

ORIGINAL

Decision No. 70736

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of CENTRAL UTILITIES INC., a California corporation, (formerly ALDERCROFT HEIGHTS COMPANY) for an order authorizing it to: (a) purchase the water system owned and operated by Earl LaPorte under the proprietary name of REDWOOD LODGE WATER SYSTEM; (b) grant to it a certificate of public convenience and necessity to construct a public water system near the Summit Woods Subdivision and authorize the distribution and sale of water to the inhabitants thereof; (c) to establish rates for the service to said area; and (d) to sell and issue stock.

Application No. 47894
(Filed September 14, 1965)

FRANK A. HAWN,

Complainant,

vs.

REDWOOD LODGE WATER SYSTEM,
A PUBLIC UTILITY,

Defendant.

Case No. 8331
(Filed January 13, 1966)

Gerald C. Venoli, for Central Utilities Inc., an applicant in Application No. 47894 and interested party in Case No. 8331, and for Earl A. LaPorte, an applicant in Application No. 47894 and defendant in Case No. 8331.

Frank A. Hawn, for himself, interested party in Application No. 47894 and complainant in Case No. 8331.

L. Raynor Talley, for Santa Cruz County Health Department, interested party.

John J. Gibbons, for the Commission staff.

INTERIM OPINION

Earl A. LaPorte (seller), an individual doing business as Redwood Lodge Water System, and Central Utilities, Inc. (buyer), a

corporation, seek authority for the transfer of a water system. Buyer also seeks (1) authority to issue securities, (2) a certificate to construct an extension of the system, and (3) a rate increase. By oral amendment at the hearing, buyer modified its original financing proposal and now requests authority to issue securities in a lesser amount than originally requested, but to assume certain indebtedness of seller. Frank A. Hawn (complainant) stipulated that his service complaint had been satisfied by the installation of an electric motor and pump to replace the gasoline-powered unit formerly used by seller.

Public hearing was held before Examiner Catey in Los Gatos on March 17, 1966. Copies of the various pleadings had been served and notice of hearing had been published and mailed in accordance with the Commission's rules of procedure. Testimony was presented by buyer's general manager, by buyer's accountant, by an engineer from the Commission's staff, by one of the developers of the area into which buyer plans to extend service, by a former owner of the water system, by two customers and by a representative of the Santa Cruz County Health Department. The matters were submitted on March 17, 1966, subject to receipt of certain late-filed exhibits within ten days thereafter. Two of the exhibits, one by buyer and one by complainant, were not filed. The third was filed by buyer after the expiration of the ten-day period.

Seller

In Decision No. 68939, dated April 20, 1965, in Case No. 8027, seller was found to be a public utility "water corporation" within the meaning of the Public Utilities Act. He had acquired the small water system which served nine customers in an area known as Redwood Lodge, in Santa Cruz County, but had failed to obtain Commission authorization for his public utility operation.

Previous Commission decisions,^{1/} of which we take official notice, show that seller has been associated with buyer since 1954, that in 1957 he was buyer's president and manager, and that he and his wife were then sole stockholders of buyer. They are now minority stockholders. Ill health now prevents seller from personally operating the system.

Buyer

Buyer is a public utility which, at the time of the hearing, served water to some 118 customers in an area known as Aldercroft Heights, located about seven miles south of Los Gatos, in Santa Clara County. Under its former corporate name (Aldercroft Heights Company), buyer was granted a certificate in 1932 to construct the Aldercroft Heights water system.

Aldercroft Heights County Water District is in the process of acquiring buyer's Aldercroft Heights water system. Buyer alleges that the district would take over only 108 customers of a total of 118 in the Aldercroft Heights area. This is in conflict, however, with the testimony of buyer's accountant to the effect that the Aldercroft Heights system has only 106 customers. It is also in conflict with Paragraph XVII of the application, which states that the customers of buyer presently number 133. The record thus is not clear as to whether or not buyer will continue to have public utility obligations in the Aldercroft Heights area after the district is in operation.

