursement is that of stock dividends. The commission has pointed out that the Public Utilities Act makes no provision for a stock issue as a bonus against surplus and therefore the authorities do not possess the power to grant such an application.¹⁴⁰

However, virtually the same thing has been accomplished in other ways. In *Campbell Water Co.* the utility showed that it had accumulated a genuine surplus out of earnings. It made another application in which it asked permission to form a new corporation and to transfer the property to it. This was allowed and thus the surplus was capitalized.¹⁴¹ It has been held, on the contrary, that when a company has re-invested stockholders' money, stock may be issued against it. Such stock may then, at the option of the company, be distributed as a dividend.¹⁴² The distinction between reimbursement and a stock dividend

is that the former requires a complete investigation into the sources and uses of the funds involved in the application. When the reimbursement is authorized, the commission investigates the accounting carefully and demands any adjustments in surplus necessary to conform to its rulings.¹⁴³ This issue came prominently to the fore in the years of prosperity following the World War. A very large number of applications to issue stock dividends were made and the commission was forced to analyze surplus carefully to see whether or not reimbursement was warranted. On innumerable occasions it was necessary to emphasize that many items customarily appearing in company surplus accounts were not appropriate for capitalization. In the request of *Bell Water Company* to issue stock for the purpose of paying a dividend, the authorities said:

When a utility applies to the Commission for permission to issue stock for the purpose of paying a dividend, it is incumbent upon such utility to prove that it has had surplus profits from its business and that such surplus profits have been invested in its properties. In our opinion, neither assessments on stocks, nor advances by consumers, nor reserve for accrued depreciation, nor donations, nor an increase in the asset accounts due to a revaluation of properties, results in surplus profits available for dividend purposes. Such items not being available for the purpose of declaring a dividend, they cannot be used as a basis for the issue of stock to reimburse a utility's treasury, which stock in turn is to be used to pay a dividend.¹⁴⁴

Furthermore, utilities are not permitted to issue stock for such purposes of a par value greater than the unappropriated corporate surplus.¹⁴⁵ Nor may they issue stock to stockholders at par, receiving cash in return for a part of the purchase price and charging the balance to surplus. If a stock dividend is desired, it must be handled directly, not indirectly.¹⁴⁶

CONSOLIDATION PROCEEDINGS

A VERY LARGE number of important cases involving consolidation have been passed upon by the commission. The first question to be settled is whether or not a consolidation is in the public interest. Then come the problems of the conditions of the consolidation, valuation, transfer price, and the securities to be issued, if any.

Applicants to consolidation proceedings must demonstrate that the public will benefit in service or in rates, or in both, as a result of the transactions. It is required that the benefits of consolidation resulting from the elimination of duplication, and so forth, be passed on to the public. If there is no prospect of this, the application will be denied. Ordinarily, when one company owns all of the stock of another, it is considered desirable that the ownership of the property also be acquired. If it should develop that the financial condition of the subsidiary is unsatisfactory and the transfer of assets would result in the embarrassment of the controlling company because of the extension of the liens, the merger will be denied.³⁴⁷

Valuation proceedings loom large in consolidation cases because of the necessity of determining the value to be received for the securities to be issued. The principles applied here are the same as those discussed in connection with valuation of public utility properties. Historical cost, including land at present values, is the basis, and usually duplications resulting from the consolidation are eliminated from the figures.³⁴⁸ In *Tulare County Power Company*,³⁴⁹ however, the commission did not evaluate the property involved, though there were many duplications, because the vendor was headed for difficulties. The proposed consolidation promised to benefit consumers, and it was believed that the purchaser would have an adequate margin of revenues on the acquired property to amortize duplications out of these earnings.

Consolidation proceedings were very numerous in the postwar period of prosperity, and, as has already been noted, reproduction cost was constantly advanced as the proper basis for valuation. It has already been pointed out that the commission took a determined stand in favor of the same principles as were used in determining the rate base, and nothing more needs to be added on this score.³⁵⁰

In authorizing the issuance of securities to consummate consolidation proceedings, the commission, except in unusual cases, takes the value of the property involved as the upper limit. The authorities, however, are constantly faced with requests to sanction consolidations which in themselves are desirable, at prices in excess of the valuation fixed for the property. The procedure usually adopted is to give consent

to the arrangement but to require the purchaser to pay the excess from surplus. Thus, in *Santa Barbara Gas and Electric Co.*,²²³ the commission fixed the value of the property at \$620,000 but the purchase price agreed upon was \$825,000. The authorities were willing to allow \$825,000 to be paid for the properties because the consolidation was evidently to the interest of the public. The amount of bonds authorized for the acquisition was limited, however, to \$620,000. The difference between the proceeds from the sale of these bonds and the purchase price agreed upon had to be made up by the stockholders of the vendee, either by the appropriation of surplus earnings or in some other manner which would not result in an increase in permanent capitalization.²²⁴

Actually, the commission does not fix directly the price which a utility may pay for properties. It has even expressed the doubt that it possessed this power. It refuses, however, to allow the purchaser to capitalize the excess price and will prohibit the consolidation if the purchase price agreed upon will embarrass the buyer. In *South Coast Gas Co.* it was stated:

The Commission has not heretofore undertaken to fix the price which a public utility may pay for properties. As a matter of fact, it is doubtful whether it has sufficient authority to fix such price. The Commission, however, has unquestioned authority over the amount of securities which a public utility may issue to finance the purchase of properties, over the utilities' accounts and over its rates and services. It has repeatedly held that if purchasers of public utility properties agree to pay more for such properties than appears reasonable to the Commission, the excess purchase price should be charged to profit and loss accounts rather than to fixed capital accounts.²²⁵

In the application of the *Associated Telephone Co., Ltd.*, to acquire properties, a stipulation designed to protect existing security holders against an excess purchase price was required. The amount to be paid over and above the figure fixed by the commission was to be represented by a nonnegotiable evidence of indebtedness which was to be "junior to the rights of the preferred stock of Associated Company, and junior to the payment of annual dividends on said company's common stock at the rate of not less than \$1.50 per share and in the

case of liquidation or dissolution of said company to the payment of not less than \$125 per share to holders of said common stock.¹⁵⁴ Where the financial condition of the company is strong, however, and the excess can satisfactorily be charged to surplus this procedure will be allowed.¹⁵⁵

Provisions of the same sort are applied to the elimination of duplications in properties to be consolidated. This was pointed out in the application of the *Santa Barbara Telephone Co.*:

We cannot agree that in determining the amount of securities which shall be authorized, the amount should be issued against the "structural value" of the combined properties . . . without reference to existing duplication of property. If losses arise from this situation, they should be borne by the utilities which have created the duplication and not by the public.¹⁵⁶

In some instances, however, it is possible to issue more securities than the value of the property would justify, but it is necessary for the utility to make provisions for the reduction of the capitalization in the future. This was the situation in *Cloverdale Light and Power Company*,¹⁵⁷ in which application was made to transfer property for securities of par value of \$200,000. The commission concluded that capitalization should not exceed \$100,000, but, because of special circumstances, authorized \$125,000 on condition that \$25,000 gradually be taken care of by stockholders. If there was still a desire to carry out the terms of the original agreement, the additional \$75,000 of stock would have to be provided by stockholders out of their holdings. Similarly, in *Southern California Edison Company*,¹⁵⁸ it was pointed out that the capitalization requested was not such as would ordinarily be sanctioned, but that the consolidation applied for was a step in the right direction. The authorities made it quite clear, however, that the relationship between the property value and capitalization would gradually have to be brought to a more conservative basis by amortization of the excess out of income.

The commission does not regard the relative bargain between the various utilities as of particular significance, provided the entire transaction is reasonable. Thus, when the Southern California Telephone Company wished to consolidate a number of properties, it was found

that the news of the proposal had leaked out, with the result that the stocks of one of the companies to be acquired rose rapidly on the Los Angeles Stock Exchange and this utility was able to drive a particularly advantageous bargain. The adjustment was made by the authorization of only a moderate amount of securities for the entire property to be acquired from the Pacific Telephone and Telegraph Company. The authorities felt that the division of the purchase price between the vendors was of little significance to the public if the total amount of stock on which dividends would have to be paid was not too great. The question of the bargain was one for the consolidating companies to settle among themselves.¹⁰⁹

Although the commission continually states that it will recommend that the application be granted on the condition that the price involved "shall not be binding on this commission or any other public body as a measure of value of said properties for rate-fixing or for any other purpose other than the transfer herein authorized,"¹¹⁰ yet it is concerned with the amount of securities, not only because of financial considerations, but also because of court decisions on rate-fixing. Hence, when it was urged by counsel for the Los Angeles Gas and Electric Company that bonded indebtedness had no influence on rates because the latter were based on fair value of property, the commission replied:

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 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 the 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.¹¹¹

The consideration of earnings is given a prominent place in consolidation proceedings. While valuation sets the upper limit for the securities to be issued, except in unusual cases, the maximum cannot be approached if earnings do not warrant it. The application of *Pacific Public Service Corporation* to purchase the Ukiah Gas Company was

denied, in part, because analysis indicated that probable net revenues could not possibly make the Ukiah Company a paying proposition.¹⁶³

Furtherome, the commission takes the attitude that the results of consolidation should never be taken as the basis for increased rates, but rather that the public should benefit from better service or a decrease in rates or both.¹⁶³ In response to the application of the *Southern California Telephone Company* to purchase properties, the authorities even went so far as to stipulate as a condition of the authorization that no rate increases were to be requested for at least five years from the date of the decision.¹⁶⁴ An even more positive stand was taken in the consolidation proceedings of the *Pacific Gas and Electric Company*:

While witnesses for applicant did not commit themselves definitely on this matter, a reading of the petition and a study of the record shows clearly that the company commits itself to the policy that the public shall be benefited directly through the acquisition of the stock and the purchase of the properties of the companies mentioned. If for any reason applicant does not voluntarily reduce its rates because of savings which can be effected, the Commission will take such steps as it deems proper and necessary.¹⁶⁵

REORGANIZATIONS

WITH RESPECT to reorganization cases coming before it, the California Commission, with a few exceptions, has been particularly strict. It has shown its determination to make one reorganization final and to ensure the financial soundness of the new company.

Valuation, in reorganization as in other financial proceedings, forms the cornerstone upon which the commission's decision rests. A very thorough discussion of the principles used in arriving at the valuation upon which securities are to be issued in reorganization cases was given in *People's Water Company*.¹⁶⁶ The commission analyzed the value of the properties under heads similar to those employed in finding "fair value" for rate-making. Land was appraised at current market value, whereas the amount attributable to the physical plant was arrived at by the historical-cost method, reproduction cost being rejected as unsatisfactory. In regard to going concern it was said:

I believe that where it can be shown that as a matter of actual cost a company expended a given sum of money to obtain its business and this

was done economically within a reasonable time and with good judgment, the resulting business is of value to the company to the extent of its expenditure to obtain.¹⁸⁷

It was also pointed out that the value fixed was not the same that would be arrived at in a condemnation case, nor was it the equivalent of the rate-base, since the latter applied only to property used and useful in rendering public utility service. In *San Francisco-Oakland Terminal Railways*¹⁸⁸ the authorities said they were not bound by the foreclosure price in authorizing the transfer of the properties, but that they should have before them the evidence of the actual or estimated cost.

Similarly, they disapproved the use of reproduction cost in the reorganization of the *Stockton Terminal and Eastern Railroad Company*. It was pointed out that the Interstate Commerce Commission had valued the property of this railroad on the basis of the 1914 price level with additions and betterments made since then valued at cost, to which was added the increase in land values. This formed the basis of the commission's valuation in the decision.¹⁸⁹

In authorizing the issuance of securities, the authorities have definitely taken the position that no plan will be approved which does not ensure, in their opinion, the success of the reorganized enterprise. They are as liberal as possible, however, in order to avoid foreclosure proceedings because these, invariably, are long drawn out and impede development and service. The case of *Citrus Belt Gas Company*¹⁹⁰ is an excellent illustration of the procedure generally adopted in refinancing. The valuation figure was fixed at \$550,000, and against this amount the company proposed to issue \$812,000 of bonds and \$440,000 of stock. The commission criticized this as a method designed to make the public pay the debts in the form of higher rates. Furthermore, it condemned the proposal to pay defaulted interest by bonds as the capitalization of bankruptcy in which a higher premium was paid for failure than for success. It also disapproved income bonds because they would be a barrier to future financing, which was imminent. Consequently, the Citrus Belt Company was given permission to assume \$351,200 of underlying bonds and to issue \$25,000 of five-year promissory notes. This left an equity of between \$158,800 and \$198,800 which

was about 50 cents on the dollar for outstanding claims. The company was refused permission to issue stock at less than 80 per cent of par. Because no organization expenses or bond discount appeared in the claims, and because net earnings were made available for additions and betterments, stock of the par value of \$200,000 was allowed.

