

ORIGINAL

Decision No. 65121

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Application of Rosa Water Company for a Certificate of Public Convenience and Necessity authorizing applicant to furnish water service to additional areas near Santa Susana, California and for an order authorizing the issuance of \$100,000 of Series A, 5% preferred stock and of \$200,000 of 3% preferred stock.

Application No. 44721
(Filed August 21, 1962)

Gibson, Dunn & Crutcher, by Raymond L. Curran,
for Rosa Water Company, applicant.

Ralph H. Brown, for Royal Water Company,
interested party.

Richard R. Entwistle, and Robert C. Durkin, for
the Commission staff.

O P I N I O N

Rosa Water Company requests authority to serve six additional subdivisions, totaling 151 acres, and three small parcels of land, comprising about 23 acres, as extensions from its existing system in the rapidly developing Simi Valley in Ventura County.

Authority is also sought to issue \$100,000 of Series A, 5 percent preferred stock at par, for cash, to provide funds for construction of off-site facilities of general use in the system not properly includable in main extension contracts. The stock would be sold to developers of the subdivisions.

Applicant also requests authority to issue \$200,000 of 3 percent noncumulative preferred stock to pay refunds, when due, on proposed main extension contracts for in-tract facilities. These contracts would call for refunds under the proportionate cost method of applicant's main extension rule, which is now being revised as the result of a recent Commission order (Decision No. 64536, November 8, 1962, Case No. 5501, et al). Such method of refund involves two deviations from the new rule: (1) use of the proportionate cost method; (2) payment of refunds in stock in lieu of cash.

The application, which was unopposed, was submitted for decision at the conclusion of a public hearing held, after due notice, before Examiner Gregory at Ventura on December 13, 1962.

The record reveals that the Simi Valley, since about 1958, has been undergoing a rapid and substantial residential growth as a result of its proximity to the industrial complex of the western San Fernando Valley and relatively low land costs. Rosa Water Company has shared in this development since its initially certificated service to the 34-acre Tract 1040 in 1959 (Decision No. 59030, September 22, 1959, Application No. 40685).

The utility, in July 1962, supplied water to 1,520 customers in an area of about 613 acres in eight locations on the Valley floor and three acres in the mountains adjacent to its Tapo Canyon transmission line, to which all areas are connected. Various county and mutual systems and one small public utility serve some other portions of the valley. Applicant estimates that, if the sought authority is granted, 516 of the 578 lots in the six new subdivisions will be fully developed by August, 1963 and the remaining 62 lots

about three months later after completion of certain drainage improvements. The Utilities Division staff report (Exhibit 12) estimates that applicant will serve about 2,300 customers by August, 1963 and about 2,900 customers upon ultimate full development of existing and requested service areas.

The utility's supply of water, blended from the Tapo Canyon source and from wells, reinforced recently by its Sycamore well, appears to meet county standards of production and potability and to be adequate for present and requested service. The local supply will be augmented, about July, 1963, with the scheduled completion of the Calleguas Municipal Water District trunk line from the Metropolitan Water District. Construction of the proposed facilities comports with standards of General Order No. 103.

Exhibit 11 shows, with respect to the utility's financial position of July 31, 1962, that advances and debt, both long- and short-term, have financed about 76 percent of total investment, with advances comprising the relatively high proportion of about 41 percent.

The new uniform main extension rule requires that the utility obtain Commission authorization before making any further extensions of distribution mains whenever the outstanding advance contract balances exceed 50 percent of the total water utility plant less depreciation reserve. The financing proposed by applicant would reduce the proportion of advances from 44.7 percent to 32.8 percent of the total water utility plant less depreciation reserve, whereas if the \$100,000 of off-site facilities were financed as proposed by applicant and the \$200,000 of in-tract facilities were covered by subdividers' advances, all in accordance with applicant's filed main extension rule, the corresponding proportion of advances would be 50.6 percent.

Present long-term debt is composed principally of a \$150,000-note repayable in increasingly large installments during 1963-1965. This borrowing was obtained from banking associates by applicant's principal stockholder on the strength of personal guarantees and pledge of personal collateral. The present capitalization of the company, and its record of earnings, would make difficult any additional debt financing at reasonable terms under present conditions.

