

**ORIGINAL**Decision No. 69268

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application  
of San Jose Highlands Water Company,  
a California corporation, for an  
extension of service.

Application No. 47357  
(Filed February 24, 1965)  
(Amended April 22, 1965)

L. Diel, for San Jose Highlands Water Company,  
applicant.  
Charles B. Parbury and Norman E. Andrews, for  
San Jose Water Works, interested party.  
John Gibbons and W. B. Stradley, for the Commission  
staff.

O P I N I O N

Applicant, San Jose Highlands Water Company, a corporation, seeks (1) a certificate of public convenience and necessity to construct an extension of its present water system, (2) authority to deviate from its filed main extension rule, (3) authority to issue preferred stock, and (4) removal of limitation on expansion to adjacent areas.

A public hearing on this application was held before Examiner Catey in San Jose on April 26, 1965. Copies of the application had been served and notice of hearing published in accordance with this Commission's rules of procedure. The matter was submitted at the conclusion of the hearing.

At the hearing, testimony on behalf of applicant was presented by its president, by its majority stockholder and by its engineer. The Commission staff presentation was made by an engineer and an accountant. There are no protestants in this proceeding.

Present and Proposed Areas

Decision No. 64952, dated February 13, 1963, in Application No. 44417, granted applicant a certificate to construct a public utility water system in Unit No. 1, San Jose Highlands, a tract approximately 88 acres in area, located just north of Alum Rock Park off Penitencia Creek Road in the City of San Jose. This area subsequently has been further divided as follows:

Unit No. 1, Tract No. 3279, 100 lots  
Unit No. 2, Tract No. 3319, 22 lots  
Unit No. 7, Tract No. 3808, 24 lots

Decision No. 66916, dated March 10, 1964, in Application No. 45913, granted a certificate to applicant to construct an extension of its system into Units Nos. 3, 4 and 5 of San Jose Highlands, also known as Tracts Nos. 3320, 3451 and 3561, respectively. Those three units contain a total of 64 residential lots.

The area for which a certificate now is requested is Tract No. 3807 (Unit No. 6) consisting of 26 lots, Tract No. 3809 (Unit No. 8) which includes 21 lots, and Tract No. 3922 (Unit No. 9) which will contain about 16 lots. These tracts are located adjacent to present facilities of the utility.

At the present time approximately 11 customers are being served within the utility's existing service area. Several homes are being constructed in the areas now requested.

Water System

Applicant's service area is immediately east of San Jose Water Works' 5 million-gallon Dutard Reservoir and a 10 million-gallon reservoir and treatment plant presently under construction by Santa Clara County Flood Control and Water Conservation District. Elevations within the area now served and requested to be served range from about 400 feet to over 1,200 feet above sea level.

Consequently, several pressure zones are required to provide appropriate water pressure to customers.

Applicant's water supply is provided by San Jose Water Works through two 2-inch meters at the latter's filed rates for general metered service, pursuant to an oral agreement between the two utilities. Applicant pumps this water into its storage tanks, from which it is distributed by gravity flow to its various customers. Upon completion of the District reservoir and treatment plant, applicant plans to purchase water directly from the District.

The facilities to be constructed to serve the requested areas consist of about 4,700 feet of 8-inch and 6-inch pipe, a 250,000-gallon storage tank, a pressure reducing station, services, meters, and fire hydrants. The undisputed testimony of applicant's engineer is that the facilities will be adequate to serve the requested areas and will conform with the requirements of General Order No. 103.

The water system is operated under the general direction of its president, who resides and maintains an office in the San Jose area. Local maintenance and emergency calls are handled by a local serviceman who lives in the immediate area and is on 24-hour call for this purpose.

#### Affiliated Interests

All of applicant's outstanding preferred stock is held by an individual who owns or controls Priscilla, Inc., the developer of applicant's present, proposed, and potential future service area. That individual and applicant's president own all of applicant's outstanding common stock.

Applicant is not affiliated with the engineering firm which designed the system. All major construction work has been, and will be, subject to competitive bidding.

