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Decision No. 83902

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
LITTLE BEAR WATER COMPANY, INC., a
California corporation, for a cer-
tificate of public convenience and
necessity to establish a sewer
system franchise area and to
establish rates for its proposed
sewer system franchise area.

Application No. 54142
(Filed July 2, 1973;
amended July 11, 1973
and September 25, 1973)

Jan Alton Walker, Attorney at Law, for Little
Bear Water Company, Inc., applicant.
James M. Barnes and John Gibbons, for the
Commission staff.

O P I N I O N

Proceeding

After due notice hearing in this matter was held before Examiner Coffey at San Francisco on July 1 and 2, 1974. The matter was submitted on the receipt of transcripts on August 29, 1974.

The Little Bear Water Company, Inc. requests a certificate of public convenience and necessity to construct and operate a sewer system and authorization of rates and rules for the operation of the utility.

Affiliation and Management

The applicant is a California corporation operating as a public water utility serving approximately 135 customers. Applicant is wholly owned by Clifford D. Hall and his wife, Dorothy M. Hall. In addition to being applicant's president, Mr. Hall supervises the operation and maintenance of the water system, intends to do the same for the proposed sewer system, owns and operates a service station in King City, and is the developer of the Royal Estates

Subdivision which will be served by applicant. The Royal Estates Subdivision is located on ranch land owned and heretofore farmed by the Halls.

Proposed Service Area

The requested service area is situated in Monterey County approximately two miles south of King City in what is known as the Pine Canyon area. As proposed by applicant, the sewer service area will encompass the entire water service area of Little Bear Water Company, Inc. Six and three-tenths acres within the water service area are to be used for the pond, reservoir, and spray area. In addition, applicant proposes to include, as part of the sewer service area, approximately 50 acres of sparsely settled land contiguous to the westerly boundary of the water service area. The 40 lots of Royal Estates Unit No. 3 are located within the corporation's water service area. Exhibit No. 4 shows the overall requested sewer service area.

Proposed System

Initially the proposed sewer system will be installed to serve 40 lots in Unit No. 3 of the Royal Estates Subdivision.

Applicant states that the pond and reservoir will have a capacity for 72 homes. With additional storage and spray area the treatment plant reportedly could serve approximately 375 single-family homes.

All collection mains will be six inches with four-inch laterals to the homes and an eight-inch trunk line to the sewage treatment plant.

Disposal of the treated effluent will be in accordance with Order No. 72-66 of the Central Coast Regional Water Quality Control Board.

Applicant's engineer has estimated the total cost of all the proposed sewer facilities to serve the 40-lot subdivision including engineering, legal, and accounting fees to be \$69,023.

Health Permit and County Franchise

Applicant was granted a health permit on January 11, 1974 by Monterey County to provide sewer service to only the 40 lots in Royal Estates Unit No. 3.

Applicant does not have a franchise permit from the county of Monterey to construct and operate a public sewer utility in Monterey County.

Environmental Impact

To determine who is the Lead Agency in preparing an Environmental Impact Report or Negative Declaration the staff used the following criteria:

1. The Commission's Rules of Practice and Procedure Rule No. 17.1, Section (N) entitled "Lead Agency Determinations" states that the Commission is the Lead Agency for the following projects:
 - "5. New and non-contiguous utility facility projects (independent of subdivision projects)."
2. The guidelines for California Environmental Quality Act of 1970, Section 15065 entitled "Designation of Lead Agency". Section 15065 states that, where two or more public agencies are involved with a project, the agency which shall be the Lead Agency shall be determined by the following principles:
 - "(b) If the project is to be carried out by a nongovernmental person the Lead Agency shall be the public agency with the greatest responsibility for supervising or approving the project as a whole."

Due to the fact that this is a subdivision project and Monterey County has the greatest responsibility for supervising and approving the project as a whole, the staff is of the opinion that Monterey County is the Lead Agency. As such, Monterey County is responsible for determining the need for preparation of an Environmental Impact Report or Negative Declaration.

Monterey County on March 12, 1974 authorized the filing of a Negative Declaration relative to Royal Estates Subdivision Unit No. 3 and has reviewed this project as it relates to the Business and Professions Code Section 11549.5, "Grounds for Denial or Approval of Subdivision Map."