With regard to stock financing, the record shows that all common stock presently outstanding was issued for cash or in payment of plant initially financed by stockholders. In addition, the company expects shortly to issue \$100,000 of common stock, as authorized by Decision No. 63875, dated July 2, 1962, in Application No. 44581, in payment of notes payable to stockholders, evidencing cash loans and payments for plant by stockholders on behalf of the company. Present stockholders have already made available in excess of \$300,000 through purchase of stock and short-term loans, and have indicated that, because of other commitments and for other reasons, future provision of funds by them will be limited. Thus, it appears doubtful that additional stock can be sold at reasonable terms and price except to present stockholders or to developers who would accept stock to finance water system construction for their developments.

The company is presently obligated under refund contracts totaling \$367,588 issued in connection with main extensions and acquisition of operating systems. Contracts issued for distribution facilities alone, now serving some 1,368 customers, total \$307,085, an average of about \$225 per customer. Based on estimated annual revenues of \$63 per customer, about 6.2 percent of the amounts advanced are refundable each year, or about \$22,000.

The record reveals that there is a reasonable prospect of almost complete customer saturation in the six tracts among the areas for which certification has been requested. In such circumstances, on the basis of this utility's past experience of revenue and cost of distribution facilities per customer, revenue basis refund contracts would pay out in 16 years or less if off-site facilities are not included in the advances.

Under the circumstances just described, it is appropriate to indicate what the probable effect on the company's cash requirements for the near future would be if the proposed financing through issuance of stock for refunding advances on a proportionate cost basis were disallowed and the company were to finance the construction of in-tract facilities by means of refundable advances under the 22-percent-of-revenue method, modified by deviation authority for making such refunds, when due, with securities rather than cash. These results assume that: (a) proposed stock financing and assumed extension agreements are added to existing capitalization; (b) a rate of return of 6 percent is earned upon net investment in plant and working capital; (c) refunds on existing and future revenue basis extension contracts will require cash equal to 6.2 percent annually of the amount advanced.

	<u>Financing Method</u>	
	<u>Applicant's Proposal</u>	<u>Authorized Basis</u>
Present plant investment	\$ 857,937	\$ 857,937
Additions proposed	300,000	300,000
	<u>\$1,157,937</u>	<u>\$1,157,937</u>
Working capital (estimated)	10,000	10,000
	<u>\$1,167,937</u>	<u>\$1,167,937</u>
Modifications:		
Depreciation reserve	(36,145)	(36,145)
Advances and contributions	(367,588)	(567,588)
	<u>\$ 764,204</u>	<u>\$ 564,204</u>
Return at 6 percent	\$ 45,852	\$ 33,852
Depreciation at 2.5 percent	28,948	28,948
	<u>\$ 74,800</u>	<u>\$ 62,800</u>
<u>Cash requirements</u>		
Debt interest @ 6 percent	\$ 12,873	\$ 12,873
Preferred dividends	11,000	5,000
Refunds on advances	22,790	22,790
Total	<u>\$ 46,663</u>	<u>\$ 40,663</u>
Net Cash Flow	\$ 28,137	\$ 22,137

(Subtraction)

In preparing the preceding tabulation recognition has been given to the fact that in this proceeding applicant's primary concern is to develop a sound plan for financing presently contemplated and future growth. For this reason, a constant rate of return of 6 percent was included in developing cash flow in order to provide reasonable support for capital costs inherent in the capital structure that will result from presently authorized and proposed stock financing.

As shown by the preceding tabulation, use of stock financing as proposed by the company would have the immediate effect of reducing by \$6,000 the company's annual cash requirements for imbedded capital costs and refunds on advances, thereby increasing cash flow as a source of capital funds. This \$6,000 reduction will gradually diminish to zero as advances are refunded with securities.

However, applicant's proposal would, for many years in the future, result in an increase in net plant investment over that which would result from the use of revenue base refund contracts for in-tract facilities.

The company has concluded, on the basis of its showing, that the proposed method of stock financing the new extensions is favorable both to the utility and its customers for the following reasons: (a) considered over a long period of years the method does not measurably increase rate requirements; (b) it decreases cash drain and increases bondable plant; (c) it avoids uncertainties in tax matters; and (d) it enhances the utility's ability to obtain conventional financing upon reasonable terms.

