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Decision No. 84389

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of PEPPERMINT CREEK WATER COMPANY, a California corporation, for a certificate of public convenience and necessity to construct a public utility water system near Sonora in Tuolumne County, California, and to establish rates for service and to issue stock.	Application No. 54986 (Filed June 24, 1974; amended July 31, 1974)

Robert E. Cowden, by James R. Hardin, Attorney at Law, Robert E. Cowden, Nemer, Kilday and Nemer, by Gerald J. Kilday, Attorney at Law, and Russell Francis Walter, for Peppermint Creek Water Company, applicant.
Malcolm H. Furbush, Robert Ohlbach, Joseph S. Englert, Jr., by Joseph S. Englert, Jr, Attorney at Law, for Pacific Gas and Electric Company; and Leslie G. Delbon, for Tuolumne County Water District #2; interested parties.
Peter Arth, Jr., Attorney at Law, John Gibbons, and Eugene Lill, for the Commission staff.

O P I N I O N

The applicant, Peppermint Creek Water Company, a California corporation, requests a certificate of public convenience and necessity for a public utility water system in Cuesta Serena subdivision in the vicinity of Sonora, Tuolumne County. Applicant also seeks to issue 1,401 shares of stock having a par value of $100 each to Robert E. Cowden and his wife. Mr. Cowden and other members of his family are the promoters of the subdivision project.

The subdivision consists of 86 lots, to be sold without homes. It lies within one mile of Pacific Gas and Electric Company's (PG&E) Jamestown Ditch water system, commonly referred to as the ditch. It is even closer to the right-of-way of PG&E's proposed treated water pipeline (see Application No. 55059 of PG&E).[1/]

Applicant's system was designed to utilize wells rather than pipeline or ditch water. Two wells with a 95 gpm capacity were drilled, and a reservoir and virtually all of the mains were constructed, prior to the filing of the application. A third well has been drilled.

Environmental Impact Reports on the subdivision were filed and adopted by the Tuolumne County Board of Supervisors in 1973 and 1974. The reports clearly contemplate a public water system as part of the project considered. It appears that the county has assumed and fulfilled the responsibilities of a lead agency in considering the environmental impact of a total project which includes the water system.

The Utilities Division made an investigation of the proposed utility and developed a report for the Commission. The report included a result of operations study which showed the utility as having 30 customers at the end of five years. Under this projection the utility would assertedly experience a net revenue of approximately $1,500[2/] on gross revenues of $5,400. The report recommended that a certificate be granted.

1/ In Application No. 55059, PG&E seeks Commission authorization to abandon the ditch and substitute a piped, treated water system. The matter is submitted but no decision has been made.

2/ The staff witness at hearing changed this conclusion and predicted a $4,500 annual loss.

The matter was heard in Sonora on October 16 and 17, 1974 before Examiner Gilman. Mr. Cowden and a registered engineer retained by him testified in support of the application. A witness from the Hydraulic Branch testified in support of the application; a member of the Finance and Accounts Division testified in opposition. A representative of Water District No. 2 (District) testified at the urging of the staff describing the policies, operations, and facilities of the District's retail water services. The District took no position on whether the certificate should be granted.

The matter was taken under submission subject to the filing of briefs. The Hydraulic Branch brief included a long-term results of operations projection not previously supported by testimony. The examiner then reopened the proceeding to determine whether service from PG&E should or could be considered as an alternative to applicant's and also to permit the Hydraulic Branch to testify in support of their most recent results of operations projection.

Another day of hearing was held in San Francisco on January 9, 1975. Applicant's counsel offered a proposal under which the utility would be given a certificate for a specific number of years, with the stipulation that the Commission could order the system transferred to the District if it failed to perform as claimed within the trial period. The Finance and Accounts Division representative opposed the proposal.

The applicant's engineer presented new results of operations projections. He also presented a copy of a resolution of the District's Board of Directors under which it conditionally offered to accept the water system as a donation from Mr. Cowden and to assume the responsibility of providing service in the territory in question.

PG&E appeared specially, claiming that the scope of its dedicated retail service territory did not include Cuesta Serena and that the Commission had no power to compel it to serve the area at retail. PG&E's allegations were based solely on the company's service area maps on file with the Commission.[3] PG&E offered to supply a limited quantity of wholesale water to the tract.

The Hydraulic Branch witness testified in support of the Branch's long-term results projection.

The matter was resubmitted without further briefs or argument.