This section states the following:

"A governing body of a city or county shall deny approval of a final or tentative subdivision map if it makes any of the following findings:

* * *

- (e) that the design of the subdivision or the proposed improvements are likely to cause substantial environmental damage or substantially and avoidably injure fish or wildlife or their habitat.
- (f) that the design of the subdivision or the type of improvements is likely to cause serious public health problems."

Exhibit No. 3 sets forth the finding of the Monterey County Board of Supervisors that the project will have no significant effect upon the environment and orders the filing of a Negative Declaration.

Based on the staff's judgment that the Board of Supervisors of Monterey County is the Lead Agency, the staff did not make an extensive investigation of the environmental impact of this development. However, after reviewing the tentative plans and specifications of Royal Estates Unit No. 3 and consultations with all interested parties, the staff concurs with Monterey County's finding that the proposed project will not have any adverse effects on the environment.

Community Considerations

Applicant proposes to dedicate 3.1 acres for recreational and park areas as shown in the tentative subdivision plans for Royal Estates Unit No. 3 which was approved by the Board of Supervisors of Monterey County.

The staff reviewed this application with respect to the Public Utilities Code, Section 1001, and could discern no detrimental effect on recreation areas, park areas, and community, historical, and aesthetic values.

Economic Feasibility

The staff engineering report states:

"21. In determining the economic feasibility of the proposed sewer utility the staff considered such factors as the customer growth rate, revenues, expenses, the financial structure and the need for establishing a Loss Reimbursement Agreement.

"22. As anticipated by staff, the utility will have a slow customer growth. This is strongly indicated by the growth rate of Little Bear Water Company, Inc.'s water system over the last nine years. The staff estimate the average growth of the sewer utility to be six customers per year. At that rate it would take over six years for Royal Estates Unit No. 3 to fully develop.

"23. The staff does not anticipate that the existing residential homes in the requested service area will change from their septic tank systems to applicant's sewer system in the foreseeable future. Consequently, the staff did not include any existing homes in its projected customer estimates."

However, the staff engineering witness testified that a nearby 22-customer mutual was on septic tanks and the individuals in the mutual were potential water and sewage customers, that applicant's water customers were on individual septic tanks and were potential sewer system customers, and that an additional real estate unit of 32 lots was under development. The witness projected that within the next 5 to 10 years applicant would have over 100 sewer customers. While anticipating that full development would be between 200 to 300, the witness could not give an estimate of the time for full development.

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Applicant's president testified that of the 40 lots in Royal Estates Unit No. 3, 17 are sold and are going through escrow. Options have been taken on 5 lots. Also, although options on the remaining lots have been sought, he was unwilling to grant the request since he was not certain of the complete costs of the subdivision and could not set a total price for the lots. He anticipates that all lots will be sold within a year and that houses on all lots will be constructed and occupied within 15 months from July 1, 1974.

When he has sold about 22 of the first lots he plans to immediately start development of an additional 32 lots to be called Royal Estates Unit No. 4. He anticipates that development of Unit No. 4 will be completed by April of 1975.

The land owned by the developer remaining after the development of Units Nos. 3 and 4 is sufficient for 20 to 25 condominium units and 20 to 25 detached houses.

The applicant testified that additional potential for expansion exists in Pine Canyon due to contemplated subdivision of land into 10-acre parcels owned by some of the members of the 22-member mutual mentioned above. Further, discussions have been had on using applicant's facilities for serving a 40-unit low cost housing project called McCarthy Farms located near the sewage ponds. All houses in Pine Canyon can be served by the use of gravity flow.

Applicant projected that 375 units would be using the sewer system within five to ten years. King City, with a population of 4,200, expanded by 200 during the past two years. Applicant testified that since King City is "boxed in" there is no place to build within the city. It appears that the Pine Canyon area is suitable for residential expansion.

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Applicant stated that the recent lack of growth in water system customers resulted from the County Health Department's not permitting any new customer hookups due to the high mineral content of the then existing wells. This limitation is temporary since suitable existing wells have been located and several new wells are being completed.