The report of the Division of Finance and Accounts on the proposed financing (Exhibit 11) reaches essentially the same conclusions, which are stated as follows:

(a) The issuance of stock in the amounts requested will improve applicant's capital structure, add materially to borrowing capacity, improve prospects for future sales of equity securities, and should make possible the obtaining of additional capital funds at lesser cost.

(b) Applicant is not obligated to undertake service to the areas proposed, and should not be expected to do so under financing arrangements detrimental to its present and future financial condition and financing prospects.

(c) Given rapid and complete consumer saturation in the areas proposed, cash refunds under either the proportionate cost or revenue basis methods of refunding would unduly drain the company's cash resources, particularly in light of growing requirements for capital funds.

(d) Under refunding alternatives available to the company under its present main extension rule [The report was prepared prior to adoption of the revised rule on November 8, 1962], advances could be almost immediately refunded, and rate base would equal that resulting from the proposed stock financing of the requested extensions. Funds obtained for the purpose of refunding advances could well be more costly than the financing requested.

The report concludes with the recommendation that if applicant be certificated to serve the areas requested, authority should also be granted to issue the securities proposed in the amounts and for the purposes indicated in the application. It is further recommended that applicant not be permitted to undertake service in the areas requested if water facilities in such areas are to be financed by extension agreements requiring cash refunds because of applicant's financial condition and inability to assume a larger burden of cash refunds.

In neither the applicant's presentation nor in the staff's Exhibit 11 was consideration given to the feasibility of making refunds of advances on a percentage-of-revenue basis in securities rather than cash. That type of deviation has been authorized under similar circumstances in at least two recent Commission decisions. (Decision No. 64048, dated July 31, 1962, in Application No. 44495, and Decision No. 64047, dated July 31, 1962, in Applications Nos. 43578 and 44149)

We have carefully considered this record in light of all pertinent circumstances, including the rapid growth in applicant's general area of operations, the company's present financial condition and its need to anticipate future growth and financial requirements, and the interest of present and future consumers in receiving adequate service at the lowest reasonable rates consistent with continuation by applicant of that service.

In the course of its opinion in the proceeding which resulted in revision of the company's main extension rule, the Commission made the following finding (Decision No. 64536, supra):

"We further find and conclude that it is in the public interest for a public utility, in acquiring its plant and facilities, to establish and maintain a balanced and elastic capital structure, reasonably proportioned between equity and debt securities, including refundable advances, so as to enable such public utility to meet its obligations and capital requirements, upon favorable terms, without interfering with its service to the public or seriously impairing its cash position."

We are of the opinion that to authorize refunds of advances on a percentage-of-revenue basis, with securities rather than cash, would be compatible with the foregoing statement of this Commission's policy.

There are two potential dangers which should be reviewed before a utility is authorized to expand after having reached the 50 percent level of advances. These are (1) the utility may be extending excessively into territory where very few customers will actually be served, and (2) the utility may be unable to obtain the cash needed to make refunds when due. The record in this proceeding shows that applicant's service area has a reasonably high customer density. If advances in the amount of \$200,000 are refunded on a percentage-of-revenue basis with securities, this will prevent such refunds from becoming a burden on applicant's cash resources.

We find that:

1. The present and future public convenience and necessity require and will require the extension of applicant's water service to all areas proposed in the application herein, and that the deviation from applicant's extension rule, herein authorized, is not adverse to the public interest.

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

3. Applicant should be authorized to make any extensions of mains required to serve its presently certificated area and that area certificated herein, even though its outstanding advance contract balances exceed 50 percent of the total water utility plant less depreciation reserve.

The certificate hereinafter granted shall be subject to the following provision of law:

The Commission shall have no power to authorize the capitalization of this certificate of public convenience and necessity or the right to own, operate, or enjoy such certificate of public convenience and necessity in excess of the amount (exclusive of any tax or annual charge) actually paid to the State as the consideration for the issuance of such certificate of public convenience and necessity or right.