Where the earning prospects under the proposed arrangements are such that they leave the future in doubt or impose obstacles in the way of future financing, the authorities either disapprove the plan or make suggestions for acceptable changes, or both.¹⁷¹ Where exceptional circumstances obtain, adherence to the valuation figures may not be insisted upon and the requirements with respect to future earnings may be dealt with more leniently. Thus, in *United Light and Power Company*,¹⁷² the authorities felt that the plan presented, by itself, left no prospect that the new company, the Consolidated Electric Company, would be solvent. However, the Great Western Power Company agreed to guarantee the bonds that were to be issued and it was also to acquire all the capital stock. The Great Western Power urged that the combination would make the Consolidated Electric pay, and the earning statements of the Great Western Power indicated that it could live up to its guaranty without embarrassment. The commission assented to the plan.

A slightly different situation was presented in the reorganization of the *Western Pacific Railway Company*,¹⁷³ in which there was some doubt that interest charges could be met, especially if dividends on preferred stock were included. However, since the new setup was such an improvement over the old one and there was a fair chance of success, assent was given.

The legal rights of the various parties interested in reorganization proceedings are not matters for the commission to decide. Nevertheless, it does not hesitate to direct attention to the equity of the situation and it endeavors to see that matters are fairly adjusted.

Of course, our action . . . is permissive only, that is to say, the Commission has power to declare what capitalization it will authorize to be issued and for what purpose the proceeds thereof shall be used. Hence while the authorization of this Commission may be persuasive, it can not be enforced

upon anybody. The various bondholders, creditors and stockholders of this corporation must determine for themselves whether or not they will proceed under the authorization of the Commission. But attention is called to the fact that the action of this Commission will finally be controlling, because whether this company be reorganized by agreement or whether it go through foreclosure, no stocks or bonds can be finally issued without its authorization.¹⁷⁴

It should be noted that the definite opinion has been expressed that investors of money in utilities should retain the rights usually appertaining thereto and that stockholders should possess the power and control to which their ownership entitles them. But when the stockholders, by agreement, surrender some of these rights, the commission will give its assent.¹⁷⁵

The authorities have been particularly critical of the practice, so prevalent in reorganization proceedings, by which every conceivable person makes reorganization a Roman holiday at the expense of the security holders. In a particularly lengthy and caustic condemnation in the reorganization of the *Western Pacific Railway Company*,¹⁷⁶ it was emphasized that the purpose of a reorganization was to give the new company a fair chance. Hence, every dollar not fairly and reasonably necessary for the payment of the expenses of the receivership and other expenses in connection with reorganization should be saved to the new company for purposes of rehabilitation. The commission has stated that reorganization expenses must be amortized out of income, because:

... the security owners who control the reorganization, and not the public, must bear the expense. The reorganization expenses represent no addition of tangible property, and it would seem wholly improper that such expense should be added to permanent capital investment.¹⁷⁷

Nevertheless, it did allow reorganization expenses, which it considered reasonable, to be capitalized by the *Western Pacific Railroad Company*.¹⁷⁸ This rule seems to be the exception, however, for the usual procedure is similar to that adopted in *People's Water Company*: "... said company will at such times, in such amounts, and in such manner as the commission may order, amortize out of income the

reorganization expenses referred to in the opinion preceding this order."¹⁷⁹ Care is also taken to analyze carefully and approve the reorganization expenses to be amortized.

INTERSTATE COMMERCE

THE PUBLIC UTILITIES ACT states that the issuance of securities by any public utility in this State shall be void unless authorized by the commission. In its first application the *Southern Pacific Railway Company*¹⁸⁰ sought permission to issue equipment trust certificates to acquire rolling stock to be used primarily in interstate commerce. A blanket order was requested in order to remove all doubts of the legality of the issue because the lien would embrace some of the property in California. The commission, after a perfunctory examination of the earnings of the company and the terms of the purchase, decided that public interest and the needs of the railroad would be served and so gave its consent.

Shortly afterward, however, the same company made a request for another issue and formally questioned the jurisdiction of the commission. The authorities directed attention to the fact that section 85 of the Public Utilities Act specifically excludes jurisdiction over interstate commerce except as permitted by the Constitution of the United States and the acts of Congress. It was found that a part of the equipment to be purchased was to be used by the Pacific Electric Railway, which operates entirely within the State, and that much of this equipment was to be used solely in intrastate commerce. It was held that the commission had jurisdiction over this part of the application, particularly in the absence of the regulation by the federal government of securities of common carriers. Consequently, the part of the certificates to be used for the purchase of equipment, over which the commission has jurisdiction, was calculated and the necessary application fee charged thereon.¹⁸¹ Consent was given to the entire application in order to remove any doubt of legality.

The Federal Transportation Act of 1920 changed the situation. The commission now advises the governor with respect to applications referred to him by the Interstate Commerce Commission.

In *Interstate Transit Company*,²⁸⁸ a utility engaged in the operation of auto stages solely in interstate commerce, an application was made to issue stock. This company did not operate under a certificate of public convenience and necessity obtained in California and the commission pointed out that it had no authority over the company's operating privileges. In order to remove all doubt of the validity of the stock to be issued, the corporation filed an application for issuance of stock with the California commission. After investigation the authorities gave the authorization.

A different type of case arose in *Winnemucca Water and Light Company*,²⁸⁹ which was a California corporation operating entirely in Nevada. The commission acted in order to remove any possible doubt with respect to the legality of the bonds applied for, but the proceedings were quite perfunctory in nature.

The reverse of this situation was presented in the application of *Albers Bros. Milling Company*,²⁹⁰ a foreign corporation, to issue bonds. This was dismissed for lack of jurisdiction and the company was ordered to cease and desist immediately from transacting a public utility business in California.

CONCLUSION

A REVIEW of the California Railroad Commission's work discloses a decided improvement in financial practice and procedure since 1912. Cognizance must be taken, of course, of the developments achieved in the general theory and practice of accounting. Even giving due weight to this, however, it must still be recognized that public utility accounting practices were far from satisfactory when regulation was first begun. Too often, surplus had little meaning, depreciation reserves were sadly neglected, decidedly improper items were capitalized, duplicate capitalization frequently appeared, and often inside manipulations, either covered up or ignored in the accounting, took place.²⁹¹ Needless to say, satisfactory financial structures were impossible under such circumstances and the public was bound to suffer. Even downright fraud appeared and common stock, to say the least, was anything but an investment of either principal or income.²⁹²

The change in this situation has been a truly great tribute to the success of the policy pursued by the California commission. It has been necessary to repeat, continuously, the admonitions, condemnations, refusals, and recommendations of earlier days. It should be noted, however, that this has occurred, in general, when new devices such as the holding company, or new industries such as automotive transport, have entered the public utility field. Successful regulation of any sort never becomes mere routine; the problem, so to speak, is never solved. It is at least comforting, however, that in spite of this a structure has steadily risen which it has not been necessary to rebuild. In financial regulation, as in every other line of development, the frontier always presents a problem of conquest, but behind the frontier a stable and mature settlement has been erected.

The financial regulation of the California commission deserves high recognition for the building up of a system of financial control which has proved to be flexible, adaptable, and workable. A tradition of regulation and spirit of coöperation has developed which makes possible continuous improvement both in regulatory practice and in the financial status of public utility securities.

Shortcomings in both legislation and policy are inevitable in any system of regulation not only because of the fallibilities of the authorities, but also because of the difficulties inherent in many of the situations which they face. There may be quite a difference of opinion, however, respecting the nature of these shortcomings and respecting what would have been the wisest policy to pursue in many cases.

Although the legislation in California is particularly broad and flexible, yet there are some phases which, the writer believes, could be improved. More positive control by the commission over consolidation programs would have the advantage of facilitating the clearing up of some unsatisfactory local competitive situations. Control over the actual price to be paid by one utility to another for its property should be included in the law. Too frequently, excessive prices have been agreed upon, and although these are not directly translated into security issues and rate bases, yet they have been the cause of many admonitions on the part of the authorities. The development of the holding

company brought this problem to the fore and it would seem wise to deal with the issue at its source.

Complete control of reorganizations should also be given to the commission. As it has pointed out in its opinions, such a provision would reduce expense, ensure greater protection to interested parties, and result in more satisfactory financial rehabilitation.

The law on hybrid corporations should be more positive. This situation presents some complications but, except in unusual situations, enterprises doing a utility business should be restricted to that type of activity. This would not eliminate control by some other corporation, and it is doubtful if that would be desirable, but it would make control of public utility activities easier.

Foreign corporations are definitely limited with respect to the public utility business which they may transact in California. As a matter of courtesy, and of practical control as well, the law of this State should forbid the formation of a corporation which is to conduct public utility activities entirely outside the State's boundaries.

In the writer's opinion the legislation permitting public utilities to issue no-par stock was a mistake. There is a general consensus among present-day students of corporation finance that no-par stock creates many more difficulties than it solves, and therefore the privilege of issuing it should be stopped.¹⁷⁷

The California Commission has indicated that it regards a share of common stock merely as a proportional claim on the residual assets. This view is indisputable as a general concept, but the costs of obtaining capital and financial solvency are integral parts of regulation. Consequently, it is desirable that common stock fall definitely into the investment category. Par value assists in achieving this aim. It is true that this frequently makes the sale of stock at a discount necessary, but there seems to be no reason why the amortization of that discount should not be counted in cost of capital and made a definite part of dividend policies.

This problem is closely related to that of a fair return. The California authorities, in common with other regulatory agencies, have taken the attitude that the public is interested in the total fair return but not

in the division of it. With this view the writer disagrees. The division of the fair return determines the total which a corporation requires. If the division of the fair return is not of significance, how can the return of a particular utility be fixed, other than by taking an arbitrary figure like seven or eight per cent?¹²⁸

The policy of security regulation of the California Railroad Commission has, on the whole, been excellent. It has been flexible, far-sighted, and very practical. Security regulation is, however, only part of a general program. Unity in the general program in this State has been achieved by keeping security regulation within the rate-making formula. The latter has not been so flexible, and the difficulty seems to be that the rate-making policy has given inadequate attention to the financial structure of particular utilities, dividend policies, and the fluctuations in business activity.

NOTES

¹ For a summary of the history of regulation in California, see Pegrum, D. E., *Rate Theories and the California Railroad Commission* (Berkeley, 1932), chap. I.

² Thelen, Max, "Desirable Scope and Method of Federal Regulation of Railroad Securities," *Annals of the American Academy*, 76, 191, 197 (1918). See also *California Water Service Co.*, 31 C.R.C. 327.

³ See Barron, Mary L., "State Regulation of the Securities of Railroads and Public Service Companies," *Annals* 76, 167, 190 (1918).

⁴ See *Annual Report of the Railroad Commission*, I (1916-1917).

⁵ *Statutes* 1917, chap. 713.

⁶ *Statutes* 1925, chap. 406.

⁷ *Statutes* 1925, chap. 398.

⁸ *Statutes* 1917, chap. 213.

⁹ The Public Utilities Act, published biennially, contains all the legislation directly pertaining to public utilities in California. On the first page is also to be found a complete list of all the statutes directly affecting public utility regulation.

¹⁰ *Annual Report of C.R.C.*, 1929-1930, chap. 4, 40. For a history of the relations between the I. C. C. and the C. R. C., see Brundige, H. W., Pres., *Annual Report* 1921-1922.

¹¹ Other sections of the Public Utilities Act also have a bearing on security issues, particularly sections 26, 50, and 57. Section 26 deals with the right of foreign corporations to transact a public utility business within the State, and section 50 sets forth the requirements in regard to certificates of public convenience and necessity. Section 57 establishes the schedule of fees to be collected by the commission on documents filed with it by the utilities.