The following results of operations table compares the utility's financial position as estimated by the engineering staff and by applicant:

Results of Operations

Item	Applicant	Staff		
	Annual Cost	1st Yr.	5th Yr.	Fully Developed
Operating Revenues	\$ 5,845	\$ 576	\$2,880	\$3,840
<u>Revenue Deductions</u>				
O & M	-	2,512	2,572	2,597
Admin. & General	-	340	390	415
Taxes Other than				
Income	-	368	368	368
Income Taxes	-	-	-	40
Depreciation	-	330(1)	330(1)	330(1)
Total Revenue Deductions	5,845	3,550	3,660	3,750
Net Revenue	0	(2,974)	(780)	90
Rate Base	21,000	-	216	1,116
Rate of Return	-	-	-	8.06%
No. of Customers	68	6	30	40

(Red Figure)

(1) The staff used a depreciation rate of 3% on an advance of \$11,000.

Exhibit No. 5 shows that Mr. and Mrs. Hall, as of May 20, 1974, have a net worth of \$632,399.

Applicant proposes a monthly rate of \$7.17 which will recover its estimated out-of-pocket expenses of \$5,845 for 68 units. The foregoing staff estimates assume a lower rate of growth than that visualized by applicant and reflect the staff recommended rate of \$8 per month.

Financial Recommendation of Engineering Staff

The staff engineering report, Exhibit No. 1, includes the following discussion of the need for a loss reimbursement fund and of how the system should be financed:

"25. To guarantee that there will be sufficient funds to cover operating expenses during the development period, the staff's opinion is that a Loss Reimbursement Fund should be established. Realizing that there will be a steady increase in revenue due to the growth rate, the staff has set up a decreasing Loss Reimbursement Fund. This fund will start at \$300 per lot and decrease in \$100 increments for each 6 lots sold. After the 18th lot is sold there will be no payments into the fund for the remaining lots. The Loss Reimbursement Fund should follow the format shown in Appendix A.

"26. For the proposed sewer system to be economically viable not only would a Loss Reimbursement Fund be necessary, but also a higher charge for service will be required. The staff's estimate of \$3,840 for operating revenue when Royal Estates Unit No. 3 is fully developed would necessitate a service rate of \$8 per month per customer. At present there are 18 sewer companies under the Public Utilities Commission jurisdiction. Their rates range from a low of \$2.25 to a high of \$7.50 per customer per month. The average is between \$4 and \$5. Although the \$8 rate is high, in the staff's opinion it is necessary to make the proposed sewer system economically feasible.

"27. The staff is also of the opinion that the \$21,000 rate base proposed by applicant is too high for the initial financial structure of the sewer system. Due to the slow growth rate

anticipated by staff, the rate base should be allowed to expand to coincide with customer growth. To accomplish this the staff proposes that \$11,000 of the cost of the sewer facilities should be advanced by the developer. The remaining costs, estimated at \$37,900 by the staff, should be contributions in the aid of construction. The refunds on the advances for construction will be credited to the utility's proprietary capital as they are earned. The amount of the refunds should be 22% of the yearly gross revenue collected by the utility."^{1/}

Financial Recommendation by Finance and Accounts Staff

The staff's financial witness, after extensive cross-examination on the operation and construction of the sewer system, recommended that:

1. The entire plant cost be contributed.
2. Applicant's estimates of operating expenses be discounted as not reflecting possible future operations if the developer's interest should be separated from the operation of the system by a change in ownership.
3. Applicant be required to establish a plant improvement fund through nonrefundable contributions by the developer of \$500 for each lot in the subdivision. These funds should be placed in a separate trust account to be disbursed only upon authorization from the Secretary of this Commission.
4. Utility be ordered to keep separate revenue, expense, and plant records for the sewer operation.

^{1/} It appears the staff assumed applicant intended to claim a rate base of \$21,000 since the application indicates that the sewer facilities are estimated to cost \$21,000 and that this money is to be borrowed from a financial agency. The staff estimated the cost of the system to serve the 40-lot subdivision to be \$48,900. The estimate of applicant's engineer for the system now is \$69,023. Applicant testified that the sale of the lots has changed the financial situation so that money will not be borrowed to build the system.

5. The developer should be ordered to contribute the entire cost of the proposed sewer facilities to the utility.

While the financial witness did not object to the proposed requirement of a loss reimbursement fund, it is his opinion that it would not serve the purpose and it would create additional accounting costs.