Because of seller's ill health, buyer has supervised the operation of the Redwood Lodge system for several months. Buyer also

^{1/} In particular, Decision No. 54628, dated March 5, 1957, in Application No. 38538 and Case No. 5494.

arranged for the installation of the electric motor and pump which replaced the former gasoline-powered unit at the Redwood Lodge spring source of water supply.

Service Area

Seller's service area is located about three miles south of Aldercroft Heights. His filed tariff service area map shows a service area of less than ten acres. Decision No. 68939, supra, prohibits seller from extending his water system without further order of the Commission.

Buyer requests a certificate of public convenience and necessity to construct a water system to serve Summit Woods, a new subdivision situated on a 56-acre parcel of land located about 1,500 feet north of Redwood Lodge, and to serve several smaller parcels located between Summit Woods and Redwood Lodge. Those areas are outlined in red on the map attached as Exhibit "B" to the application. Additional areas south of Redwood Lodge are outlined in red on Exhibit "B" but no certificate is requested at this time covering those areas.

In 1963, the subdivider of Summit Woods installed a water distribution system in part of the subdivision and formed a nonprofit corporation to own and operate the facilities as a mutual water company. The three customers in the tract are being furnished free water by the subdivider until it determines whether it can and will develop sufficient water to carry through its original plans for a mutual water company. One of the four stockholders of the subdivider testified that he would probably prefer that a public utility water purveyor such as buyer serve Summit Woods, provided an adequate supply could be assured by the utility. He was opposed, however, to the Commission's granting to buyer a certificate covering Summit Woods until such time as the adequate supply is assured.

Buyer's general manager estimates that, aside from Summit Woods, about 35 customers in territory contiguous to Redwood Lodge could be added to the eight now served, if the present restriction against expansion were removed. He estimates that five of the additional customers would qualify for main extensions at the utility's expense under the 50-feet-per-customer free-footage allowance of buyer's main extension rule. Late-filed Exhibit No. 4, which buyer failed to file before the record herein was closed, was to have shown the names and addresses of the potential customers.

Water Supply and Requirements

Buyer's general manager estimates that the Redwood Lodge spring was producing from 4 to 5 gallons per minute (gpm) in June of 1965 and that the minimum flow later in the summer was 3-1/2 gpm. He estimates that the consumption per customer, if metered service were provided in Redwood Lodge, would be about the same as in Aldercroft Heights, where water bills average about \$6 per month. (At Aldercroft Heights rates, \$6 will purchase approximately 500 cubic feet of water.)

Buyer did not present any engineering study as to the maximum number of customers which could be supplied from a 3-1/2 gpm source. We will make the reasonable assumptions that (1) a peak day's demand could be twice the average demand, (2) most of the peak day's demand would occur during 12 daylight hours, (3) during peak days, the full output of the spring can be utilized by storing water at night for use during the day, and (4) it would not be economically feasible to install tanks or reservoirs to accumulate and store water during winter months for summer use. Under those assumptions, an absolute maximum of 20 customers could be served. The present 5,000-gallon storage tank and 2,500-gallon sump tank would permit the assumed utilization of 3-1/2 gpm from the spring during peak periods,

but would provide only about one-half day of reserve supply in case of shutdown of the spring or pump for maintenance or repairs and would provide virtually no reserve for fire protection.

It is apparent from the foregoing discussion that the present restriction against extension of the Redwood Lodge system should remain in effect until additional storage capacity is installed. Buyer intends to install a 100,000-gallon tank on a site 75 to 100 feet higher in elevation than the Redwood Lodge service area, but dispute over access to the property may delay construction. Late-filed Exhibits Nos. 9 and 10, which buyer and complainant failed to file, were to have presented information as to probable availability of access to the tank site. Even with the greater storage capacity, service should be restricted to not more than 20 customers until an additional source of supply is developed to supplement or replace the present limited spring supply.

Buyer has applied to the State Water Rights Board for authority to divert water from the west branch of Sequel Creek to serve the Summit Woods development. If that source becomes available to applicant in sufficient quantities, and if part of that supply can be delivered to the Redwood Lodge area, expansion of the Redwood Lodge system would be feasible. Until buyer obtains the authority to divert water, no determination can be made as to the adequacy of the supply proposed for Summit Woods.