In issuing our order herein, we place applicant and its shareholders on notice that we do not regard the number of shares outstanding, the total par value of the shares nor the dividends paid as measuring the return applicant should be allowed to earn on its investment in plant and that the approval herein given is not to be construed as a finding of value of applicant's stock or properties nor as indicative of amounts to be included in a future rate base for the determination of just and reasonable rates.

O R D E R

IT IS HEREBY ORDERED that:

1. A certificate of public convenience and necessity is granted to Rosa Water Company, a corporation, to construct and operate extensions of facilities from its existing water system in Ventura County, California, to serve the tracts and parcels of land described in Exhibit 2 of the record herein entitled "Legal Description of Parcels Sought to be Certificated Herein".

2. Applicant is authorized to apply, after the effective date hereof, its presently effective tariff schedules to the areas certificated herein.

3. Within thirty days after the effective date of this order, applicant shall file, in conformity with General Order No. 96-A and in a manner acceptable to this Commission, revised tariff sheets, including a tariff service area map, reflecting the additional areas certificated herein. Such tariff sheets shall become effective upon five days' notice to the Commission and to the public.

4. Applicant, after the effective date of this order, may issue and sell not to exceed \$100,000 aggregate par value of Series A, five percent preferred stock, at par for cash, for the purposes stated in the foregoing opinion, and not to exceed \$200,000 aggregate par value of three percent noncumulative preferred stock, for the purpose of refunding the advances involved herein.

5. Applicant is authorized to deviate from its filed main extension rule to the extent that it may substitute the securities authorized herein for cash, in refunding the \$200,000 of advances discussed in the foregoing opinion.

6. Applicant is authorized to make any extensions of mains required to serve its presently certificated area and that area certificated herein, even though its outstanding advance contract balances exceed fifty percent of the total water utility plant less depreciation reserve.

7. Applicant shall file with the Commission a report, or reports, as required by General Order No. 24-A, which order, insofar as applicable, is made a part of this order.

8. Applicant is hereby prohibited from further extending its service outside its presently certificated service area, including the service area herein certificated, unless first securing authority from the Commission so to do.

The effective date of this decision shall be established by supplemental order upon a showing by applicant on or before July 1, 1963 that it has (1) reached agreement with developers for the cash sale of \$100,000 aggregate par value of five percent preferred stock authorized herein and refunding of approximately \$200,000 of advances on a 22-percent-of-revenue refund basis with the three percent preferred stock authorized herein, and (2) issued \$100,000 of common stock in payment of notes payable to stockholders, as authorized by Decision No. 63875, dated July 2, 1962, in Application No. 44581.

Dated at San Francisco, California, this 19th day of March, 1963.

George A. Grover
President

Carl W. Rego

Fredrick B. Halaloff

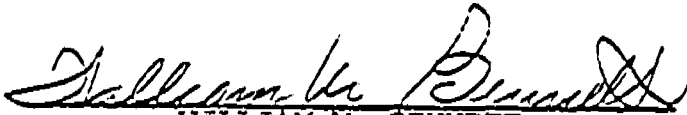
Commissioners

BENNETT, William M., Commissioner, concurring and dissenting.

I concur with the decision of the majority in so far as it finds the present and future public convenience and necessity require and will require the extension of applicant's water service to the areas proposed in the application, in so far as it authorizes not to exceed \$100,000 of 5% preferred stock for the purposes set forth in the hearing, and in so far as it authorizes the issuance of not to exceed \$200,000 of 3% preferred stock for the purpose of refunding the advances involved herein.

I dissent to the majority decision to the extent that it requires that the advances be refunded with the 3% preferred stock on a 22-percent-of-revenue basis. The applicant requested that the advances be refunded on a proportionate cost basis. The reason for this request is clear on the record: the developers' agreement to purchase the 5% preferred stock at par for cash is contingent upon their advances being refunded with the 3% preferred stock on a proportionate cost basis. The majority's assumption that these two classes of preferred stock with such widely varying rates of preference are equally marketable at par under conditions of authorization not requested by the applicant is conjectural and is without support on the record.

Dated at San Francisco, California, this 19th day of March, 1963.


WILLIAM M. BENNETT
Commissioner