The financial witness proposed that the \$500 per lot donation for future plant additions not be applied to the next unit of 32 lots to be subdivided and that all future developers be required to donate the mains and laterals to serve their subdivisions as well as \$500 per lot to pay for treatment plant facilities.

Applicant opposed applying the \$500 per lot donation to the first 40 lots since 17 of the lots had been sold and options given on 5 at less than a break-even price. To do so would burden the subdivider who could not recoup the \$500 donation by a price adjustment. The subdivider was willing to donate the \$500 per lot for each lot sold in the future which would enable him to be compensated by raising his price per lot.

Engineering Staff Recommendations

The following recommendations of the engineering staff are set forth in Exhibit No. 1:

1. Applicant should be granted a certificate of public convenience and necessity to construct and operate a public utility sewer system to serve Royal Estates Unit No. 3.
2. Service should be restricted to the 40 connections in Royal Estates Unit No. 3 until the utility proves to the Commission that it has adequate capacity to serve additional connections.
3. Sewer service may be extended within the certificated water service area on the approval of an advice letter filing.

4. Applicant should obtain a franchise permit from Monterey County and file a copy with the Commission within 30 days from the effective date of the order in this application.

5. Applicant should establish a loss reimbursement fund.

6. All sewer facilities except for \$11,000 should be contributed.

7. The \$11,000 should be made an advance for construction with the refund contract reassigned to the utility.

8. All refunds should be credited to the utility's proprietary capital.

9. Refunds should be in the amount of 22 percent of the annual revenues generated from sewer service to Royal Estates Unit No. 3.

10. Appendix B attached to Exhibit No. 1 should be filed as the utility's rate schedule.

Discussion

Testimony during the hearing demonstrated that all elements of the staff are unduly pessimistic in their views of applicant's potential for growth. Considering the housing situation in King City, the favorable location of applicant's service area, the present availability of water, the combination of water and sewer operations, and the present sales commitments, it appears the proposed sewer system will be a viable operation within the near future.

The testimony of Mr. Hall, as developer, owner of the land, and owner-operator of the water and sewer systems, makes it clear that all improvements, any loss reimbursement fund, and any plant improvement fund would be obtained from the customers by increases in prices they would pay for their properties. With the utility and the developer being substantially one and the same, the provision of the proposed funds to provide for future exigencies would be an exercise in moving money from pocket to pocket of the developer without a substantial increase in customer protection.

In this instance the customer appears to have far better than average assurance of service continuation because of the potential for growth in the area which will ensure an economic and viable utility operation, by the possible purchase of the water system by a large water utility, by the possible annexation of the area and operation of the sewer system by King City, and finally by the agreement for contingent operation and ownership of the sewer system by the county of Monterey if the system fails to provide adequate service as set forth in Exhibit No. 7.

Thus, the provision of special operational and construction funds as recommended by the staff does not appear to be appropriate in this instance. However, since the developer indicated willingness at transcript page 83 to donate to the utility the entire cost of the sewer system and to earn no depreciation and return on the sewer plant, since no monies are being borrowed to develop the first two units, and since this record demonstrates that the customers are providing the sewer system plant by the prices paid for the lots they purchase, we shall require the developer to donate the entire sewer system to applicant. The question of whether advances or contributions should be required for construction of the system to serve more customers than those in Royal Estates Units Nos. 3 and 4, a total of 72, can be determined when applicant applies for permission to extend beyond these units.

This record does not demonstrate whether the proposed rates are excessive or if comparable rates are too low. Nevertheless, we will adopt the rates proposed by the engineering staff to implement the feasibility of the system but shall expect the staff to review the operation periodically to insure that the rates are reasonable.

Findings

1. There is no other purveyor of sewer service ready, willing, and able to supply sewer service to the subdivision known as Royal Estates Unit No. 3.

2. The facilities, as proposed, are adequate to accommodate the subdivision known as Royal Estates Unit No. 3.

3. Applicant has adequate financial resources to build and operate this sewer system.

4. The county of Monterey is the Lead Agency which has the principal responsibility for approving the Royal Estates Unit No. 3 project, including the sewer system here being considered.

5. The Monterey County Board of Supervisors has found that the Royal Estates Unit No. 3 project will have no significant effect upon the environment and has ordered the filing of a negative declaration.