Financing

Applicant proposes to finance the estimated \$40,232 cost of off-tract facilities and meters by sale of preferred stock to the affiliated developer. Applicant requests authority to deviate from the provisions of its filed main extension rule by issuing preferred stock to Priscilla, Inc., in lieu of refunding, over a period of years, the \$65,539 of advances for main extensions in Units Nos. 3, 4, 5, 6, 8 and 9. Applicant's majority stockholder testified that preferred stock was proposed, rather than common stock, primarily in order (1) to maintain the present approximately equal ownership of common stock by the two stockholders, and (2) to guarantee the majority stockholder's investment in the facilities when and if they are sold.

The Commission staff recommends denial of the requested deviation for the following reasons, set forth in Exhibit No. 1:

- "a. It would result in the substitution of relatively high-cost capital for interest-free money obtained from main extension agreements.
- "b. It is not in the public interest to permit small, newly formed utilities to finance their expansion beyond the basic initial system by use of equity capital in lieu of main extension agreements. Such authorization would encourage subdividers in the periphery of existing utilities to install their own water systems with the hope that they might subsequently sell the properties to the larger utilities at a more advantageous price than they could obtain for main extension agreements."

In addition, a staff witness stated that the proposed deviation would increase applicant's rate base, as compared with the refund plan prescribed by applicant's tariffs. This could have an adverse effect upon applicant's customers in future rate proceedings. Although applicant's majority stockholder stated that he was willing to have rates established in future proceedings as though applicant had followed its extension rule, future owners of his present stock might not be so inclined.

The staff has no objection to the issuance of common stock by the applicant for off-tract facilities and for refunds on advance contracts as they become due.<sup>1/</sup> The staff recommends common stock instead of preferred stock to reduce dividend requirements and cash drain. Exhibit No. 1 shows that issuance of common stock for off-tract facilities and financing main extensions in accordance with applicant's filed tariffs would help to balance applicant's capital structure, which would be top-heavy with preferred stock under applicant's requested financing. The staff's proposal would result in an initial level of advances at approximately 30 percent of net plant, which is well below the 50 percent maximum prescribed by applicant's main extension rule.

The following Table I is a comparison of applicant's present capital structure with that which would result from applicant's and staff's proposed financing:

TABLE I  
Capital Structure

Item	Recorded 12-31-64		Pro Forma 1965			
	Amount	%	Applicant		Staff	
			Amount	%	Amount	%
Contributions	\$ 19,000	14	\$ 19,000	9	\$ 19,000	9
Advances	24,645	17	-	-	65,540	30
Pref. Stock	95,000	69	200,772	91	95,000	43
Common Equity	(30)	-	(30)	-	40,202	18
Total	\$138,615	100	\$219,742	100	\$219,742	100

(Red Figure)

<sup>1/</sup> Refunds of advances as they become due, with securities in lieu of cash, has been authorized for other utilities. For example:

Decision No.	Date	Application No.	Utility
61956	5-9-61	42584	LaGranada Water Company
64047	7-31-62	43578	Suburban Water Systems
64767	1-8-63	44281	Vandenburg Utilities Co.
65121	3-19-63	44721	Rosa Water Company
67109	4-21-64	46077	Meyers Water Co.
68313	12-9-64	47118	Village Water Company

It appears that the preferred stock financing is proposed for the convenience of the utility's owners. The relationships of those owners could, however, be established by private agreement even if common stock were issued. This would avoid further distortion of applicant's capital structure through an excessive proportion of preferred stock.

Limitations on Expansion

Applicant requests that the limitations on expansion imposed by Decision No. 64952 and continued by Decision No. 66916 be lifted. The staff points out that at the present time the utility has only 11 active connections, although it has authorization to serve a total of 210 lots. The company presently is operating at a loss. There is no assurance that revenues from the existing water system will be sufficient to meet present operating expenses, let alone the greater expenses of a vastly expanded water system. The staff recommends that the limitations on expansion not be lifted.

The stated position of San Jose Water Works is that it does not wish to increase its supply to applicant and that it wishes to be relieved of this resale service as soon as another supply is available to applicant from Santa Clara County Flood Control and Water Conservation District. Under these circumstances, it would not be appropriate to permit unlimited expansion of applicant's service area.

Rates and Earnings

Applicant proposes to furnish service to all customers under its present meter rates. Flat rate service is not now authorized nor is it proposed by applicant.

