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Decision No. 76117

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of INDIAN WELLS WATER COMPANY, a California corporation, for a certificate of public convenience and necessity to construct a public utility water system near Coarsegold, in Madera County, and establish rates for service and to issue stock.	Application No. 48211 (Petition Filed June 19,1968)
In the Matter of the Application of INDIAN WELLS WATER COMPANY, a California corporation, for authority to extend water service to Indian Lakes Estates, contiguous area.	Application No. 48838 (Petition Filed June 19,1968)

O P I N I O N

Applicant Indian Wells Water Company, Inc.[1/] seeks modification of Decision No. 70864, dated June 14, 1966, in Application No. 48211 and Decision No. 71670, dated December 6, 1966, in Application No. 48838. The Commission staff has investigated matters pertinent to the petition for modification and has prepared a report, dated June 19, 1969. A copy of the staff report hereby is received as Exhibit No. 2 in Application No. 48211 and incorporated by reference in Application No. 48838. Copies of the staff report were sent to applicant. A letter dated June 27, 1969 from applicant concurring with most of the staff's recommendations hereby is received as Exhibit No. 3 in Application No. 48211 and incorporated by reference in Application No. 48838.

1/ Applicant's articles of incorporation filed January 17, 1966 with the Secretary of State show that applicant's corporate title is Indian Wells Water Company, Inc. Various documents in these proceedings erroneously have referred to applicant as Indian Wells Water Company or Indian Wells Water Co.

Previous Decisions

Decision No. 70864 granted applicant a certificate to construct a water system to serve Lots Nos. 36 through 78 and 245 through 318 in the subdivision known as Indian Lakes Estates, near the community of Coarsegold, Madera County. The decision also authorized applicant, on or before December 31, 1966, to issue not to exceed 25,000 shares of its $1 par value capital stock in the aggregate amount of $25,000 to cover all or a portion of the cost of in-tract facilities actually installed during the first year of operations. The certificate and the authorization to issue stock were made subject to stockholders' agreeing in writing to provide additional funds as required until such time as the utility's income is adequate to cover all out-of-pocket operating expenditures. Further, the authority to issue stock was conditioned upon the establishment of an escrow holder for the stock, which escrow holder would not be permitted to transfer the stock, or any interest therein, or receive any consideration therefor, without further order of this Commission.

Decision No. 71670 granted applicant a certificate to construct an extension of its water system to serve the remaining 393 lots in Indian Lakes Estates. The deviation from applicant's filed main extension rule inherent in the previously authorized security issue was extended to cover any facilities to serve the additional 393 lots, if installed prior to July 4, 1967, which date is one year after the effective date of Decision No. 70864.

The record in these proceedings shows that applicant selected Robert E. Lewis, attorney at law of Oakland, California, as escrow holder of the certificates representing shares of stock to be

issued pursuant to Decision No. 70864. Approval of this escrow holder was granted by Decision No. 71580, dated November 29, 1966, in Application No. 48211. As discussed later herein, the shares were not issued.

On December 5, 1966, pursuant to one of the requirements of Decision No. 70864, applicant filed in Application No. 48211, a "Guaranty Agreement" executed by the developers of the Indian Lakes Estates subdivision, which developers also were the proposed stockholders of applicant. The developers agreed to provide additional funds as required until such time as the utility's income is adequate to cover all out-of-pocket operating expenditures.

Applicant's Requested Modifications

Applicant requests that Decisions Nos. 70864 and 71670 be modified as follows:

1. a. To permit applicant to acquire from its affiliated land developer the facilities constructed to serve the 117-lot area certificated by Decision No. 70864, by issuance of the $25,000 aggregate par value of securities originally authorized.

   b. To permit applicant to credit capital surplus with the amount by which the actual cost of such facilities exceeds $25,000.

2. To permit applicant to deviate from its filed main extension rule by executing a form of main extension agreement not conforming with its filed tariff form for the cost in the amount of $174,477 of extending facilities to serve the additional area certificated by Decision No. 71670.

3. To extend the time to December 31, 1968 for final completion and acceptance of the water system, for issuance of securities and for execution of the main extension agreement.

4. To limit the applicability of the "Guaranty Agreement" to five years.

Financing of Initial Unit

Applicant's proposed means of acquisition of facilities to serve the original 117-lot certificated area would treat that area as an "initial unit" to which applicant's main extension rule would not apply. This approach is consistent with the general practice at the time the certificate was granted. The staff, in its report, confirms the amount of the reported actual cost of facilities installed and recommends authorizing the stock issuance and capital surplus entries requested by applicant.

