

**ORIGINAL**Decision No. 63145

## BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
 SOUTHWEST WATER COMPANY, a )  
 California corporation, for authority )  
 to issue and sell \$290,000 of its )  
 Class "A" 5-1/4% Preferred Stock. )

Application No. 42217

In the Matter of the Investigation )  
 on the Commission's own motion into )  
 the operations, practices, rules )  
 contracts, tariffs, accounts and )  
 securities issues of SOUTHWEST WATER )  
 COMPANY, respondent herein. )

Case No. 6541

Arthur D. Guy, Jr., and Carr H. Deitz, for Southwest  
 Water Company.

Everett B. Clary, for Garnier Construction Company  
 and San Jose Ranch Company.

William W. Leavitt, in propria persona.

Hugh N. Orr, for the Commission staff.

O P I N I O NNature of the Proceeding

This consolidated proceeding, heard at Los Angeles before Examiner John M. Gregory on July 6, 7 and 17, 1961 and submitted for decision on the latter date, involves a request, filed by Southwest Water Company on May 3, 1960, to issue, over a 12-month period, 5,200 shares of Class "A" 5-1/4% cumulative preferred stock, of par value of \$50 per share, for cash, to be used with other sources of funds for general corporate purposes during 1961, principally for repayment of bank loans and for construction of water facilities.

Case No. 6541 is an investigation, instituted June 20, 1960 by the Commission on its own motion, and consolidated with Application No. 42217, into the operations of the utility, chiefly to determine whether its water main extension practices and related

financial transactions have been in violation of its tariff rules or Commission orders.

The Issues

The case was submitted on evidence adduced at the hearing from officials of the utility and a member of the Commission's Division of Finance and Accounts, supplemented, in the investigation case, by a stipulation between counsel for the utility and the Commission staff that certain "agreed facts", concerning a number of the utility's water facility installations and related financial transactions with tract developers during the period 1955-1960, would be included in the record for the purpose of affording a factual basis upon which the following issues, stated in general terms in the investigatory order, might be determined:

1. Has the utility engaged in practices contrary to its main extension rule or Commission orders?
2. Is the main extension rule, promulgated by the Commission in 1954 (Decision No. 50580, Case No. 5501, 53 Cal. P.U.C. 490), mandatory "in every instance that water service is supplied by respondent to a territory contiguous to its service or certificated system at the time?"
3. Such other issues implicit in the investigatory order for which the agreed statement of facts may afford a factual basis for determination.

The issue in Application No. 42217 concerns the propriety of granting the requested authority to issue preferred stock and will be considered first.

Application No. 42217

The evidence shows that applicant's estimated sources and uses of funds during 1961 are as follows:

Cash Balance 11/1/60 \$ 145,000

Source of Cash:

Bank Loans	\$500,000	
Sale of Balance of Authorized Stock		
Common (Dec. No. 60308)	236,000	
Class A Preferred (Dec. No. 58835)	58,000	
Sale of Preferred Stock (This Appl.)	290,000	
Consumers' Advances for Construction	260,000	
Income for Period (Before Income Tax)	150,000	
Depreciation	111,000	
Sale of Series D Bonds	750,000	<u>2,355,000</u>

Total \$2,500,000

Use of Cash:

Sinking Funds - A and B Bonds	\$ 13,000	
1960 Income Tax	70,000	
Refunds Due on Contracts	85,000	
Dividends	77,000	
Purchase Mutual Water Company Stocks	10,000	
Debt Expense	10,000	
Repay Bank Loans	700,000	
Reduce Accounts Payable	40,000	
Construction Budget (Itemized in Exhibit 4)	962,000	
Construct Tracts	450,000	<u>\$2,417,000</u>

Estimated Cash Balance 12/31/61 \$ 83,000

The itemized 1961 construction budget of \$962,000, to be partially financed by proceeds from the requested stock issue, covers chiefly meter installations in the company's three districts (\$132,800) and improvements in the La Sierra District (\$514,400) recommended by Commission engineers in a previous rate proceeding, following acquisition by applicant of the substandard system of a predecessor in La Sierra. The balance of that budget covers various source of supply, land, storage, transmission and distribution main items for the other two operating districts, La Mirada and Etiwanda, including an item of \$51,500 for "miscellaneous and unforeseen items"

for all districts. The items in this budget are not related to normal main extensions for specific tracts or subdivisions.