¹² This section of the law has also been interpreted as requiring commission approval for an operating agreement. See *County of Sacramento vs. Northern Electric Railway Company et al.*, 4 C.R.C. 725 (1914); 4 C.R.C. 1203 (1914). The commission has ruled, too, that when auto-transport companies find it necessary to finance additional equipment by purchase contracts, the latter must be sanctioned. *Golden State Stages Co.*, 33 C.R.C. 426 (1929); *Central Pacific Ry. Co.*, 34 C.R.C. 153 (1930). Similarly, an existing lease cannot be altered without commission consent. *Southern Pacific Coast Railway Company and Southern Pacific Company*, 4 C.R.C. 484 (1914).

While it is necessary to obtain the consent of the commission to encumber public-utility property in any way, the granting of permission to execute a mortgage to secure a bond issue does not authorize the issuance and sale of bonds nor does it limit the commission's power to determine the conditions of issue, sale, or pledge of bonds secured by such mortgage. *East Bay Water Company*, 20 C.R.C. 712 (1921); *San Geronio Power Co.*, 22 C.R.C. 717 (1922).

But of course the authorities will not authorize the issuance of securities where the conditions of the deed have not been complied with. *Great Western Power Co.*, 19 C.R.C. 45 (1920).

¹³ There seems to be a contradiction in the law on this point, but presumably the first reference to "maintenance of service" is to be interpreted as coordinate with improvements. See *Oakland, Antioch and Eastern Ry. Co.*, 8 C.R.C. 452 (1915).

¹⁴ To this is also added the qualification, "except as otherwise permitted in the order in the case of bonds, notes or other evidences of indebtedness, such purpose or purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income." See *Oakland, Antioch and Eastern Ry. Co.*, 8 C.R.C. 452 (1915).

¹⁵ Sections 309 and 456 of the Civil Code are declared to have no application to public-utility corporations, in so far as they conflict with this provision.

¹⁶ This does not apply "except as to a corporation or person taking the same otherwise than in good faith and for value and without actual notice." But see *Economic Gas Co.*, 3 C.R.C. 66 (1913), "Of course this Commission has nothing to say nor authority over the right of action of the parties who bought these bonds in good faith, but the bonds are absolutely void under the law and these parties will either be compelled to make other arrangements with this company or to pursue whatever action they have for the return of the purchase money." In the order given, the commission followed its customary course of action authorizing bonds equal in par value to those voided by the order on condition that the former be exchanged for those illegally issued. The commission had already found that the bonds previously issued were for proper purposes. See also *Pacific Gas and Electric Company*, 3 C.R.C. 167 (1913).

¹⁷ This order is printed in full in *Annual Report, 1912-1913*, 171. In one section it stipulates: "A separate bank account shall be opened with a state or national bank, to which shall be charged or credited all receipts and disbursements of money derived from the sale of stock, bonds or other evidences of indebtedness authorized to be issued by the Commission." Each order of the commission authorizing the issuance of securities contains a stipulation similar to the following:

"It Is HEREBY FURTHER ORDERED, that Pacific Gas and Electric Company shall keep such record of the issue, sale and delivery of the stock herein authorized to be issued and of the disposition of the proceeds as will enable it to file on or before the twenty-fifth day of each month a verified report, as required by the Railroad Commission's General Order No. 24, which order, in so far as applicable, is made a part of this order." *Pacific Gas and Electric Company*, 37 C.R.C. 94, 96 (1932).

¹⁸ *Davis Water Co.*, 4 C.R.C. 404, 405 (1914): "Applicant asks authority to issue one share of stock to each of the five persons who are designated as directors in its articles of incorporation. This Commission has heretofore held that it is not necessary to secure its authority for the issue of stock for such purpose, and the order in this proceeding will consequently make no reference to this request."

¹⁹ *Central California Gas Co.*, 1 C.R.C. 134, 141 (1912). See also *San Francisco-Richmond Ferry Co.*, 8 C.R.C. 889 (1915).

²⁰ *San Rafael and San Anselmo Valley Railway Company*, 3 C.R.C. 874, 883 (1913). See also, *Northern California Power Co.*, 1 C.R.C. 407 (1912); *Empire Water Co.*, 3 C.R.C. 673 (1913).

In *Pacific Gas and Electric Co.*, 6 C.R.C. 926, 928-929 (1915), the matter was discussed at great length. The applicant asked for the authorization of a stock dividend and urged that matters of valuation and rates could be based only on the actual assets of the corporation without reference to security issues. To this the reply was made:

"In this matter I confess to certain difficulties. When this Commission authorizes an issue of stock there is always the danger of a misunderstanding on the part of the investigating public that in making the authorization this Commission, in some degree, inferentially expresses its belief that that stock is supported by reasonable assets. Upon the faith of this view investors might be led to purchase securities which they would otherwise not acquire. It would be extremely unfortunate if the idea should become

lodged in the public mind that Commission authorization to issue stock entails a recognition or belief on the part of the Commission that such stock is necessarily a good investment. The Public Utilities Act does not contemplate that the Commission shall exercise any such function. It does contemplate that the Commission shall, in the exercise of its duties, see that the utility receives an adequate return for the stock which it issues. But this Commission cannot go into the past and breathe value into stock which has no value, nor can this Commission go into the future and say that values of today shall not shrink next year, or the year after, or ten years hence.

"It has been the aim of the Commission, as far as could reasonably be done, to safeguard the issue of stocks and bonds. It has never pretended to say that stocks and bonds which it authorized were necessarily good stocks and bonds for an intending investor to buy. On the contrary, it has specifically and repeatedly stated that stocks and bonds issued upon Commission authorization must take their place in the financial world with stocks and bonds heretofore or hereafter issued, and were, therefore, liable to the same economic laws to which all investment is necessarily subject. There is no guarantee by the state.

"In many instances the Commission is obliged, under the necessities of a corporation, to authorize securities to be issued, even when it may believe that such securities, though beneficial to the corporation, might not be beneficial to the intending purchaser. Take, for example, a new enterprise, as an electric railway. The project is organized and in order to construct the line it is necessary to sell stocks or bonds. The most conservative way is perhaps the sale of stock. An application is brought to the Commission thereupon to sell stock to build such a railway. It is the most conservative way in which the project can be presented. It may appear to the Commission that the project is not wholly feasible; that the investors may perhaps lose a part, and, it may be, all of their investment. In such an instance it is not the province of this Commission to assume to set up its judgment as a barrier to the investment by those who are willing to assume the risks involved. It is the duty of the Commission to see that the project is surrounded with all reasonable safeguards, to see that the enterprise is carried forward honestly along approved lines, and beyond that it cannot go."

²¹ 4 C.R.C. 503, 512 (1914): "Purchasers of this stock must share, not only in the hope of reward, but in the responsibility of losses as well. Because of the nature of this enterprise, no investor should be encouraged to purchase stock until he has been placed in possession of full information bearing upon the enterprise. The order in this case will provide, therefore, that the applicant must submit to this Commission for its approval a prospectus for the benefit of prospective purchasers of stock."

In this case the railway which was projected would benefit the community considerably but the investment nature of the securities was in doubt. It was expected that the restrictions imposed by the Commission would limit the purchasers of the stock largely to those who resided in the community and who would benefit by the project. See also *Sierra Water Co.*, 19 C.R.C. 900 (1921), in which case the commission ordered the applicant to require subscribers to stock to sign a consent and waiver agreeing to abide by pending litigation. This was to be done before any stock certificates could be issued.

²² This is particularly true with respect to bonds. See *Empire Water Co.*, 3 C.R.C. 673 (1913). For a careful statement by the commission of its conception of its responsibility in sanctioning securities issues see *Annual Report 1911-1912*, 92; also *Annual Report 1912-1913*, 174 f.

²³ *Annual Report 1912-1913*, 169. The same ruling applies to treasury stock; see *Annual Report 1924-1925*, 59, and *United Stages, Inc.*, 25 C.R.C. 506 (1924).

²⁴ *Home Telephone Co. of Covina*, 3 C.R.C. 466, 468 (1913): "As this Commission's authority is not required for the initial authorization of a bond issue, but merely for the actual issue of bonds so authorized, it will not be necessary to pass on that portion of the prayer which asks this Commission to authorize the creation of a possible bonded indebtedness in the amount of \$200,000."

²⁵ See *San Diego and Southeastern Ry. Co.*, 3 C.R.C. 84 (1913); *Corcoran Mill and Warehouse Co.*, 8 C.R.C. 793 (1915); *Black Diamond Water Co., et al.*, 17 C.R.C. 260 (1919); *Redondo Home Telephone Company*, 26 C.R.C. 1 (1925).

²⁶ *Death Valley Railroad Company*, 11 C.R.C. 608, 610 (1916): "Applicant testified that it understood at the time of the transaction that its bonds were issued when they were executed and placed with its treasurer ready for sale, although not then sold or delivered. Until actual delivery of a contract note or bond no legal obligation is created against the maker. The word 'issue' as used in the Public Utilities Act means execution and delivery of the instruments referred to." See also *Tidewater and Southern Railway Co.*, 1 C.R.C. 232 (1912).

²⁷ *Western States Gas and Electric Co.*, 16 C.R.C. 162, 167 (1918): "The Commission determines whether public convenience and necessity will be served by the grant of the application and the terms and conditions, if any, necessary to this end. It does not determine whether the proceedings which have preceded the filing of the application or those which are contemplated thereunder *apart from the Public Utilities Act* are regular" (Italics mine.)

²⁸ *Delta Warehouse Company*, 20 C.R.C. 289 (1921); *Gray Line Motors Tours*, 33 C.R.C. 26 (1929).

²⁹ 1 C.R.C. 888, 899 (1912): "This Commission will not be disposed hereafter to view with favor the petition of an applicant to issue securities, particularly in large amounts, unless it shall appear to the Commission that the applicant has manifested good faith in its formation and in the acquisition and retention of its franchise rights. Applicants should certainly be required to clear away all clouds upon their legal existence and to show a compliance with ordinary dictates of good faith before this Commission can well consider a request for an authorization to incur the responsibilities and obligations imposed by the issuance of stocks and bonds."

In *Application of Northern Electric Railway et al.*, 4 C.R.C. 735 (1914), to transfer property, the request was dismissed without prejudice because transferee had no franchise rights to operate the property involved. If a proper franchise was secured, the matter could be resubmitted. This case involved the consolidation of properties but no new securities were asked for. See also, *Tracy Gas Co.*, 30 C.R.C. 22 (1927).

³⁰ 2 C.R.C. 1025, 1027 (1913). See also, *Yreka Railroad Co.*, 32 C.R.C. 260 (1928). The railroad was ordered either to secure a new charter or to arrange its financing so that it would fall within the present life of the applicant.

³¹ "The Commission manifestly cannot authorize an issue of bonds based on a lawsuit, where a substantial issue is involved in the suit!" *Indian Valley Electric Light and Power Co.*, 4 C.R.C. 1365, 1366 (1914). See also *Plumas Light and Power Co.*, 6 C.R.C. 267 (1915).

³² *Southern Sierras Power Co.*, 20 C.R.C. 663, 664-665 (1921), and 21 C.R.C. 691 (1922).

³³ 19 C.R.C. 900 (1921).

³⁴ *Annual Report 1911-1912*, 93.

³⁷ 7 C.R.C. 597, 616 (1915). See also, *People's Water Co.*, 4 C.R.C. 1187, 1192 (1914): "For what happened before than time [March 23, 1912] this Commission is not responsible. The most this Commission can be expected to do is to see that by none of its acts does the condition of utilities become worse than it was before March 23, 1912. When a utility which has been improvident or recklessly financed prior to March 23, 1912 comes before this Commission, the Commission will seek to compel the utility to better its financial condition, instead of making it worse. And while the Commission must, perforce, permit for a while many conditions to continue which it would never have sanctioned, initially, it will constantly strive to bring public utility financing more nearly to the level which it should have assumed at the start."

³⁸ 1 C.R.C. 134 (1912).

³⁹ The commission added: "As an original proposition the Railroad Commission would not have consented to the issue of common stock to the extent to which it has been issued by the applicant. In this case, however, as the stock was issued prior to the effective date of the Public Utilities Act, and as the danger of sale to purchasers will be removed by the adoption of Mr. Forney's suggestion [to turn the stock over to the commission], the Commission will not exercise authority with reference to the common stock further than to make as a condition of its order the turning in of the stock for the purpose of having stamped thereon the language hereinbefore quoted or language to the same effect" *Ibid.*, 140.