The order herein grants the portion of applicant's request regarding financing of the "initial unit". We place applicant on notice, however, that in similar circumstances where customers have not had the protection provided by the main extension rule from the effects of speculative and uneconomical investment of utility funds, a "saturation adjustment" has been made when setting rates. This adjustment takes into consideration the degree of utilization of facilities so that customers in a thinly developed area are not required to pay a return on investment in an excessive amount of plant.

The escrow requirements of Decision No. 70864 preclude, among other things, the possibility that an unsophisticated party might acquire applicant's securities without being aware that a portion of the investment is not eligible for a return until a reasonable customer saturation is achieved. Applicant does not request any other change in the escrow requirement and the approved escrow holder.

Extension Beyond Initial Unit

A form of main extension contract applicant proposes to use beyond the "initial unit" is attached to the petition for modification. The staff report points out a number of undesirable deviations from applicant's main extension rule and general orders of this Commission. The staff recommends that applicant's proposed deviations not be authorized. Applicant has shown no reason that its standard main extension agreement is not applicable. The standard form is appropriate even though applicant's proposed initial stockholders are the same parties as the developers advancing the cost of facilities.

Recommendations by the staff of a funded reserve in lieu of the "guaranty agreement", as hereinafter discussed, are conditioned upon some arrangement whereby at least during the pendency of that agreement refunds of advances will not create a cash drain upon applicant. Two possible methods for eliminating the potential cash drain are suggested by the staff.

The first, and simpler, method proposed by the staff is to have the developers turn over the main extension contract to applicant, which initially is their wholly-owned corporation, to be held alive as an investment, with refunds being credited to capital surplus as they become due. This solution to the cash-drain problem is one of those mentioned in Decision No. 75205, dated January 21, 1969, in Case No. 5501, the Commission's investigation of the uniform water main extension rule.

The second method proposed by the staff is to have the developers agree that the utility will not be required to pay cash refunds on the contract during such time that the funded reserve is being used, such refunds being treated as additional capital investment in applicant by the developers. This could create problems if,

at some future date, the parties holding the main extension contract were not the same parties as the then stockholders of applicant. The staff's first suggestion is adopted herein.

Guaranty Agreement

At the time applicant first requested a certificate, there was some doubt that the subdivision would have many active services within any reasonable time. It was apparent that, without some more normal customer density and at any reasonable level of water rates, operating expenses would exceed gross revenues for the utility operation. The Commission was aware that there have been instances where, after all or most of the lots have been sold, subdividers who form new water utilities lose their enthusiasm for subsidizing the utility during the developmental period. Decision No. 70864 required, as a condition of the various authorities granted in that decision, written agreement by applicant's proposed stockholders that they would provide additional funds as required until such time as the utility's income is adequate to cover all out-of-pocket operating expenditures. That agreement, termed a "guaranty agreement" was filed in Application No. 48211.

The staff report shows that the early doubts as to speed of development were justified. Although most of the lots in the entire subdivision have been sold, only one home had been completed at the time of the staff's investigation, and that home was unoccupied. Applicant now seeks a time limit on the liability of its stockholders to cover operating losses.

In the staff report, recommendations for modification alternatives to the "present guaranty agreement" are set forth which, in some respects, would be preferable to the present agreement, yet

would not hold applicant's initial stockholders perpetually liable for operating losses. Essentially, the staff's suggestion would provide for a funded, interest-bearing reserve in the original amount of $15,000 to be supplied by applicant's initial stockholders, to be used for the specific purpose of covering certain of applicant's out-of-pocket losses and, under certain circumstances, plant replacements, during its early development period. Estimates by the staff indicate that, during the next ten years, applicant will sustain an out-of-pocket loss of about $15,000, and that operations should thereafter at least break even. These estimates are based upon recent staff studies of probable customer growth in recreational or second-home types of subdivisions, with particular attention to factors affecting Madera County in general and Indian Lakes Estates in particular.

Details of two suggested plans are set forth in the staff report. One plan would terminate in fifteen years and would make the fund generally applicable only to certain basic maintenance and operation expenses. The other plan would terminate in ten years and would be less restrictive in the classification of expenses which could be covered by the fund. Applicant indicates a preference for the 10-year plan but does not state that the 15-year plan would be unacceptable.

It is important that some limitation be placed upon the extent of use of the reserve fund so that it will not be depleted in the early years and have nothing available for later periods. In the particular circumstances in this proceeding, however, it appears simpler and more direct to establish a dollar limitation, rather than to have the reserve cover only part of each year's actual out-of-pocket

losses, as proposed by the staff. This is accomplished by the order herein, which provides for a special savings or escrow account. Annual withdrawals to be made by applicant from the special account are to be limited to the sum of $400 plus 15 percent of the beginning-of-year balance in the account. If we ignore any interest for the first partial year and assume only four percent interest over the life of the special account, applicant will receive about $15,000 from the fund during the first ten years. Due to the interest accrued during that time, withdrawals would continue from the account for four more years. The annual withdrawals would be greater in the first part of the 14-year period than in the last part, consistent with an assumption of gradual growth in revenues and resultant gradual decline in operating losses.