Rates and Revenues

Seller's filed rate for water service in Redwood Lodge is \$5 per month. Buyer proposes, upon acquisition of the system, to install meters and charge the following monthly rates:

First	400 cu.ft. or less	\$8.00
Next	200 cu.ft., per 100 cu.ft.....	1.10
Over	600 cu.ft., per 100 cu.ft.	1.00

At the present flat rate, annual revenues of \$480 per year are received from the eight customers in Redwood Lodge. Buyer's proposed monthly minimum charge is \$3 per month higher than the corresponding charge in its Aldercroft Heights rates and would thus produce about \$860 per year from the eight Redwood Lodge customers. This is an increase of about 80 percent over the revenues produced by the present Redwood Lodge rates.

Expenses and Earnings

Buyer's accountant presented the following estimates of minimum out-of-pocket monthly expenses for operation of the present Redwood Lodge water system:

<u>Expense</u>	<u>Amount</u>
Maintenance	\$ 55
Electric Power	15
Insurance	10
Taxes	10
Vehicle Expense	25
Miscellaneous	15
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Total Monthly	\$ 130
	x 12
Total Yearly	\$1,560

Even if it were reasonable to cut the foregoing estimates almost in half, it is evident that the rates requested by buyer will not produce sufficient revenue to cover the out-of-pocket operating expenses of the Redwood Lodge system, nor will they provide for depreciation and return on the investment in the system, including the recently installed electric pumping plant. Buyer is aware of this and alleges that its stockholders are willing to finance operating losses during the developmental period of its anticipated expansion into other areas.

When buyer installs additional storage facilities and is permitted to serve 20 customers, it will be better able to cover

operating expenses. A normal return on buyer's investment is not likely, however, until it develops an additional source or sources of supply and extends into a larger service area.

Financial and Accounting Issues

Decision No. 24453, dated February 8, 1932, in Application No. 17768, authorized Aldercroft Heights Company to issue 600 shares of common stock at not less than \$25 per share. The shares were issued after that authority had expired. On or about October 1, 1954, the outstanding invalid capital stock certificates were acquired by Earl A. LaPorte and his wife, Elsie C. LaPorte. In a supplemental order, Decision No. 50932, dated January 4, 1955, in Application No. 17768, authority was granted to issue new shares to replace the void issue.

On July 6, 1965, amended articles of incorporation were filed with the Secretary of State, changing buyer's name from Aldercroft Heights Company to Central Utilities, Inc., and establishing two classes of shares, designated "Class A Common" and "Class B Common". The number of Class A shares is shown as 10,000 without par value and the number of Class B shares is shown as 40,000 at a par value of \$10. Class A stockholders are to elect a majority on the board of directors; Class B stockholders are to have minority representation. The amendments to the articles further provided for a stock split of 5 shares of Class A common stock for each share of outstanding no par value common stock. The 5 for 1 stock split was accomplished in 1965 without application to or authority from this Commission.

The balance in the capital stock account immediately prior to the amendment of the articles of incorporation amounted to \$15,000 for the then outstanding 600 shares of no par common stock. The balance in the capital stock account subsequent to the amendment of the articles amounted to \$42,598.96, representing 3,000 shares of

Class A common stock at no par value. The increase in the capital stock account from \$15,000 to \$42,598.96 resulted from unjustified and unauthorized arbitrary write-ups of balances in the utility plant accounts, primarily in the land account. In effecting the recapitalization, Central canceled the original stock certificates and issued new stock certificates.

The Uniform System of Accounts for Class D Water Utilities requires that all utility plant be recorded at cost (Utility Plant Account Instruction 3), and thus prohibits arbitrary write-up of plant account balances. The Public Utilities Code (Sections 816-830, Stocks and Securities Transactions) prohibits the issuance of stock and stock certificates without Commission authorization. In Exhibit No. 5, the Commission staff recommends that buyer be required to reverse the write-up of plant and stock, and to recall the void stock certificates issued after the split.

Buyer proposes to issue 200 shares of Class B common stock with an aggregate par value of \$2,000 to seller in exchange for his equity in the Redwood Lodge system. Buyer also proposes to assume all of seller's liabilities related to the water system.