Similarly in *Tidewater Southern Railway Company*, 1 C.R.C. 232 (1912), 2,188,600 shares of stock (par value \$1.00) had been issued to B. A. Bearce for right of way by Tidewater and Southern Transit Company, a party to the consolidation. As a condition to the order given by the commission, Mr. Bearce agreed to return 188,600 shares, when issued, to the treasury for cancellation. The remaining 2,000,000 were to be turned over to the railroad commission to be stamped: "Issued for voting purposes only. Not to be transferred, and to be cancelled and returned to the treasury on or before July 1, 1919, as provided in agreement dated July 1, 1912, between Byron A. Bearce and Tidewater Southern Railway Company" (235.) It was also stated "that the Commission does not by this opinion commit itself to a policy of sanctioning the issue of stock for control only"

⁴⁰ 1 C.R.C. 134, 141 (1912).

⁴¹ 1 C.R.C. 253, 267 (1912): "It should be plainly stated that in taking this position, this Commission disavows any intention to try by indirection to exercise control over any securities lawfully issued prior to the effective date of the Public Utilities Act. It is merely announced as a principle, that when the facts in any particular case show that the utility seeking to enter a territory is so situated financially that there is strong likelihood that it will be unable to render adequate service at reasonable rates, regardless of its desire to do so, its application for certificate of public convenience and necessity will be denied if there is no way of improving its financial condition; or, if a way is open to it so to change its financial status as to insure its ability to render adequate service at reasonable rates, its application may then be granted, but solely contingent upon its satisfying the requirements of the Commission as to financial condition, because otherwise the public convenience and necessity would not be subserved by the grant of the application."

⁴² "I believe that under ordinary circumstances the financial condition of a utility should always be considered in allowing the issuance of stocks and bonds, whether the same are for refunding purposes, or will result in additions to the already outstanding obligations." *Northern California Power Co.*, 1 C.R.C. 407, 409 (1912). See also, *Mill Valley and Mt. Tamalpais Ry. Co.*, 1 C.R.C. 422 (1912). The railway wished to reim-

burse the treasury for money spent for capital purposes from income. The commission insisted that the financial structure should be analyzed as a whole and that the application should be granted only if the entire capitalization warranted it.

When expenditures from income have been made prior to the effective date of the Public Utilities Act it still remains to be determined whether they were for purposes properly capitalizable. *Western States Gas and Electric Co.*, 1 C.R.C. 587 (1912).

⁴³ 3 C.R.C. 66 (1913). In 4 C.R.C. 117 (1914) the company presented a revamped structure and corrected many of the abuses. The commission gave its assent although \$850,000 of the common stock remained outstanding, over which the commission had no jurisdiction. For further cases regarding stockholders' readjustments see: *San Diego Consolidated Gas and Electric Co.*, 2 C.R.C. 264 (1913); *Coast Counties Gas and Electric Co.*, 3 C.R.C. 1012 (1913); *Southwestern Home Telephone Co.*, 4 C.R.C. 247 (1914); *Midland Counties Public Service Corp.*, 13 C.R.C. 321 (1917).

⁴⁴ The method of valuation which the California commission has used is now being challenged in the courts. The decision of the commission in *Pacific Gas and Electric Co.*, 39 C.R.C. 53, was challenged on the grounds that the method used was unconstitutional, since cost of reproduction was not considered. In *Pacific Gas and Electric Co. v. Railroad Commission*, 13 Fed. Supp. 931 (1936), the Federal court held that the order of the commission denied due process of law and therefore the order is unconstitutional. No appraisal of the facts was given. A rehearing has been denied (October 16, 1936).

⁴⁵ See Pegrum, D. F., *op. cit.*, chap. II. See also, *Stockton-Terminal and Eastern Railroad Company*, 2 C.R.C. 777 (1913); *City of Palo Alto vs. Palo Alto Gas Company*, 2 C.R.C. 300 (1913). The commission reiterated its stand again in *Los Angeles Gas and Electric Corporation*, 35 C.R.C. 442, 445-446 (1930), although the hedging nature of the language in parts of the decision was particularly unfortunate. To quote:

"This Commission for many years, in the exercise of its jurisdiction to establish reasonable rates for utilities of this character, has fixed rates to yield upon the historical or actual cost of the property, taking land, however, at current values and depreciation calculated on a sinking fund basis, a return somewhat in excess of the cost of the money invested in the property. When the books have been accurately kept these have been deemed to most accurately reflect the actual cost of the structural and other property. Sometimes when these are not reliable it has been found necessary to estimate what it cost to produce the whole or parts of the property historically."

⁴⁶ 2 C.R.C. 694, 695 (1913).

⁴⁷ 7 C.R.C. 597 (1915). For discussion of reorganization and consolidation proceedings see *infra*.

⁴⁸ *Ibid.*, 606: "With ordinary commercial property a value may be arrived at by considering the earning power of such property and capitalizing the same, but here the earning power is fixed by the same body, the Railroad Commission, which fixes and determines the value of the plant, and in determining the earning power of the plant, the value of the plant must be taken into consideration. Hence, the value of the plant must first be established and upon this valuation rates are fixed which determine the earning power of the plant."

In *San Diego Consolidated Gas and Electric Co.*, 16 C.R.C. 809 (1919), it was stated that a public utility will be permitted to issue securities for the purpose of increasing its working capital to an amount equal to that allowed in a rate-fixing inquiry, but it will not be permitted to issue securities to purchase construction materials when it also intends to issue securities to pay for estimated extensions to be made during the next year. This was designed, of course, to avoid duplicate capitalization. The rate decision

for this company had allowed \$386,000 for working capital, so stock of the same amount was sanctioned.

In *El Pizmo Water Co.*, 29 C.R.C. 261 (1927), application was made to purchase the plant of Citizens' Water Company. In a previous decision the commission had fixed the rate-base for the latter concern. As the same property was to be transferred and securities were to be issued in exchange, the same figures were used by the authorities. Perhaps attention should be called to the fact that depreciation is not deducted in fixing the rate-base because the California Commission uses the sinking-fund method in calculating depreciation. Hence, in transferring properties, depreciation must be deducted from the rate-base. In the rate case the depreciation charges had been calculated, and hence the total deduction was arrived at by using these same figures.

⁴⁸ *Ibid.*, 610: "I believe that where it can be shown that as a matter of actual cost a company expended a given sum of money to obtain its business and this was done economically within a reasonable time and with good judgment, the resulting business is of value to the company to the extent of its expenditure to obtain it" See also, *Monahan vs. San Jose Water Company*, a rate case, 4 C.R.C. 1101 (1914). The same engineers investigated both cases for the commission and similar conclusions were reached. The Monahan case was referred to in *People's Water Company* with the indication that the same principles of valuation were followed in each.

⁴⁹ 31 C.R.C. 327 (1928). The original case was decided in 29 C.R.C. 466 (1927). A supplemental opinion was given in 30 C.R.C. 876 (1927) and then an opinion and order on rehearing in 31 C.R.C. 327 (1928). For other cases involving the Foshay interests, with similar problems presented, see: *Santa Cruz County Utilities*, 31 C.R.C. 32 (1928); *Hollister Water Co.*, 33 C.R.C. 345 (1929); *Francis Land and Water Co.*, 33 C.R.C. 560 (1929).

⁵⁰ 30 C.R.C. 876, 882 (1927).

⁵¹ For other cases emphasizing this attitude on valuation see: *Southern Counties Gas Co.*, 16 C.R.C. 799 (1919); *Harbor City Water Co.*, 21 C.R.C. 638 (1922); *Shasta Transit Co.*, 24 C.R.C. 165 (1923); *Golden Gate Ferry Co.*, 28 C.R.C. 268 (1926); *Peerless Stages, Inc.*, 30 C.R.C. 346 (1927).

⁵² 32 C.R.C. 703, 707 (1929): "In no instance has the Commission permitted a public utility to refinance its properties because the reproduction cost new might exceed the original cost which the Commission theretofore permitted to be capitalized through the issue of stock and bonds. While the original cost of some of applicant's properties is not available, we believe that the rate bases heretofore established by the Commission for applicant, plus the net cost of additions and betterments and net current assets, presents the maximum figures which should be recognized for capitalization purposes." For other cases involving valuation for security issues see: *Pacific Gas and Electric and Western States Gas and Electric*, 22 C.R.C. 736 (1922); *California-Nevada Stages, Inc.*, 26 C.R.C. 259 (1925); *Stockton-Terminal and Eastern Railroad Co.*, 28 C.R.C. 419 (1926); *Los Angeles County Water Works*, 30 C.R.C. 577 (1927); *Tuolumne County Electric Power and Light Co.*, 31 C.R.C. 189 (1929); *Santa Rosa Water Works Co.*, 35 C.R.C. 766 (1931).

⁵³ The relationship of par value to fair value presents a different situation in which other factors must be taken into account. This matter is discussed below.

⁵⁴ "The Commission is of the opinion that promotion and organization expenses, honestly and wisely incurred, are as necessary to the success of a public utility and are as properly subjects of capitalization as the cost of the component parts of the utility's

physical plant or system, and that the same should be paid for, in cash, where possible, at their reasonable value to the utility. Wherever possible, the moneys actually spent on these items should be ascertained and reimbursement made for them. While it is not always easy to estimate the value of a promoter's services, inquiry should be made as to the amount of time which he has devoted to the organization of the utility and to the reasonable value of the work such as that which he performed during that time. A public authority, in estimating the value of such services, should be liberal so that men of ability may be attracted to the development of new utility enterprises where needed for the development of the State. The need for a liberal policy in this regard is particularly apparent in states like California, in which there is still a wide field for legitimate new public utility development. It may well be that in addition to a reasonable compensation for the time devoted to the work, the promoter should be allowed an additional remuneration to compensate him for his risk of failure and the use of such money as he may have invested in the organization and promotion of the enterprise. In this, as in other respects, this Commission believes that the State of California should deal liberally with those who, by the establishment of utility enterprises, are aiding in the legitimate development of the State." *Central California Gas Co.*, 2 C.R.C. 116, 120 (1913). See also: *Southern Terminal Warehousing and Stge. Corp.*, 22 C.R.C. 652 (1922); *Dillingham Transfer Co.*, 23 C.R.C. 115 (1923).

⁵² *Central California Gas Co.*, 2 C.R.C. 116 (1913). Expenses connected with reorganization are scrutinized with the same care and only reasonable amounts allowed. *Western Pacific Railroad Co.*, 10 C.R.C. 563 (1916); *Southern Terminal Warehousing and Stge. Co.*, 22 C.R.C. 652 (1922); *Central Mendocino County Power Co.*, 22 C.R.C. 933 (1923); *Dillingham Transfer Co.*, 23 C.R.C. 115 (1923).

⁵⁴ 3 C.R.C. 66, 73-74 (1913): "While unquestionably the legal title to the stock which has heretofore been appropriated by promoters of enterprises for which nothing has been paid into the treasury of the corporation is in such promoters or their assignees, yet the Commission is not impressed with the propriety of such a procedure notwithstanding. It has always been the design of the constitution and laws of this state that payment should be made into the treasury of a corporation for stock issued, and it does not change the design of the laws for corporation promoters to take this stock as their own property, sell it to the public and retain the proceeds as their own private funds." See *infra* 181-182, for further discussion of the case. See also: *Tidewater and Southern Railway Co.*, 12 C.R.C. 182 (1917); *Western Motor Transport Co.*, 17 C.R.C. 778 (1920).

⁵⁵ 6 C.R.C. 217 (1915).

⁵⁶ "In view of the situation herein found to exist, I recommend that a final order be granted to this applicant to issue bonds only after it shall have adjusted its accounts with its affiliated and associated companies, to the end that any profit heretofore made or proposed to be made by such affiliated or associated corporations at the expense of this applicant be eliminated. . . . The practice cannot be defended and the recommendation herein made will suggest that bonds be authorized only after the proper adjustments have been made to give to this applicant all that rightfully belongs to it." *Ibid.*, 224. For a parallel treatment of the same sort of situation in a valuation case see *Central Pacific Company*, 8 C.R.C. 640 (1915). In *Feather River Power Co.*, 27 C.R.C. 43, 47 (1925), the commission said: "The contract has not been awarded under competitive bidding. The record shows that the contractor has an interest in this project other than constructing the same. While the extent of such interest is not disclosed, the contract does have the earmarks of an old time practice which has repeatedly come into disfavor. We will not approve the construction contract. . . ."