Applicant recognizes that it will not receive enough revenue during the early development period of the subdivisions to cover its operating expenses. Priscilla, Inc. has agreed to reimburse applicant for those operating losses. The written agreement so providing is Exhibit No. 3 herein.

Findings and Conclusions

The Commission finds that:

1. Public convenience and necessity require the construction of extensions of applicant's water system to serve the areas requested herein.

2. San Jose Water Works has made available to applicant an adequate water supply to serve the areas requested. Applicant has not shown, however, that it has sufficient water available to permit unrestricted further expansion.

3. It is fair and reasonable for applicant to charge the same rates in the requested areas as it charges in its present areas.

4. The facilities proposed to be installed by applicant are adequate to serve the requested areas and conform with the requirements of General Order No. 103. Authority for issuance of common stock will give applicant the financial ability to install those facilities.

5. The issue of preferred stock and deviation from the main extension rule, as requested by applicant, would further distort applicant's presently unbalanced capital structure and could have an unreasonable adverse effect on future ratepayers.

6. The issue of common stock 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.

7. The staff's suggested deviation from applicant's main extension rule to permit the refund to Priscilla, Inc. of advances as they become due, in common stock rather than in cash, is reasonable and is not adverse to the public interest.

8. The agreement, Exhibit No. 3, providing for the payment by Priscilla, Inc. of applicant's initial operating losses, is reasonable and is not adverse to the public interest.

The Commission concludes that the application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that:

1. A certificate of public convenience and necessity is granted to applicant San Jose Highlands Water Company, authorizing it to construct extensions of its public utility water system to serve Units Nos. 6, 8, and 9 (Tracts Nos. 3807, 3809 and 3922) of San Jose Highlands Subdivision in San Jose, Santa Clara County, as such territory is outlined in red on the map attached to the amended application herein.

2. Applicant shall not extend service outside of its certificated areas, nor file any revised tariff service area map indicating its willingness to so extend service, without first having obtained authorization therefor by further order of this Commission.

3. After the effective date of this order, applicant is authorized to file revised tariff sheets, including tariff service area maps, to provide for the application of its present tariff schedules to the areas certificated herein. Such filing shall comply with General Order No. 96-A. The effective date of the revised sheets shall be four days after the date of filing.



4. Compliance by applicant with paragraph 3 of this order shall constitute: (a) acceptance by it of the right and obligation to furnish public utility water service within the area certificated herein; and (b) a commitment by it that this application will be amended to request authority to issue common stock. The authority granted herein shall expire unless the designated tariff sheets are filed within one year after the effective date of this order.

5. Applicant's requests for authority to issue preferred stock and to deviate from certain provisions of its main extension rule are denied.

6. After appropriate amendment of this application, approved by a supplemental order herein, applicant may issue not to exceed \$106,000 aggregate par value of its common stock for the following purposes:

- a. Not to exceed \$40,500 in payment of the back up plant and meters discussed in the foregoing opinion.
- b. Not to exceed \$65,500 as refunds of advances relating to the main extensions discussed in the foregoing opinion, the timing and amounts of refunds to be determined in accordance with applicant's filed main extension rule.

7. Applicant is authorized to deviate from the provisions of its filed main extension rule to the extent that it may enter into, and carry out the terms of, main extension agreements with the affiliated developer of San Jose Highlands Units Nos. 3, 4, 5, 6, 8 and 9, providing for refund of advances in common stock as authorized in paragraph 6.b. of this order.

8. Applicant is authorized to carry out the terms and conditions of the operating loss reimbursement agreement, Exhibit No. 3 herein.

9. Applicant shall prepare and keep current the system map required by paragraph I.10.a. of General Order No. 103. Within 180

days after the effective date of this order, applicant shall file with the Commission two copies of this map.

10. Applicant shall file with the Commission a report, or reports, as required by General Order No. 24-B, which order, in so far as applicable, is made a part of this order.

11. Within thirty days after the execution of each agreement pursuant to paragraph 7 of this order, applicant shall file in this proceeding two copies of the agreement and shall file with this Commission a revised summary list of contracts and deviations to include such agreement. The filing of the revised list shall comply with General Order No. 96-A.

The effective date of this order shall be ten days after the date hereof.

Dated at San Francisco, California, this 27th day of June, 1965.

Frederick B. Hallock  
President  
George H. Crowe  
William G. Burnett  
Commissioners