6. An Environmental Impact Report or a Negative Declaration is not required of this Commission.

7. Sewer service to Royal Estates Unit No. 3 will have no detrimental effect on values, recreational and park areas, community, historical, and aesthetic values, or the environment.

8. Sewer service to Royal Estates Unit No. 3 under the terms and conditions authorized herein is financially and operationally feasible.

9. It is reasonable to limit applicant's sewer service to Royal Estates Unit No. 3 until it demonstrates that it has adequate capacity for expansion.

10. It is reasonable that sewer service may be extended on the approval of an advice letter filing to Royal Estates Unit No. 4 and to any future subdivisions developed by Clifford D. Hall and Dorothy M. Hall within applicant's service area, but that any other service extension authorization shall be by application.

11. It is reasonable that all sewer facilities should be contributed (donated) to the utility by the subdividers of Royal Estates Units Nos. 3 and 4.

12. The rates proposed by the staff are reasonable for the purpose of this proceeding.

13. Applicant has not obtained a franchise permit from Monterey County

14. The sewer customers of applicant will pay the sewer system construction costs since these costs are recovered from the lot purchasers by the developer who will donate the system to applicant.

15. Applicant has agreed to the gift of the sewer system to the county of Monterey if the system fails to provide adequate service.

16. It is reasonable that applicant be required as a condition on the certificate of public convenience and necessity to donate the sewer system to a party the Commission may designate if the Commission finds applicant's sewer service is not adequate.

Conclusion

We conclude that a certificate of public convenience and necessity to construct and operate a public utility sewer system to serve Royal Estates Unit No. 3 should be granted under the terms and conditions hereafter ordered.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, Little Bear Water Company, Inc. is granted a certificate of public convenience and necessity authorizing it to construct and operate a public utility sewer system to serve 40 residential customers in the area known as Royal Estates Unit No. 3, Monterey County, near King City subject to the following conditions:

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- a. Applicant shall enter into a contract with the developer of Royal Estates Unit No. 3 which shall provide that the sewer system plant shall be contributed to the utility without refund.
- b. Applicant shall have filed with the Commission a copy of a franchise permit from Monterey County or written demonstration that such a franchise permit is not required by the county.
- c. Applicant shall have filed its agreement, in writing to donate all sewer operating property to any mutual, public utility, or public entity designated by this Commission upon a finding by this Commission that applicant's sewer service is not adequate.

2. Applicant shall not extend sewer service from the area certificated herein into contiguous territory without further authorization of this Commission. Authorization for extending sewer service to serve the 32 residential customers in the area known as Royal Estates Unit No. 4 and to serve subdivisions developed within applicant's certificated water service area by Clifford D. and Dorothy M. Hall may be approved by an advice letter filing.

3. After the effective date of this order and compliance with the conditions of Ordering Paragraph 1, applicant is authorized to file the tariff sheet set forth in Appendix A and a revised tariff service area map providing for the application of the tariff schedule to the area authorized herein. The tariff filing shall comply with General Order No. 96-A insofar as such compliance is possible for a sewer utility. The effective date of the revised tariff sheet shall be four days after the date of filing.

4. Compliance by applicant with paragraph 3 of this order shall constitute acceptance by it of the right and obligation to furnish public utility sewer service to the area authorized herein. The authority granted herein shall expire unless the designated

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tariff sheet is filed within one year after the effective date of this order.

5. Applicant shall keep its books of record and accounts so that revenues, expenses, and plant for its water and sewer operations are separately recorded.

6. Within ten days after service is first granted to the public under the authority granted herein, applicant shall file in this proceeding written notice thereof to this Commission.

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

Dated at San Francisco, California, this 20th
day of DECEMBER, 1974.

Vernon L. Steiner
President
William J. Brown
John M. Wain
Stanley
Robert E. McIlwain
Commissioners

APPENDIX A

Schedule No. 1

RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat rate residential sewer service.

TERRITORY

Royal Estates Unit No. 3 and vicinity, Monterey County.

RATES

	<u>Per Service Connection Per Month</u>
For a single-family residential unit	\$8.00
a. For each additional single-family residential unit on the same premises and served from the same service connection	\$8.00

SPECIAL CONDITION

The above flat rates apply to a service connection not larger than four inches in diameter.