²⁷ 30 C.R.C. 761 (1927), and 31 C.R.C. 49 (1928).

²⁸ "The authority granted can not deprive applicant of the right to earn a reasonable return on its investment and, in our opinion, is not confiscatory. The question of rates and return is not involved in this proceeding. In fixing rates it is not the practice of the Commission to use as a rate base the amount of securities outstanding, nor does it use as a rate base the figures carried in the fixed capital accounts on the utilities' books, unless such figures at the time the rates are fixed, represent, in the opinion of the Commission, the reasonable value of a utility's property." *Pickwick Stages System*, 31 C.R.C. 746, 750 (1928), second supplemental opinion.

²⁹ See footnote 13.

³⁰ 8 C.R.C. 452 (1915).

³¹ *Ibid.*, 465. See: *Citrus Belt Gas Co.*, 2 C.R.C. 725 (1913); *Midway Gas Co.*, 7 C.R.C. 246 (1915); *El Segundo Water Co.*, 21 C.R.C. 695 (1922).

³² *Los Angeles and San Diego Beach Ry. Co.*, 5 C.R.C. 623 (1914).

³³ *Black Diamond Water Co.*, 17 C.R.C. 260, 262 (1919): "It is true that at times the Commission has fixed rates designed to yield an 8 per cent return, but it should be remembered that in all rate, as well as in all other proceedings, the orders of the Commission are based upon the facts before it. . . . The proper remedy in case of a loss would appear to be to ask for a revision of rates before or shortly after the effective date of the Commission's decision and not wait for three years and then apply for permission to capitalize the difference between the actual net return and an assumed return." See Pegrum, D. F., *op. cit.*, chap. III, on this point.

³⁴ *Cloverdale Light & Power Co.*, 2 C.R.C. 1002 (1913); *City of San Diego*, 4 C.R.C. 902 (1914); *San Joaquin Light & Power Corp.*, 9 C.R.C. 543 (1916). See also Pegrum, D. F., *op. cit.*, chap. II. In *Southern Counties Gas Co.*, 5 C.R.C. 110 (1914), the commission refused to allow the company to fund money expended in the purchase of gas stoves and other gas appliances which the applicant had sold in the development of its business. Since the consumers had paid for these appliances, the expenditures were properly chargeable against income and therefore not capitalizable. In *Mesmer City Water Co.*, 31 C.R.C. 661 (1928), application was made to issue securities in the transfer of properties, against operating losses which the previous owners had incurred. The applicants asked permission to issue securities for good will to the amount of \$15,000, contending that this represented amounts which had been advanced and which would have to be advanced to cover operating losses. The commission said it did not possess the power to grant such a request.

For another illustration of refusal to allow capitalization of intangible good will see, *California-Nevada Stages Co.*, 26 C.R.C. 259 (1925).

³⁵ See: *San Diego Consolidated Gas & Electric Co.*, 2 C.R.C. 264 (1913); 3 C.R.C. 80 (1913), and 7 C.R.C. 244 (1915); *Great Western Power Co.*, 2 C.R.C. 276 (1913).

³⁶ "The main purpose of a sinking fund is to gradually reduce indebtedness created by the issuance of bonds, and in order to carry out such purpose, the sinking fund should, under ordinary circumstances, be maintained from the earnings of a corporation, or at least from sources other than those which create new obligations. Manifestly, to permit the issuance of new bonds with which to acquire underlying bonds to be placed in a sinking fund, in effect, continues the indebtedness of the company and defeats the real purpose of the sinking fund. Of course, if the financial condition of the company is such that its earnings and margin of property over indebtedness warrants the continuance of its obligations undiminished, the process might not be objectionable, but

unless this condition is disclosed the real purpose of creating the sinking fund should be adhered to and it should be maintained out of earnings, thus diminishing the obligations of the corporation." *Pacific Light and Power Corporation*, 3 C.R.C. 787 (1913). In *Western States Gas & Electric Co.*, 27 C.R.C. 312 (1925), the commission refused to allow the refunding of sinking fund payments through the issuance of preferred stock until such time as the company's net earnings were substantially in excess of preferred stock dividends. This was done to prevent jeopardizing the equity and dividends of the preferred stocks.

But sinking fund payments cannot be treated as expenses. See *Associated Telephone Co.*, 21 C.R.C. 130 (1922).

⁶⁷ *Pacific Gas & Electric Co.*, 9 C.R.C. 492 (1916).

⁶⁸ *Great Western Power Co.*, 18 C.R.C. 654, 656 (1920): "No doubt, applicant's officers are aware that sinking fund payments are not and cannot be regarded by this Commission as an operating expense and that such payments are an obligation assumed by the stockholders, and must be paid out of funds contributed by stockholders or out of surplus earnings which might be distributed to stockholders."

⁶⁹ See below for discussion of reimbursement.

⁷⁰ 14 C.R.C. 798, 799 (1917): "Because of the fact that this property is viewed as having a short term life, the function of the depreciation reserve seems to me, in this case, to be not so much to replace the property as worn out and thus to keep the investment intact, as to restore the investment to the investors. . . ."

"No matter for what purpose the depreciation fund has or will be used, I am of the opinion that it should not be capitalized. Counsel for the petitioner agrees with me on this conclusion."

⁷¹ "This Commission cannot, of course, authorize the issue and sale of stock to cover the cost of franchises in excess of the actual cost of the same (Public Utilities Act, sec. 52). The order herein will limit the amount of stock which the petitioner may issue and sell for this purpose to such amount as petitioner may show as its actual cost." *Colorado Telephone Co.*, 12 C.R.C. 708 (1917). See also *Boulevard Express, Inc.*, 23 C.R.C. 299 (1923) in which the commission refused to allow the capitalization of a leasehold because rent on a lease is an operating expense.

⁷² 15 C.R.C. 175 (1918). See also *Pickwick Stages Co.*, 20 C.R.C. 672 (1921).

In *Inland Navigation Co.*, 1 C.R.C. 245 (1912), a request to capitalize contracts made with private concerns for transportation, the claim was made that considerable time and expense was involved in securing these. Permission was sought to issue stock of the par value of \$20,000 against these contracts and a steamer valued at \$10,500. The commission gave consideration to the cost of securing the contracts and authorized \$12,000 of stock.

"It must be borne in mind that in fixing the rates and fares which it will charge the public as a common carrier, applicant may reasonably be expected to ask for such rates and fares as will give fair return upon its investment, and in view of this fact, I am of the opinion that this Commission cannot consistently permit applicant to capitalize its contracts in the manner asked for." (246).

⁷³ 2 C.R.C. 273, 274 (1913): "I am not disposed to say to applicant that it shall not expend the sum of \$12,000 for a lot and a new building thereon, but I desire earnestly to draw applicant's attention to the necessity of conserving its resources to take care of the growing demands of the territory which it holds itself out as serving. Applicant should understand that this Commission will expect it to furnish adequate service on

reasonable demand entirely irrespective of whether applicant purchases the new lot and erects the proposed building thereon. . . .

"It should be borne in mind that a utility's first duty is to render efficient and sufficient service for both its present and its prospective consumers."

The commission has even refused to allow a purely private payment for a certificate of convenience and necessity because such payment would financially embarrass the applicant. *C. N. Clark and E. J. Ramsey*, 21 C.R.C. 505 (1922).

⁷⁴ 18 C.R.C. 889 (1920).

⁷⁵ 18 C.R.C. 471, 480 (1920). See also *Great Western Power Co.*, 18 C.R.C. 494 (1920). But bonds may be refused when the interest rate is too high. See *Pasadena Electric Express Co.*, 26 C.R.C. 568 (1925).

⁷⁶ 2 C.R.C. 352, 357 (1913): "I am unable to say from the evidence whether or not the applicant will be able to earn the revenue it anticipates. In this case as in all others involving the development of the State, in which there is a reasonable doubt, I believe that the doubt should be resolved in favor of the utility. The Commission can see to it that the money derived from the sale of the securities goes into the property, but it cannot say whether or not the enterprise will succeed and will be able to pay the hoped for interest on bonds or dividends on stock" 2 C.R.C. 352, 357 (1913). See also: *San Jose Terminal Ry. Co.*, 1 C.R.C. 708 (1912); *Los Angeles and San Diego Beach Ry. Co.*, 5 C.R.C. 623 (1914).

⁷⁷ *Empire Water Co.*, 3 C.R.C. 673, 674 (1913). Unusual conditions surrounding the business of a utility are also grounds for greater latitude, *Midway Gas Co.*, 7 C.R.C. 246, 268 (1915):

"The ordinary principles of public utility finance, which imply a fixed condition of assets and a stable and continuous condition of income, are not applicable to the affairs of a natural gas corporation, such as is here under consideration. It partakes more of the nature of an oil or mining enterprise. For that reason the regulating body should allow the greatest latitude commensurate with the public interest." And in a supplemental opinion, 8 C.R.C. 9, 13 (1915): "The ability to earn on the stocks, bonds, and notes herein authorized is dependent upon so many elements of hazard that there has been no endeavor herein to limit stocks, bonds and notes to a basis upon which the applicant might reasonably be expected to earn a return." But it should be noted that the financing approved of presented a marked improvement over that which had previously existed.

⁷⁸ *Central California Gas Co.*, 1 C.R.C. 134 (1912); *Tonopah and Tidewater Railroad Co.*, 3 C.R.C. 1057 (1913); *James Murray and Ed. Fletcher*, 4 C.R.C. 1294 (1914); *Oakland, Antioch and Eastern Ry. Co.*, 5 C.R.C. 117 (1914); *Long Beach Consolidated Gas Co.*, 6 C.R.C. 419 (1915); *Pacific Gas and Electric Co.*, 6 C.R.C. 926 (1915); *Santa Barbara Telephone Co.*, 11 C.R.C. 740 (1916); *San Joaquin Light and Power Corp.*, 16 C.R.C. 440 (1919); *Southern Sierras and San Francisco Power Co.*, 16 C.R.C. 825 (1919); *Union Home Telephone and Telegraph Co.*, 18 C.R.C. 80 (1920); *El Pismo Water Co.*, 29 C.R.C. 261 (1927).

"The Commission does not use the value or cost of properties as the sole measure in determining the capitalization but gives consideration to earnings and various other elements. It will not, for example, permit the issue of securities to acquire a property, equal to the value thereof, if the earnings have not been and apparently will not be sufficient to meet fixed charges on such securities. To this extent the revenue is a limiting factor." *Annual Report 1926-1927*, 56.

⁷⁹ 16 C.R.C. 825, 829 (1919): "If the company expects to continue its existence as an active utility rendering reasonable service to the public and fulfilling its obligations

and continuing as a monopoly in the district, it must put itself in such financial condition as will make possible financing of sufficient magnitude to enlarge its system and maintain service to meet the demands of the territory it holds itself out to serve. If its financial structure is such as to make impossible reasonable financing it is its duty to promptly remedy the same even if this requires drastic action on its part."

⁸⁰ *Annual Report 1912-1913*, 174 f.

⁸¹ *Pacific Gas and Electric Co.*, 2 C.R.C. 931, 933 (1913): "As a matter of general policy I am strongly of the belief that public utility corporations should finance additions and betterments both through bonds and stock. In cases in which a corporation has an unusually large unbonded equity it may be the part of wisdom to issue bonds for the full amount of new construction. Where such is not the case, however, and a merely normal relationship exists between outstanding bonds and the value of the property, I believe utilities should be encouraged to raise their additional funds partly from bonds and partly from stock." See *Central California Gas Co.*, 1 C.R.C. 134 (1912); *San José Terminal Ry. Co.*, 1 C.R.C. 708 (1912); *San Diego, Riverside and Los Angeles Ry. Co.*, 1 C.R.C. 888 (1912); *Lindsay Home Telephone and Telegraph Co.*, 10 C.R.C. 715 (1916).