Findings and Conclusions

The Commission finds that:

1. Applicant's true corporate title is Indian Wells Water Company, Inc.

2.a. The authorization granted by Decisions Nos. 70864 and 71670 to issue securities has expired.

b. The property to be paid for by the issuance 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.

c. The cost of the water facilities to serve the area certificated by Decision No. 70864 is $85,965.

3. If a funded reserve in a special savings or escrow account replaces the present "guaranty agreement", as authorized herein, refunds of advances for construction could create an undesirable cash drain on applicant.

4. The establishment by applicant's stockholders of a special savings or escrow account in the original amount of $15,000, with withdrawals by applicant as provided herein, is a suitable substitute for the presently effective "guaranty agreement".

The Commission concludes that applicant should be authorized to issue securities, to accept from its stockholders the assignment of a main extension agreement and to substitute a special savings or escrow account for the present loss-reimbursement agreement.

O R D E R

IT IS ORDERED that:

1. Wherever heretofore in these proceedings applicant has been referred to as "Indian Wells Water Company" or "Indian Wells Water Co.", those designations shall be deemed to be corrected to "Indian Wells Water Company, Inc".

2.a. After the effective date of this order but prior to January 1, 1970, applicant may issue not to exceed 25,000 shares of its $1 par value capital stock in the aggregate amount of $25,000 for the purposes set forth in the foregoing opinion.

b. The escrow provisions of paragraph 12 of Decision No. 70864 and the escrow holder approved by Decision No. 71580 shall apply to the securities issued pursuant to the authority hereinabove granted.

c. Upon issuance of the securities as hereinabove authorized, applicant shall credit to Ac.200, Common Capital Stock, the amount of $25,000 and shall credit to Ac.270, Capital Surplus, the amount of $60,965; the sum of $85,965 representing the cost of the portion of the water system serving the area certificated by Decision No. 70864.

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

3. If the present "guaranty agreement" is replaced with a cash special savings or escrow account, as hereinafter authorized, applicant shall accept from its stockholders assignment of the main extension agreement, executed in accordance with applicant's tariffs, relating to the extension to serve the area certificated by Decision No. 71670. Applicant shall hold this agreement alive as an investment, with refunds being credited to capital surplus as they become due.

4.a. After the effective date of this order applicant is authorized to exchange its present "guaranty agreement" with the subdivision developers for an interest-bearing special savings or escrow account in a bank or savings and loan association. The original amount of the special account is to be $15,000, to be withdrawn, including interest, by applicant in annual installments in January of each year, in the amount of $400 plus 15 percent of the beginning-of-year balance in the special account. Deviation from these pay-out provisions may be made only upon authorization of this Commission.

b. Funds withdrawn by applicant from the aforementioned special account shall be used by applicant only (1) to the extent that out-of-pocket expenses from the utility operation exceed gross revenues and (2) for replacement of existing plant facilities if later authorized by this Commission. No payments to shareholders or their families for management of the utility shall be considered to be "out-of-pocket" expenses for purposes of this limitation.

c. One year after applicant receives final withdrawal from the special account, any amount of the withdrawals which has not been utilized for the purposes hereinabove prescribed shall be refunded to the subdivision developers who provided the funds for the account or shall be paid to their designee.

d. Not later than the due date of filing of applicant's annual report to this Commission each year, applicant shall furnish to the subdivision developers a statement detailing (1) the amount of the annual withdrawal from the special account (2) the purpose, description and amount of out-of-pocket net losses covered by all or part of that withdrawal, and (3) the cumulative total of funds which had been withdrawn from the special account but which had not been expended by the close of the year. A copy of each such statement shall be filed concurrently in this proceeding.

The effective date of paragraphs 2.a, 2.b. and 2.c will be established by supplemental order herein after applicant has filed in this proceeding proof of compliance with paragraphs 3 and 4. In all other respects, the effective date of this order shall be twenty days after the date hereof unless, prior to that effective date, applicant files a request for hearing.

A certified copy of this Opinion and Order shall be mailed to Robert E. Lewis, Esquire, escrow holder of Applicant's stock, at 1805 Harrison Street, Oakland, California, by the Secretary of the Commission against the receipt of the escrow holder.

Dated at San Francisco, California, this 3rd day of SEPTEMBER, 1969.

William Symons, Jr.
President

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

Commissioners