A portion of the proceeds of the requested stock issue is proposed to be used to install some of the facilities required for extensions to serve specific subdivisions or tracts. A separate budget for these facilities, totalling \$450,000 for 1961, is included in Exhibit 3, Source and Use of Cash, but is not itemized nor does the record otherwise indicate the proportionate amounts assigned as between off-site and on-site construction.

The evidence reveals that it is the utility's policy, in financing the construction of facilities to serve completed tracts or subdivisions in which homes will be built and offered for sale to the public, to consider such a development as an "economic unit" that would justify investment of the company's funds, derived, in part, from sale of stock to the developer, in the construction of whatever facilities may be required to provide water service to the eventual occupants of the homes. If a developer of this type of tract desires a refund contract, he is given that option in lieu of construction of the necessary facilities by the utility with its own funds. If the development is merely a "lot-sale" subdivision, with the possibility that it may not become "saturated" with homes, the utility insists on a refundable advance from the developer under the provisions of its water main extension rule.

The rule does not expressly confer an option on the developer to have the facilities to which it refers constructed with company funds in lieu of advancing the costs thereof subject to refund by whichever method of the rule may be selected by the utility. The company's view of the matter, as stated at the hearing by the official in charge of its financial activities, is that

although the rule does not expressly provide for such an option it does not prohibit it.

The evidence further shows that with respect to sales of applicant's Series D bonds, authorized in the amount of \$750,000, \$500,000 have been sold and that the utility expected that additional bondable plant to support the balance would be derived during the latter part of 1961 through use of interim bank loans to finance plant construction and by payments to holders of main extension refund contracts, as well as by sale of the securities for which authority is here requested. The utility does not expect to derive sufficient funds to finance its \$450,000 tract construction budget from the sale of Series D bonds alone.

A substantial portion of the utility's preferred stock has been sold, in the past, to subdividers or land developers who have requested water service for their various tracts, or to their nominees. The company's preferred and common shares appear to have a limited market and are traded principally through three Los Angeles brokerage firms. The evidence shows that in selling its \$50 par value stock to original subdivider-purchasers the company has received an equivalent amount in cash.

Applicant's position is that the requested authority is necessary in order to provide cash, along with other sources of funds, for the company's construction program and for other operating needs, and that its main extension rule does not prohibit the exercise of such authority. The position of the Commission's Finance and Accounts Division, as stated by its representative, is that if the main extension rule does not permit the sale of stock to, in lieu of requiring advances from, subdividers and, as is indicated by the record, there is no other substantial market for

the sale of such securities, there would seem to be no purpose in granting the company's request. If, however, the rule may be interpreted to permit such sales, it is the staff representative's view that the requested authority might appropriately be granted.

The issue, consequently, is whether the company's present water main extension rule forbids the issuance and sale of preferred stock to land developers or subdividers and the use of the proceeds of such sales by the utility for construction of either off-site or on-site facilities, or both, for specifically designated tracts or subdivisions. A related question--whether unrefunded balances due to subdividers under outstanding main extension contracts may be converted to stock--is not before us in this proceeding.

The Public Utilities Code, Sections 816-830, provides for issuances by a utility of "stock and stock certificates or other evidence of interest or ownership..." for various purposes, pursuant to the provisions of the Code and under such rules and conditions as may be prescribed by the Commission. Among the purposes, pertinent here, for which a utility may issue and sell stocks or other specified securities are (P.U. Code, Sec. 817):

- a. For the acquisition of property.
- b. For the construction, completion, extension or improvement of its facilities.
- c. For the improvement or maintenance of its service.

The present application has been filed pursuant to the requirements of Sections 816, 818 and 819 of the Code.

The company's water main extension rule provides, with respect to extensions to serve a new subdivision, tract, housing project, industrial development or organized service district, that an "applicant for a main extension" to serve such a development:

"shall be required to advance to the utility before construction is commenced the estimated reasonable cost of installation of the mains, from the nearest existing main at least equal in size to the main required to serve such development, including necessary service stubs or service pipelines, fittings, gates and housings therefor, and including fire hydrants when requested by the applicant or required by public authority, exclusive of meters. If additional facilities are required specifically to provide pressure or storage exclusively for the service requested, the cost of such facilities may be included in the advance upon approval by the Commission." (Main Extension Rule, par. C.1.)

With respect to refunds of such advances, the rule (par. 2.a., b.) provides that:

"The money so advanced will be subject to refund by the utility without interest to the party or parties entitled thereto. The total amount so refunded shall not exceed the amount advanced. Refunds may be made under either of the following methods at the option of the utility:..."