⁸² *Torrance Water, Light & Power Co.*, 3 C.R.C. 361 (1913): "The public has a direct interest in the capitalization of a public utility corporation. If such a corporation is conservatively capitalized it makes it possible to obtain money to make extensions, additions and betterments as they are needed; whereas if the corporation is overbonded it becomes impossible to use the property of the company as security for such purposes, and the public suffers the lack of much needed service."

⁸³ 6 C.R.C. 776 (1915).

⁸⁴ *Annual Report 1927-1928*, 10.

⁸⁵ 30 C.R.C. 411 (1927). See also, *California Water Service Co.*, 30 C.R.C. 876 (1927).

⁸⁶ *Central California Gas Co.*, 1 C.R.C. 664 (1912): "Heretofore this Commission has only allowed issues of bonds against property in an amount substantially less than the value of the property. The difference necessary to be added in order to produce the property should ordinarily be raised from the sale of common stock the holders of which have no promise implied or otherwise, that they will participate in any amount of dividends." (664) Bonds and preferred stock of par value greater than the value of the property were allowed because of exceptional circumstances and because much of the financing took place before the effective date of the Public Utilities Act.

⁸⁷ 5 C.R.C. 639, 640 (1914); see also: *Santa Barbara Telephone Co.*, 11 C.R.C. 470 (1916); *Home Telephone Co. of Covina*, 27 C.R.C. 179 (1925).

⁸⁸ *Ibid.*, 642. The commission required: "That any order made be made upon the condition that the present stockholders of this applicant shall supply any deficiency, if such be found to exist, between the sum of the obligations of this applicant and its preferred stock on the one hand and the value of its property as it may be determined by the Commission, on the other hand"

In *San Geronio Power Co.*, 25 C.R.C. 484 (1924), it was said: "While it is true that the dividends on the preferred stock are not a fixed charge, yet it is a fact that many purchasers of preferred stock believe or are led to believe that dividends on such stock are guaranteed and will be paid without fail," (487). But in *El Pismo Water Co.*, 29 C.R.C. 261, 262 (1927), it was definitely stated: "Neither the articles of incorporation nor any action taken by this Commission guarantees the payment of dividends on preferred stock." For other cases on the care taken to safeguard preferred stock, see: *San*

Joaquin Light and Power Corp., 24 C.R.C. 377 (1924); *Western States Gas and Electric Co.*, 27 C.R.C. 312 (1925); *San Joaquin Light and Power Co.*, 28 C.R.C. 864 (1926); *Los Angeles-Long Beach Despatch Line*, 36 C.R.C. 754 (1931).

¹⁰ See: *Central California Gas Co.*, 1 C.R.C. 134 (1912); *San Jose Terminal Ry. Co.*, 1 C.R.C. 708 (1912); *Great Western Power Co.*, 2 C.R.C. 276 (1913); *Pacific Gas and Electric Co.*, 2 C.R.C. 931 (1913); *San Diego Electric Ry. Co.*, 5 C.R.C. 517 (1914); *San Francisco-Richmond Ferry Co.*, 22 C.R.C. 52 (1922).

¹¹ 3 C.R.C. 1057 (1913). See also, *Trona Ry. Co.*, 5 C.R.C. 620 (1914); *Reorganization of United Light and Power Co.*, 6 C.R.C. 808 (1915); *Minarets and Western Ry. Co.* 22 C.R.C. 39 (1922), and 23 C.R.C. 257 (1923).

¹² 7 C.R.C. 246 (1915).

¹³ 3 C.R.C. 24 (1913).

¹⁴ 3 C.R.C. 817 (1913).

¹⁵ *Ibid.*, 828.

¹⁶ See *Pacific Gas and Electric Co.*, 6 C.R.C. 926, 929 (1915): "The evil in the whole situation of common stock arises primarily from the par value feature by which a certificate bears a fixed par value and assumes to represent that par value when, as a matter of fact, it represents nothing more than a proportional interest in the remaining assets and profits." See footnote 20, *supra*.

¹⁷ *United Railroads of San Francisco*, 2 C.R.C. 140 (1913); *San Diego Cons. Gas and Electric Co.*, 2 C.R.C. 264 (1913); *San Joaquin Light and Power Co.*, 28 C.R.C. 864 (1926).

¹⁸ Thus, in *East Bay Water Co.*, 22 C.R.C. 370, 371 (1922), "... the Commission recited that there was no objection to the refunding of funded debt through the issue of stock, provided that the company's properties were reasonably capitalized. If the capitalization is in excess of the reasonable value of the properties, surplus earnings should be used to pay funded debt and no stock issued to reimburse the treasury because such earnings were used to meet sinking fund requirements."

¹⁹ *Northern California Power Co.*, 1 C.R.C. 407 (1912); *Oakland, Antioch and Eastern Railway Company*, 4 C.R.C. 142 (1914), and 5 C.R.C. 117 (1914); *Midland Counties Public Service Corp.*, 13 C.R.C. 321 (1917). In *Coast Valleys Gas and Electric Co.*, 20 C.R.C. 873, 875-876 (1921), the commission said:

"It occurs to me that applicant should refund all of its outstanding stock and bring its capitalization in line with its rate-base plus a proper allowance for non-operative income producing properties.

"Improper financing, carried over from the period when this Commission did not have control over the issue of stocks and bonds, has resulted in some utilities depending entirely on borrowed funds or earnings for moneys to pay for additions and betterments. The result has been the payment of high interest rates for loaned capital. The inability to sell stock is not always due to low earnings on property used and useful in rendering service to the public, but frequently is caused by the fact that a large amount of stock is outstanding which does not rest upon any real equity. It is only through refinancing and the sale of stock that such conditions can be remedied. It is unfortunate that the Commission has not sufficient power to take positive action in these matters. I am convinced that antiquated financial structures have seriously handicapped utilities in their financing and have been a cause in rendering unsatisfactory service to the public."

But bonds were authorized even though overcapitalization existed and earning prospects were unsatisfactory in *Sonoma Water and Irrigation Co.*, 36 C.R.C. 461 (1931),

because of the serious service situation which obtained. Public interest was considered of paramount importance and funds were urgently needed for reconstruction.

⁹⁹ 20 C.R.C. 799 (1921). See: *Santa Monica Bay Home Tel. Co.*, 21 C.R.C. 766 (1922). In *Southern California Telephone Co.*, 31 C.R.C. 255, 258 (1928), the commission said: "... the mere fact that in 1921 the applicant executed an instrument providing for the issue in 1927 of 7 per cent notes is not in itself sufficient reason for this Commission to now authorize the issue of the notes."

¹⁰⁰ In *California and Southern Railway Co.*, 8 C.R.C. 36 (1915), sales below 80 were allowed but there was the prospect that the railroad would receive bonuses from settlers and land companies which would assist in the promotion of the enterprise. See also *Federal Telegraph Co.*, 22 C.R.C. 661 (1922); *Palm Valley Water Co.*, 24 C.R.C. 615 (1924).

¹⁰¹ 2 C.R.C. 618 (1913). In *Tulare County Power Co.*, 2 C.R.C. 227 (1913), the commission authorized the sale of bonds at 80 although it felt that 85 should be the minimum price. Consequently, it ordered the company to raise the balance from stockholders and to invest that amount in additions or betterments.

¹⁰² 2 C.R.C. 610 (1913).

¹⁰³ 4 C.R.C. 127 (1914). This was an instance of concern doing both a utility and non-utility business; see *infra*, pp. 184 f.

¹⁰⁴ *Ibid.*, 129: "It must be admitted that a public utility's ability to raise money when needed for extensions, additional service, improvements of service, etc., is a matter of importance to the public, at least that part of the public represented by the patrons of public utilities. And it must also be admitted that capital stock is a very important asset which may be sold to raise money for these purposes.

"Obviously, then, to sell stock at less than its market value is to deprive the utility company by that much of an opportunity to raise money for the purposes above mentioned and to that extent the public is injured."

¹⁰⁵ *Southern Counties Gas Co.*, 32 C.R.C. 570 (1929); *San Diego Consolidated Gas Co.*, 32 C.R.C. 573 (1929); *Pacific Gas and Electric Co.*, 32 C.R.C. 594 (1929); *Southern California Edison Co.*, 32 C.R.C. 659 (1929).

¹⁰⁶ *Pacific Gas and Electric Co.*, 32 C.R.C. 594, 596 (1929). The Southern Counties Gas Co. and the San Diego Cons. Gas Co. were both subsidiaries of holding companies which owned practically all the common stock. The same remarks applied to both however.

¹⁰⁷ *Southern California Edison Co.*, 27 C.R.C. 761 (1926); *Pacific Gas and Electric Co.*, 29 C.R.C. 139 (1926).

¹⁰⁸ 35 C.R.C. 144 (1930).

¹⁰⁹ *Sierra Water Service Co.*, 38 C.R.C. 809 (1933).

¹¹⁰ 30 C.R.C. 168 (1927).

¹¹¹ 1 C.R.C. 510 (1912). The exchange of securities was also illegal because the railway had not received the consent of the commission. See also, *Sacramento Valley Electric Ry. Co.*, 1 C.R.C. 389 (1912).

¹¹² *Golden Gate Ferry Co.*, 19 C.R.C. 238, 242, (1921). See also *Donovan Transportation Co.*, 24 C.R.C. 723 (1924). For other cases objecting to excessive selling costs, see: *Richmond-San Francisco Transportation Co.*, 24 C.R.C. 257 (1923); *Pasadena Electric Express Co.*, 26 C.R.C. 568 (1925).

In *Consolidated Motor Freight Lines*, 27 C.R.C. 813 (1926), the commission found

that the company had paid more in selling commissions and expenses than it had been authorized to do. "When this Commission grants a utility permission to issue securities and fixes the terms and conditions under which such securities may be issued and sold, it expects and must require the officers of the utility to comply with its orders. If such orders are violated, we believe that they and not the company or its innocent stockholders should be required to make restitution." (813) Restitution was ordered and no new securities were to be issued until these instructions were complied with.

¹¹⁸ 3 C.R.C. 980, 983 (1913). See also: *San Rafael and San Anselmo Valley Ry. Co.*, 3 C.R.C. 874 (1913); *Sausalito Incline Ry. Co.*, 5 C.R.C. 448 (1914); *California and Southern Ry. Co.*, 8 C.R.C. 36 (1915); *Tidewater and Southern Ry. Co.*, 12 C.R.C. 182 (1917). In *Marin County Electrical Rys.*, 4 C.R.C. 840, 841-842 (1914), the commission said: "This Commission has heretofore found that the promoter of a public utility enterprise is entitled to liberal reward for his service. If the promoter is entitled to his profit, he must be willing to bear his responsibility. It may often happen that a promoter risks nothing, and if the stock sale is unsuccessful, the financial loss falls solely upon those whom his efforts have persuaded to invest. It is proper that the expense of preliminary organization and of stock selling should be borne at the beginning by the promoter. If the enterprise fails it is his loss. If he succeeds then he is entitled to reimbursement either in stock or in cash from the company's funds."

¹¹⁹ 3 C.R.C. 66 (1913); see *supra*, note 54.

¹²⁰ 26 C.R.C. 118, 119-120 (1925): "The records of the Commission show that it has repeatedly denied requests for permission to issue stock for control purposes. It has followed the policy that those who purchase stock and pay cash therefor should control the affairs of a corporation rather than those who transfer to the corporation in exchange for stock, intangible property values, such as franchise rights, good will and going concern value. True, heretofore, stock sought to be issued carried a par value, but the mere fact that stock may be without par value, does not alter the situation. In the present instance, the end sought through the issue of no par stock, is control of the corporation. George R Schneider, as said, though furnishing less than 20 per cent of the tangible capital, is to be given control. I believe that the policy of the Commission not to authorize the issue of stock for control purposes is sound and have no intention to recommend a departure therefrom in this proceeding." See also, *Public Utilities Storage Co.*, 27 C.R.C. 539 (1926). In *California-Oregon Power Co.*, 36 C.R.C. 717 (1931), the commission refused an application to issue no-par common stock at \$25 because the preferred had a par of \$100 and each share had one vote. The granting of the request would have vested control in the common stockholders who had contributed the smallest part of the investment.

¹²¹ *Annual Report 1915-1916*, I, 107.

¹²² *Big Four Electric Ry. Co.*, 2 C.R.C. 546 (1913).

¹²³ 3 C.R.C. 874 (1913). See also *Marin County Electric Rys.*, 4 C.R.C. 840 (1914).