Exhibit No. 5 shows net plant of \$7,162 in the Redwood Lodge system as of July 6, 1965. Seller has liabilities of about \$3,500 as the unpaid balance on the \$4,000 purchase price of the water system from its former owner, and \$600 of accounts payable. An additional liability of \$1,850 for the new pump is offset by the additional \$1,850 of utility plant represented by that pump.

Buyer ultimately expects to receive over \$25,000 in cash from Aldercroft Heights County Water District as compensation for the Aldercroft Heights system. Buyer's general manager estimates that this will cover the first 2-1/2 to 3 years' capital requirements

for expanding the Redwood Lodge operation into additional territory. Buyer does not intend to use those funds at the present time to pay off the outstanding balance due the former owner of the Redwood Lodge water system. Instead, buyer proposes to issue its 70-month note for some \$3,500, payable in monthly installments of \$60, including interest at a 6 percent annual rate.

Supplemental Filings

There are several deficiencies in the showing made by buyer. These could be overcome, however, by the filing of supplemental pleadings in Application No. 47894. The deficiencies are:

1. In regard to the unauthorized \$27,598.96 write-up of utility plant accounts cited in Exhibit No. 5, buyer should certify that it has reversed those improper entries.

2. In regard to the unauthorized issue of 3,000 shares of new Class A stock, which issue we hereby find to be void (Sec. 825, Public Utilities Code), buyer should certify that it has recalled the spurious documents. If buyer then wishes to obtain authority to issue shares of Class A common stock, it should make a proper showing in accordance with this Commission's rules of procedure.

3. In regard to the proposed transfer of the Redwood Lodge Water System from seller to buyer, a copy of the proposed deed and bill of sale should be filed herein.

4. In regard to the long-term note to be issued by buyer, a copy of the proposed note should be filed herein. If a deed of trust, chattel mortgage, or other encumbrance of utility property is to be executed, a copy of any such proposed documents also should be filed herein.

5. In regard to authorization to serve not more than 20 customers from the Redwood Lodge system, a showing should be made

that sufficient additional storage has been installed to serve those customers during temporary shutdown of the single source of supply for maintenance and repairs.

6. In regard to authorization to serve more than 20 customers from the Redwood Lodge system, a showing should be made that a sufficient additional source of supply has been developed to serve the anticipated number of customers.

7. In regard to the requested certificate to construct a water system to serve Summit Woods, a showing should be made (a) that buyer can and will develop an adequate source of supply for that area, (b) that there is a need and desire by property owners in the area for public utility water service, and (c) as to method of financing.

A supplemental application incorporating several of the above items could presumably be filed almost immediately. Some of these items must await future events, such as the possible granting of a right to divert water from Soquel Creek.

Findings and Conclusions

The Commission finds that:

1. A supplemental application or applications must be filed as discussed in the foregoing opinion before the record is sufficiently complete to support the granting of the various requests in Application No. 47894.

2. The installation of an electric motor and pump to replace the gasoline-powered unit formerly in use has satisfied the complaint in Case No. 8331.

The Commission concludes that:

1. Submission of Application No. 47894 should be set aside for receipt of a supplemental application or applications as discussed herein. If, within a reasonable time, Central Utilities, Inc., Earl A. LaPorte, or both, file a supplemental application or applications in support of the relief requested, or a portion thereof, as discussed in the foregoing opinion, consideration will be given thereto. Otherwise, Application No. 47894 will be dismissed.
2. Case No. 8331 should be dismissed.

INTERIM ORDER IN APPLICATION NO. 47894

IT IS ORDERED that submission of Application No. 47894 is set aside.

ORDER IN CASE NO. 8331

IT IS ORDERED that Case No. 8331 is dismissed.

The effective date of these orders shall be twenty days after the date hereof.

Dated at San Francisco, California, this 24th day of MAY 4, 1966.

Frederick B. Hill
President
George E. Crover
Commissioners
Reginald

Commissioner William M. Bennett, being necessarily absent, did not participate in the disposition of this proceeding.