The rule then provides for refunds under either a "proportionate cost" or a "percentage of revenue" method, both related to the number of "bona fide customers" directly connected to the extension for which the cost was advanced.<sup>1/</sup>

We hold that the present water main extension rule requires that funds for construction of an extension of the utility's mains and other facilities referred to in paragraph C.1. of the rule, to serve the tract or other developments specified in that paragraph, be obtained by means of a cash advance from the applicant for such extension, subject to refund under either of the methods provided by the rule at the utility's option and in accordance with other provisions of the rule.

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<sup>1/</sup> Proposals for modification of the water main extension rule, advanced by a number of utilities, by the Home Builders Council of California and by the Commission staff, are now under consideration by the Commission following proceedings commencing in 1959 and terminating with submission of the case for decision on October 23, 1961 (Case No. 5501)

We further hold that the present rule, by requiring the utility to take a refundable cash advance to cover the "estimated reasonable cost of installation" of the mains and other items specified in paragraph C.1., has provided a unique method for sharing with tract or subdivision developers, because of the economic risk involved, the initial cost of installing specific facilities "from the nearest existing main at least equal in size to the main required to serve such development...", or, in special cases, the initial cost of additional pressure or storage facilities required "exclusively" for the service requested. By thus providing a specific method for obtaining construction funds for what are generally termed "in-tract" or "on-site" facilities, the rule, to that extent, operates as a limitation with respect to such facilities on the purposes, stated in Section 817 of the Public Utilities Code, for which a utility may be authorized to issue stock or other securities.

It results, from the foregoing, that the only option afforded the utility by the rule (except to seek authority to deviate from its provisions pursuant to Section 532 of the Public Utilities Code and Section X of General Order No. 96) is with respect to the method of refunding the advance. Nor does the rule confer an option upon the extension applicant to purchase the utility's stock or other securities, in lieu of making a refundable cash advance, in order to provide funds with which to construct or install the mains and other items specified in paragraph C.1. of the rule.

The rule is silent concerning provision of funds, in the case of new tract or subdivision developments, for acquisition or construction of facilities other than those named in paragraph C.1.

So far as appears from the rule itself, the utility is at liberty, subject to obtaining appropriate authority from the Commission, to provide funds for acquisition or construction of water production, pressure, storage and metering facilities to serve subdivision developments, or for general system improvements, by whatever financial operations may be open to it under the governing law and the Commission's rules, including the issuance and sale of stock or other securities to land developers, subdividers, or any other willing purchaser.

Case No. 6541

The order instituting an investigation into the utility's main extension practices directs that the investigation be consolidated for hearing with Application No. 42217. Following a prehearing conference, counsel for the utility and the Commission staff, after numerous consultations, agreed that essential facts concerning certain main extension transactions of the utility with land developers during the period 1955-1960 would be stipulated to for the purpose of presenting to the Commission a factual basis for determination of the issues raised in general terms by the investigatory order. Ten such examples are included in the agreed statement of facts placed in the record (Exhibit 1).

A recital of the details of these transactions, many of which took place over a period of years and involved complex financial dealings between the utility, the various tract developers and others, would unduly prolong this decision. In substance, they all relate to the construction of distribution and other facilities by the utility for the purpose of supplying water to various tracts within, contiguous to, or in the vicinity of, the company's service area at the time. The following table summarizes some of the features of those transactions as related to the method of financing the installations:

<u>Tract No.</u>	<u>Developer</u>	<u>Estimated Cost of Construction</u>	<u>Initial Source of Costs</u>	<u>Acct. No. Recorded(a)</u>	<u>Later Financing</u>	<u>Acct. No. Recorded</u>
(21411 21412 21413)	Fisher & Glick " "	\$13,300 \$14,700 \$14,700	Proceeds of prom. notes S.W.Co. to 3 corporate Fisher-Glick subsidiaries	242 242 241	Exchange of notes for 854 sh. "A" 5 $\frac{1}{4}$ pfd.stk. issued to Glick	201
16970 (9 units)	Buck	\$29,450	Refund con- tracts	241	Contracts assigned to broker for 589 sh.com. stock	
Town & Country Estates	Maurer	\$68,000	Cash (no re- fund contract)		Pfd.&com. stk.(\$68,000 p.v.) to developer associates or nominees	
(24958 { 24511)	Macco Const. Co. Green Hills Dev. Co.	Not indicated "	(Supplied through purchase of contiguous B.F.S. Mutual Water Co. and connecting S.W. Co. facilities. Refund agreements executed with subdividers)			
Indus- trial Tract	Central Mfg. Dist.	"	\$70,000 "earn- est money" advanced by CMD	242	1400 sh.com. stk. (p.v. \$70,000) issued to A. Crooke for \$15,000 cash	200
Indus- trial Tract	Vina Vista Dev. Co.	\$40,410	\$45,450 cash deposits	242	809 sh.com. stk. to title com- pany in trust for Vina Vista Dev.Co.	
			Note: This is an isolated service to a 100-acre tract of Freuhauf Trailer Co. from a well purchased by Southwest Water Co. Total cost of installation was \$47,428.83.			
Not iden- tified	Granger & Quick	Not indicated	\$65,500 cash	242	220 sh.com. and 1086 sh. "A" pfd.stk. issued per instruction of title company	Capital stock acct.

(a) Description of accounts used in above summary:

<u>Acct. No.</u>	<u>Item</u>
242	Other Deferred Credits
241	Advances for Construction
200-201	Capital Stock

It appears from the stipulated facts that no water main extension rule refund contracts were executed by the utility for the estimated cost of construction of distribution facilities (i.e., mains, etc., specified by par. C.1. of the rule) in connection with the following developments: Fisher and Glick - Tracts 21411-2-3; Colyear and Maurer - Town & Country Estates; Central Manufacturing District - Industrial Tract; Freuhauf Trailer Co. - Industrial Tract; Granger and Quick Tract.

The utility contends, as it has in prior formal proceedings, that when a developer requests "water service" for a subdivision or tract, rather than a "main extension", the main extension rule does not apply and the utility then has the discretion of determining if it will make a "prudent investment" of its funds in the requested facilities pursuant to the provisions of the Public Utilities Code, referred to above, which relate to the issuance of securities for certain purposes and subject to later adjustment of its rate base by the Commission if the investment should prove to be imprudent.

Counsel for the staff maintains that the provisions of the rule calling for a refundable advance constitute the only permissible method (aside from authorized deviations from the rule) for providing the cost of construction of the tract facilities described in the rule.

What we have said in the preceding discussion of the main extension rule, as related to the utility's request to issue preferred stock, applies with equal force to the issues raised by the investigation and requires no further elaboration.

Findings and Conclusions

I. Application No. 42217

With respect to applicant's request to issue and sell 5,800 shares of its Class "A" 5½% cumulative preferred stock, we find that:

1. Applicant's bond borrowing capacity is limited and that it cannot expand its facilities to meet service demands, including extension of facilities to serve tracts or subdivisions, and continue to meet existing obligations unless it obtains additional funds from external sources.

2. Previous authority, conditionally granted to applicant to issue 5,800 shares of Class "A" 5½% preferred stock of an aggregate par value of \$290,000 (Decision No. 58835, July 28, 1959, Application No. 41144), will expire on December 31, 1961 unless further extended by the Commission.

3. Applicant's water main extension rule does not provide a source of funds for construction of tract or subdivision facilities other than those facilities specified in paragraph C.1. of said rule. As to such facilities, said rule requires that funds be obtained by a cash advance from the applicant for extension of service, subject to adjustment to reasonable actual costs and to refund as provided by said rule.

We conclude that applicant's request to issue and sell 5,800 shares of its Class "A" 5½% cumulative preferred stock, of the par value of \$50 each, should be granted, subject to the condition that no part of the proceeds of the sale of any of said shares should be used by applicant for the purpose of constructing any of the facilities specified in paragraph C.1. of applicant's water main extension rule in any case in which an extension of service is

requested or required for a new development of the character specified by said paragraph C.1.

The authorization herein granted is for the issuance of securities and is not to be construed as indicative of amounts to be included in a future rate base for the determination of just and reasonable rates.

II. Case No. 6541

With respect to the Commission's investigation herein, we find that:

I. Between the years 1955 and 1960, at the times and under the circumstances related in the "agreed statement of facts", Exhibit 1 herein, respondent, in violation of the provisions of paragraph C.1. and C.2. of its rule governing water main extensions on file with the Commission and in effect during all of said times, has constructed or installed extensions of water facilities to serve specific new tracts or subdivisions, other than improvements or replacements of its existing system made in the ordinary course of operations, without requiring from each applicant for such main extension a refundable cash advance, before commencement of construction, of the estimated reasonable cost of installation of the distribution facilities required for such extension as specified in paragraph C.1. of said rule.