¹²⁴ 5 C.R.C. 613 (1914).

¹²⁵ 26 C.R.C. 801 (1925). See also, *San Joaquin Compress and Warehouse Co.*, 26 C.R.C. 805 (1925). On the same grounds the commission refused to allow the *Pittsburg-Sacramento Auto Ferry Co.*, 22 C.R.C. 355 (1922), to require notes for deferred payments on subscriptions.

¹²⁶ 21 C.R.C. 468 (1922).

¹²⁷ 3 C.R.C. 167 (1913).

¹⁸⁰ "Before the Public Utilities Act was drawn, one of the members of the Public Service Commission of New York drew attention to the fact that under a similar provision in the public service commission law of New York, some utilities were giving notes for periods of less than twelve months and then refunding these notes by means of other notes also running less than twelve months with the result that in this way their financial operations were being taken out from the jurisdiction of the Commission" *Ibid.*, 169.

¹⁸¹ *Ibid.*, 169.

¹⁸² See, *People's Water Co.*, 2 C.R.C. 448 (1913); *Southern Counties Gas Co.*, 15 C.R.C. 106 (1920).

¹⁸³ 5 C.R.C. 177 (1914). In *San Diego Home Telephone Co.*, 3 C.R.C. 856 (1913), application was made to issue notes to be secured by bonds due serially from one to five years. The bonds were to be pledged in a 3 to 1 ratio. "This Commission has never authorized the pledging of bonds in so large a ratio and I can not believe that it is necessary in this case. Bonds in the ratio of 2 to 1 will give the lenders on the notes ample security." (859)

¹⁸⁴ *Pacific Gas and Electric Co.*, 3 C.R.C. 382 (1913); *Tulare Home Telephone and Telegraph Co.*, 4 C.R.C. 621 (1914).

¹⁸⁵ *United Railroads of San Francisco*, 9 C.R.C. 40, 42 (1916): "As the interest coupons which United Railroads of San Francisco attached to the bonds of Ferries and Cliff House Railway Company are clearly promises to pay interest, they constitute 'notes' and 'evidences of indebtedness,' as those words are used in section 52 of the Public Utilities Act. Hence, in so far as such interest coupons were payable at periods of more than twelve months after the date of their issue, this Commission's authority for the issue thereof should have been secured."

¹⁸⁶ 2 C.R.C. 124 (1913).

¹⁸⁷ See also, *Farmers' Warehouse Co.*, 3 C.R.C. 661 (1913); *Griffin Transfer and Storage Co.*, 3 C.R.C. 977 (1913); *Standard Oil Co.*, 4 C.R.C. 127 (1914); *Southern Pacific Milling Co.*, 5 C.R.C. 630 (1914); *Modesto Farmers' Union*, 13 C.R.C. 233 (1917); *Security Wholesale Cold Storage Co.*, 17 C.R.C. 584 (1919); *Western States Warehouse Corp.*, 19 C.R.C. 527 (1921).

¹⁸⁸ 11 C.R.C. 888.

¹⁸⁹ *H. Clay Needham*, 8 C.R.C. 403 (1915). See also, *Laguna Heights Water System*, 18 C.R.C. 116 (1920).

In its order the commission usually includes some provision such as the following: "The order herein will require applicant to file with the railroad commission a stipulation duly authorized by its board of directors agreeing that it, its successors and assigns, will never ask the Railroad Commission, or any other public body having jurisdiction, to include in a rate-base such an amount of the proceeds realized from the stock herein authorized as may be expended for nonpublic utility property or purposes." *Northern California Wool Warehouse Co.*, 19 C.R.C. 593, 594 (1921). See also, *Butte Meadows Tel. and Tel. Co.*, 28 C.R.C. 304 (1926).

¹⁹⁰ 25 C.R.C. 231 (1924).

¹⁹¹ When the Public Utilities Act was first passed, refunding of this nature was limited to expenditures made within five years next prior to the filing of the application. This time limit was removed in 1915.

¹²⁶ 1 C.R.C. 422, 427 (1912). "It should be distinctly understood that this Commission does not in its decision on this application commit itself to the extent that it will necessarily authorize the capitalization of moneys spent from income whenever the fact of such expenditure for the purposes authorized by law is shown. The Public Utilities Act gives the Commission in this regard a wide discretionary power. The Commission will on such applications always take into consideration the amount of capital stock and of bonds, notes or other evidence of indebtedness already outstanding and will in each case determine on the facts of that case whether, in view of all the facts, including particularly, the amount of stock and securities already outstanding, the additional capitalization prayed for should be permitted."

¹²⁸ 29 C.R.C. 158, 161 (1926). See, *Pacific Gas and Electric Co.*, 21 C.R.C. 268 (1922); *Pacific Tel. and Tel. Co.*, 21 C.R.C. 522 (1922); *Key System Transit Co.*, 29 C.R.C. 33 (1926).

¹²⁷ *Sawtelle Water Co.*, 4 C.R.C. 723, 724 (1914): "An application for reimbursement must be substantiated by proper showing that such money has been earned and thereafter invested for purposes properly chargeable to capital account." See also, *San Joaquin Light and Power Co.*, 16 C.R.C. 885 (1919); *San Diego Consolidated Gas and Electric Co.*, 27 C.R.C. 678 (1926); *San Joaquin Light and Power Co.*, 28 C.R.C. 864 (1926).

¹²⁸ *Pomona Valley Tel. and Tel. Union*, 21 C.R.C. 367 (1922); *Wilmington Transportation Co.*, 24 C.R.C. 407 (1924); *Associated Telephone Co.*, 26 C.R.C. 514 (1925).

¹²⁹ *Western States Gas and Electric Co.*, 17 C.R.C. 917 (1920); *Great Western Power Co.*, 18 C.R.C. 654 (1920).

¹²⁰ *Campbell Water Co.*, 3 C.R.C. 863 (1913). In *Auto Transit Co.*, 25 C.R.C. 184, 187 (1924), it was stated: "The Commission under the Public Utilities Act has no power to authorize the issue of stock for the purpose of paying a stock dividend. It can, however, upon proper showing authorize the issue of stock for the purpose of reimbursing the company's treasury because of earnings invested in the properties and business of the company and if such order is made the company thereafter can distribute the stock as a stock dividend." See also, *San Diego Consolidated Gas and Electric Co.*, 27 C.R.C. 678 (1926).

¹²¹ *Campbell Water Co.*, 4 C.R.C. 961 (1914). The amount of the surplus was determined by valuation of the property.

¹²² *Annual Report 1923-1924*, 59; *Valley Natural Gas Co.*, 14 C.R.C. 798 (1917); *Truckee Light and Power Corp.*, 24 C.R.C. 385 (1924).

¹²³ *Pacific Gas and Electric Co.*, 6 C.R.C. 926 (1915); *Valley Natural Gas Co.*, 14 C.R.C. 798 (1917); *Southern Counties Gas Co.*, 22 C.R.C. 740 (1922).

"While I recognize that the relation of a corporation's assets to its capitalization may be such as to make it relatively unimportant whether sinking funds reserves be allowed to remain in surplus, I am convinced that, as has heretofore been shown, the relation of applicant's assets to its capitalization at this time is such as to make it improper that it should set aside sinking funds reserves which are designed to reduce capitalization as compared to assets, and at the same time allow these reserves to appear in surplus out of which dividends will be declared, thus in effect, nullifying the benefits by way of decreased capitalization which would result if the money represented by the dividends had been allowed to remain in assets." *Pacific Gas and Electric Co.*, 9 C.R.C. 492, 498-499 (1916).

¹⁴⁴ 25 C.R.C. 858, 860 (1925). Similarly in *Redondo Home Telephone Co.*, 26 C.R.C. 1, 4 (1925): "An issue of stock for the purpose of paying a dividend is limited by the amount of money not obtained from the issue of stocks, bonds or other evidences of indebtedness expended for the purposes mentioned in section 52 of the Public Utilities Act, and by the amount of unappropriated corporate surplus." See also, *California Transit Co.*, 21 C.R.C. 211 (1922).

¹⁴⁵ *Redondo Home Telephone Co.*, 26 C.R.C. 1 (1925); *San Diego Consolidated Gas and Electric Co.*, 27 C.R.C. 678 (1926).

¹⁴⁶ *Ojai Power Co.*, 26 C.R.C. 756 (1925).

¹⁴⁷ *Coast Valleys Gas and Electric*, 1 C.R.C. 839 (1912), and 1 C.R.C. 1016 (1912).

¹⁴⁸ *Valley Fuel and Gas Co. et al.*, 2 C.R.C. 589 (1913); *Cloverdale Light and Power Co.*, 2 C.R.C. 1002 (1913); *Livermore Water and Power Co.*, 2 C.R.C. 618 (1913); *San Joaquin Valley Farm Lands*, 4 C.R.C. 375 (1914); *Hughson Water Co.*, 5 C.R.C. 251 (1914); *Santa Barbara Telephone Co.*, 11 C.R.C. 470 (1916); *Pacific Public Service Corp.* 14 C.R.C. 53 (1917); *New Freeport Telephone and Telegraph Co.*, 14 C.R.C. 729 (1917); *Santa Barbara Gas and Electric Co.*, 16 C.R.C. 799 (1919).

¹⁴⁹ *Tulare County Power Co.*, 7 C.R.C. 703 (1915). *San Diego Consolidated Gas and Electric Co.*, 10 C.R.C. 230 (1916).

¹⁵⁰ For consolidation cases involving valuation see: *Pacific Gas and Electric Co. and Western States Gas and Electric Co.*, 22 C.R.C. 736 (1922); *California-Nevada Stages*, 26 C.R.C. 259 (1925); *Peerless Stages, Inc.*, 30 C.R.C. 346 (1927); *Los Angeles County Water Works*, 30 C.R.C. 577 (1927); *California Water Service Co.*, 30 C.R.C. 876 (1927); *Santa Cruz Utilities Co.*, 31 C.R.C. 32 (1928); *Tuolumne County Electric Power and Light Co.*, 31 C.R.C. 189 (1928); *California Water Service Co.*, 31 C.R.C. 327 (1928); *Great Western Power Co.*, 31 C.R.C. 718 (1928); *South Gas Co.*, 33 C.R.C. 52 (1929); *Hollister Water Co.*, 33 C.R.C. 345 (1929); *Francis Land and Water Co.*, 33 C.R.C. 560 (1929); *Santa Rosa Water Works Co.*, 35 C.R.C. 766 (1931); *Sierra Water Service Co.*, 38 C.R.C. 809 (1933).

¹⁵¹ 16 C.R.C. 79 (1919). The opposite of this situation was presented in application for consolidation by *Sacramento Northern Railroad, et al.*, 20 C.R.C. 679 (1921). Inter-venors in this case objected to the application on the ground, among others, that the price offered for the properties was such that the transfer would result in actual or implied fraud upon the rights of the stockholders and bondholders who had not deposited their securities. The commission stated that it had announced on several occasions that it did not have sufficient jurisdiction to determine charges of fraud and that these would have to be adjudicated in the courts. It pointed out also that 97 per cent of the stockholders and 98 per cent of the bondholders had deposited their securities and that the consolidation was in the public interest. The application was granted. See also, *Western Pacific Railroad Co.*, 12 C.R.C. 624 (1917).

¹⁵² See also, *Livermore Water and Power Co.*, 2 C.R.C. 618 (1913); *California and Oregon Telegraph Co.*, 4 C.R.C. 168 (1914); *San Diego Consolidated Gas and Electric Co.*, 10 C.R.C. 230 (1916); *San Diego Consolidated Gas and Electric Co.*, 12 C.R.C. 481 (1917); *Pacific Public Service Corp.*, 14 C.R.C. 53 (1917); *San Diego Consolidated Gas and Electric Co.*, 21 C.R.C. 858 (1922), and 22 C.R.C. 167 (1923); *Tuolumne County Electric Power and Light Co.*, 31 C.R.C. 189 (1928); *California Water Service Co.*, 31 C.R.C. 327 (1928); *Great Western Power Co.*, 31 C.R.C. 718 (1928).

¹⁵³ *South Coast Gas Co.*, 33 C.R.C. 52, 55 (1929).

¹⁵⁴ 36 C.R.C. 433, 439 (1931).

¹⁸⁰ *San Diego Cons. Gas and Electric Co.*, 10 C.R.C. 230 (1916); *Tuolumne Electric Power and Light Co.*, 31 C.R.C. 189 (1928); *Southern California Edison Co.*, 31 C.R.C. 262 (1928); *California Water Service Co.*, 31 C.R.C. 327 (1928); *Pacific Gas and Electric Co.*, 34 C.R.C. 814 (1930); *San Diego Cons. Gas and Electric Co.*, 35 C.R.C. 366 (1930).

¹⁸¹ *Santa Barbara Telephone Co.*, 11 C.R.C. 470 (1916). See: *Riverside Home Telephone and Telegraph Co.*, 11 C.R.C. 922 (1916); *Pacific Gas and Electric Co.*, and *Western States Gas and Electric Co.*, 22 C.R.C. 736 (1922).

¹⁸² 2 C.R.C. 1002 (1913).

¹⁸³ 13 C.R.C. 262 (1917).

¹⁸⁴ *Southern California Telephone Co.*, 11 C.R.C. 806, 851 (1916): "The general public, however, is not so much interested in the amount of securities which will be issued to the Home Company and the Pacific Company, respectively, as in the total amount of securities issued by the Southern company, on which it will hereafter expect to earn interest and dividends. If the total amount of securities to be issued by the Southern company is not unfairly high, the general public is not so much interested in the division of these securities as between the Home company and the Pacific company, or in the question as to which of these companies has driven the better bargain."

In reality this amounted to writing the excess out of surplus since the Pacific Telephone owned the Southern Telephone Company. However, the authorities have pointed out that in an application of one utility to acquire by exchange outstanding stock of other utilities any action that they or the applicant may take in the matter is not compulsory, and any holders of stock not desiring to accept the offer of exchange may continue the ownership of stock held by them. *Pacific Gas and Electric Co.*, 30 C.R.C. 756 (1927).

¹⁸⁵ *Santa Barbara Gas and Electric Co.*, 16 C.R.C. 799, 806 (1919).

¹⁸⁶ *Valley Gas and Fuel Co.*, 2 C.R.C. 589, 592 (1913); also, *Livermore Water and Power Co.*, 2 C.R.C. 618 (1913). In view of the arguments advanced by utility attorneys in rate cases, it is no wonder that the authorities are wary.

¹⁸⁷ *Pacific Public Service Corporation*, 14 C.R.C. 53 (1917). The Commission "is firmly convinced that its policy of limiting security issues to the actual cost of the properties, allowing the present land value, due consideration being given to earning rather than the sale price of such properties, is sound and in the interest of both the purchaser of public utility securities and the patron of the utility." *Annual Report 1927-1928*, 10. See also *Annual Report 1926-1927*, 56.

¹⁸⁸ *Tulare County Power Co.*, 7 C.R.C. 703 (1915); *San Diego Cons. Gas and Electric Co.*, 10 C.R.C. 230 (1916); *Santa Barbara Telephone Co.*, 11 C.R.C. 470 (1916).

¹⁸⁹ 11 C.R.C. 806 (1916). Of course, this order applied only with respect to a request for increased rates resulting from the conditions of the consolidation.

¹⁹⁰ 34 C.R.C. 661, 670 (1930). On the contrary, demands for rate reductions, as a condition of consolidation, or protests that consolidations would lead to an increase in rates are deemed inappropriate in financial proceedings because they belong to rate cases. See *Pacific Gas and Electric Co.*, 21 C.R.C. 268 (1922); *Los Angeles Water Service Co.*, et al., 28 C.R.C. 403 (1926).

¹⁹¹ 7 C.R.C. 597 (1915); see also *Citrus Belt Gas Co.*, 2 C.R.C. 725 (1913). *San Francisco-Oakland Terminal Rys.*, 24 C.R.C. 231 (1923).

¹⁶⁷ *Ibid.*, 610. In connection with finding the value the commission also said: "With ordinary commercial property a value may be arrived at by considering the earning power of such property and capitalizing the same, but the earning power is fixed by the same body, the Railroad Commission, which fixes and determines the value of the plant, and in determining the earning power of the plant, the value of the plant must be taken into consideration. Hence the value of the plant must first be established and upon this valuation rates are fixed which determine the earning power of the plant" (606)

¹⁶⁸ 24 C.R.C. 231 (1923).

¹⁶⁹ 28 C.R.C. 419, 420 (1926): "We do not believe that the capitalization of the properties should be based on prices prevailing on December 31, 1925, or on any other particular date. Capitalization should be based on cost of the properties. It is of record, however, that the original cost of the properties is not available. We are of the opinion that a valuation of this property based on the 1914 price level plus the cost of additions and betterments, the increase in land values and the current assets afford a sounder basis for the issue of stock than a valuation of today, based on present prices."

¹⁷⁰ 2 C.R.C. 725 (1913).

¹⁷¹ *Los Angeles Railway Corp.*, and *City Railway Co.*, 6 C.R.C. 272 (1915); *People's Water Co.*, 9 C.R.C. 447 (1916). *Tropico City Water Co.*, 12 C.R.C. 174 (1917); *Oakland and Antioch Ry.*, et al., 16 C.R.C. 990 (1918).

¹⁷² 6 C.R.C. 808 (1915).

¹⁷³ 10 C.R.C. 438 (1916). See also: *Midway Gas Co.*, 7 C.R.C. 246 (1915), and 8 C.R.C. 9 (1915); *United Rys. of San Francisco*, 19 C.R.C. 180 (1920); *California-Oregon Power Co.*, 19 C.R.C. 447 (1921); *San Francisco-Oakland Terminal Rys.*, 24 C.R.C. 231 (1923).

¹⁷⁴ *People's Water Co.*, 7 C.R.C. 597, 616 (1915). This company did not go through foreclosure. The commission's attitude on this score has been very salutary and has given it virtually complete control over the reorganization situation. See also, *Union Home Tel. and Tel. Co.*, et al., 19 C.R.C. 436 (1921). In *Central Counties Gas Co.*, 25 C.R.C. 489 (1924) (not a reorganization case), the commission objected to a bond indenture which excluded recourse, for the payment of principal or interest, against the incorporators, stockholders, directors, or officers. Objection was also registered against a clause by which the bond house sought the special privilege of examining the books. It was felt that the ordinary provisions were quite adequate. This, of course, was at the time when proportional liability obtained in California. This particular question is, apparently, only of academic interest now.

¹⁷⁵ *People's Water Co.*, 9 C.R.C. 447 (1916); *Northern Electric Railway Co.*, 15 C.R.C. 747 (1918). In *San Francisco-Oakland Terminal Rys.*, 24 C.R.C. 231 (1923), the commission frowned upon the establishment of a voting trust and would not compel the stockholders to deposit their stock. It also would not "direct that the bondholders be given a voice in the management of the properties." Nevertheless, approval was given provided the matter was handled voluntarily. (248) See *Fresno-Hanford and Summit Lake Interurban Ry. Co.*, 3 C.R.C. 687 (1913), for a similar position in ordinary financing.

¹⁷⁶ 10 C.R.C. 563, 568-569 (1916). The remarks deserve to be quoted in their entirety:

"It seems to be entirely too usual when a railroad or other utility passes through receivership, for everybody connected therewith, the lawyers, the bankers, the re-

organizers, the officers of committees and the special masters, to regard the unfortunate corporation as legitimate prey for the most exorbitant claims—claims which would never be presented by a rational person, for services of the same value, to a going concern. Why services of this character should be deemed so much more valuable when performed for a bankrupt concern than for a going concern is difficult to understand.

"Among the most extravagant of the claims presented in the federal court are, of course, the claims for various counsel fees. Fees amounting to five times the entire salary roll of the legal department in San Francisco prior to the receivership, are demanded by the counsel for the receivers, and fees amounting to three times the annual salaries of the entire San Francisco legal department [of the company] are demanded by the counsel for the Equitable Trust Company of New York. The claims would, of course, never be presented except in the case of a receivership. . . .

"It is significant to draw attention to the fact that for the simple service performed by the special master, he is to receive a compensation within \$1,000 of the annual salary of the members of the Supreme Court of the State of California.

"The history of this and similar receivership proceedings from one end of the United States to the other prompts us to suggest that the time has come for a complete change in the handling of such proceedings. Instead of having such proceedings handled by special attorneys, special experts and special officials of various kinds, all claiming extravagant compensation, they could be handled far more economically and generally more efficiently through the Interstate Commerce Commission in case of federal receiverships, and through the state railroads or public service commissions in case of state receiverships of public utility properties. These commissions have available impartial experts, trained in every branch of public utility business. With the necessary changes in the laws, the Commissioners and their experts could handle receivership matters more expeditiously, generally more efficiently and always at tremendously less expense than the present court proceedings."

¹⁷⁷ *Annual Report 1918-1919*, 100.

¹⁷⁸ 10 C.R.C. 438 (1916). The proceeds of part of the authorized bond issue were to be used for the following purposes:

"To pay the distributive shares of non-assenting bondholders, underwriting commission, expense of foreclosure and reorganization, including court costs, compensation and allowances of the receivers and their counsel, the mortgage, taxes on the creation and issue of new securities, compensation and expenses of the protective and reorganization committees, their depositaries and counsel, fees of engineering, accounting and other experts, engraving, printing and miscellaneous requirements, not to exceed the sum of \$2,000,000." (468)

In a supplemental opinion, 10 C.R.C. 563 (1916), this was reaffirmed, but it was stated that any additional items would have to be borne in some other way.

¹⁷⁹ *Reorganization of People's Water Co.*, 12 C.R.C. 323, 327 (1917). See also: *Petaluma and Santa Rosa Ry. Co.*, 15 C.R.C. 1079 (1918); *Oakland and Antioch Ry.*, 16 C.R.C. 960 (1919); *San Francisco-Oakland Terminal Rys.*, 24 C.R.C. 231 (1923).

¹⁸⁰ 2 C.R.C. 602 (1913). See also, *Southern Pacific Co.*, 4 C.R.C. 191 (1914).

¹⁸¹ *Southern Pacific Company*, 3 C.R.C. 562 (1913). See also: *Southern Pacific Co.*, 18 C.R.C. 365 (1920); *Los Angeles and Salt Lake Railroad Co.*, 13 C.R.C. 119 (1917). In the last-named case the larger part of the money derived from the issue was to be spent on construction in California although the railroad was part of an interstate line. A careful analysis was made of this part of the application.

¹⁸² 28 C.R.C. 262 (1926).

¹⁸⁶ 22 C.R.C. 903 (1923). See also, *California-Oregon Power Co.*, 30 C.R.C. 2 (1927), an application for consolidation. In another application of the same company, 36 C.R.C. 717 (1931), in which request was made to refund indebtedness and to sell common stock without par value, the commission made a thorough examination and refused the request on common stock because the granting of it would prejudice the control by preferred stockholders who had made the larger investment.

¹⁸⁴ 31 C.R.C. 851 (1928).

¹⁸⁵ See: *San Diego Cons. Gas & Electric Co.*, 2 C.R.C. 264 (1913); *Economic Gas Co.*, 3 C.R.C. 66 (1913); *San Diego Electric Ry. Co.*, 5 C.R.C. 517 (1914); *San Diego Cons. Gas & Electric Co.*, 5 C.R.C. 724 (1914); *Central California Gas Co.*, 7 C.R.C. 67 (1915), and 9 C.R.C. 62 (1916); *Pacific Gas and Electric Co.*, 9 C.R.C. 492 (1916); *Hanford Gas & Power Co.*, 12 C.R.C. 135 (1916); *Coast Valleys Gas & Electric Co.*, 20 C.R.C. 873 (1921).

¹⁸⁶ See: *United Railways Co.*, 4 C.R.C. 1124 (1914), 6 C.R.C. 961 (1915), and 8 C.R.C. 693 (1915).

¹⁸⁷ See Austin, J. A., *Stock Without Par Value*, Senate Document 92, part 73-A, 70th Congress, 1st Session, 83 ff.

¹⁸⁸ See Jones & Bigham, *Principles of Public Utilities*, 274 f.; Pegrum D. F., *op. cit.*, 148; Pegrum, D. F., "Legal vs. Economic Principles in Valuation," *Jour. Land & Pub. Util. Econ.*, 6:127-135 (May, 1930); 235-240 (August, 1930).