We conclude that respondent should be directed to cease and desist from constructing such main extensions otherwise than by requiring a refundable cash advance from the applicant therefor as provided by its main extension rule. The company should also be directed to file a list of main extensions installed by or for it under terms or conditions at variance with its main extension rule.

The disposition here made of the issue concerning violation of respondent's main extension rule renders unnecessary, in our opinion, the consideration or disposal of whatever other issues may be presented by the investigatory order herein.

O R D E R

A public hearing having been held herein, evidence and argument having been received and considered, the matters having been submitted for decision, the Commission now being fully advised and being of the opinion that the request of Southwest Water Company herein to issue and sell stock should be granted subject to the conditions hereinafter set forth; that the money, property or labor to be procured or paid for by said issue of stock is reasonably required for the purposes specified herein and that such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income; and basing its order upon the findings and conclusions contained in the foregoing opinion; therefore,

IT IS HEREBY ORDERED that:

1. Southwest Water Company, on and after the effective date hereof and on or before December 31, 1962 may issue and sell not to exceed \$290,000 of its Class "A" 5½% cumulative preferred stock at not less than par, provided that in offering the stock for sale, the utility shall first notify a prospective purchaser in writing that purchase of the stock will not relieve the purchaser of any obligation which may exist to advance costs as required by the utility's filed main extension rule.

2. Southwest Water Company shall deposit the proceeds from the sale of the preferred stock herein authorized in a separate bank account and disburse such proceeds only for the purpose of paying

outstanding bank loans, as set forth in the tabulation "Use of Cash" in the preceding opinion, and of financing the cost of water facilities other than the facilities described in paragraph C.1. of the company's presently effective water main extension rule.

3. On or before the 25th day of each month applicant shall file with the Commission a report of the issue of stock under the authorization herein granted and a statement of said separate bank account showing the balance in cash at the beginning of the preceding month, the deposits and, in detail, the purposes for which it expended moneys from said account, and the balance in cash at the end of the month. The expenditures shall be segregated to accounts provided in the uniform system of accounts for water utilities and the statement shall be verified by the president or secretary of the company.

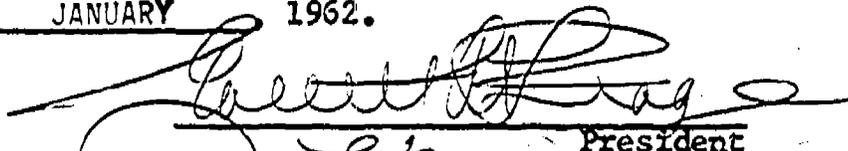
4. Southwest Water Company shall cease and desist and hereafter refrain from construction or installation of main extensions to serve subdivisions, tracts or other developments specified in paragraph C.1. of its currently effective water main extension rule unless and until it shall have received from the applicant for any such extension of facilities or service, prior to commencement of construction, a refundable cash advance in the amount of the estimated reasonable cost of installation of the mains and other required facilities as specifically described in said paragraph C.1. of said rule, or unless and until the company shall have sought and secured from the Commission, prior to such construction, appropriate authority to deviate from the provisions of said rule with respect to any such main extension, including the method of providing funds for the cost thereof.

5. Southwest Water Company shall file, within one hundred twenty days after the effective date of paragraph 4 hereinabove, a list of each and every main extension which has been installed by or for it under terms or conditions which deviate in any way from the provisions of its filed main extension rule, together with a description of, and explanation for, each deviation involved.

6. The Secretary is directed forthwith to cause personal service of a certified copy of this decision and order to be made upon Southwest Water Company, a corporation.

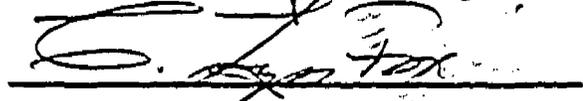
7. This order shall become effective, with respect to the authority herein granted to issue preferred stock, twenty days after the date hereof. With respect to the order to cease and desist contained in paragraph 4 hereinabove, said order shall be and become effective immediately upon personal service thereof on said corporation.

Dated at San Francisco, California, this 22nd day of JANUARY 1962.

  
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President

  
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Commissioners

Commissioner Frederick B. Holoboff being necessarily absent, did not participate in the disposition of this proceeding.