Significance

This water utility certificate application follows our decision in Old Ranch Road (Decision No. 83670 in Application No. 54395 issued October 29, 1974). That decision is worthy of note in two respects. First, we voluntarily adopted the Scenic Hudson doctrine,[4] thus mandating sua sponte consideration of alternative means of providing service, before granting a new water company certificate. Secondly, we reaffirmed a long-standing policy by

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3/ We note that each of those maps bears on its face the following statement:

> "This map shall not be considered by the Public Utilities Commission of the State of California or any other public body as a final or conclusive determination or establishment of the dedicated area of service or any portion thereof."

4/ In essence this doctrine is based on the principle that regulatory Commissions cannot surrender the initiative to regulated industries by allowing certificate proposals to be adopted by default. Rather, any proposal for a project to serve a public need must be actively evaluated, at least insofar as necessary to determine whether there are any feasible alternatives. The goal is the selection of the best feasible solution to a problem, not merely an unobjectionable one. (Scenic Hudson, etc. v FPC (1965, 2nd Circ.) 354 Fed 2d 608, cert. den. 384 US 941.)

holding that new water utilities, like other classes of utilities, should not be certificated without a showing that the proposed operation would be economically feasible.

We also refined our definition of economic feasibility to distinguish those temporary fiscal problems which are properly dealt with by a loss reimbursement fund or similar devices which tide a utility over its development problems, from permanent fiscal insufficiency, which we have found no reliable means to counter.

Finally, we revived and re-emphasized our policy against service area fragmentation. This policy is based on a recognition that per capita costs tend to vary inversely with the number of customers a utility serves; within limits, maximum cost-effectiveness and reliability are to be achieved by extending an existing utility rather than creating a new utility for each new subdivision. Even where physical interconnection between an existing system and a new territory is infeasible, administrative consolidation may have significant service or cost advantages.

Applicant's Status

Applicant contends that neither it nor Mr. Cowden were public utilities at the time the water system was constructed and that therefore they were not required to obtain a certificate under § 1001 of the Public Utilities Code[5/] before commencing construction. The obvious purpose of § 1001 of the Public Utilities Code is to permit

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5/ "1001. No railroad corporation whose railroad is operated primarily by electric energy, street railroad corporation, gas corporation, electrical corporation, telegraph corporation, telephone corporation, water corporation, or sewer system corporation shall begin the construction of a street railroad, or of a line, plant, or system, or of any extension thereof, without having first obtained from the commission a certificate that the present or future public convenience and necessity require or will require such construction." (Emphasis added)

the Commission to pass on public interest issues involved in the creation of a new utility while there is a real opportunity to find alternatives or to require modification in construction, financing or operational plans. Applicant's interpretation would largely deprive the Commission of these important powers. It would enable private developers to make unilateral decisions as to what the public interest requires and to present them to the Commission as a fait accompli. In our view, a person or corporation becomes a public utility within the meaning of § 1001 by commencing construction of a privately owned utility system intended to serve the public. (See PT&T v S.P. Communications Co. (1975) Decision No. 84167 in Case No. 9728.) Civil and criminal penalties are provided by §§ 2104-2112 of the Public Utilities Code for violations of § 1001.

Development Potential

Cuesta Serena subdivision will contain 73 residential lots. In addition, the tract includes one 35-acre parcel intended as a mobile home park with room for 150 homes. Another 35-acre lot is planned as the site of a multiple housing development which would contain approximately 50 dwelling units. One of the 73 existing lots contains 21 acres and is planned for a facility such as a light industrial park which might require considerably more water than the two- and three-acre single-residence lots.

An area in the subdivision known as Unit Three is a legally salable parcel as it now exists. If a final map for Unit Three is not recorded, this parcel could be sold as is and the correct total of legal lots or parcels would be 74 lots instead of 73. Thus, if further development is discounted and the most pessimistic view taken, the total number of lots under consideration is 74. Adjacent to the subdivision is another area composed of 78 parcels, not owned by Mr. Cowden nor purchased by him. Several of these are now occupied by residences which use water from individual wells, others are undeveloped and have no water.

The Finance and Accounts Division witness compared the residential portion of the subdivision to nearby recreational or second-home subdivisions at higher elevations. This comparison would support a conclusion that only a fraction of the lots would be occupied and that full development might be postponed for a very long period. Applicant claims, however, that the two- and three-acre parcels are designed, and will be promoted, for full-time residences. Based on experience from several similar nearby tracts, applicant's engineering witness conservatively estimated a 75 percent build-out in less than four years. He compared the planned mobile home development to Mr. Cowden's existing park, which was 100 percent occupied in the first month of availability.

The Hydraulic Branch witness assumed that there would be 16 customers during the first year, 30 at the fifth year, 40 at the tenth year, and 46 at the fifteenth year. Under his projection start-up deficits would be substantial, finally decreasing to approximately 1 percent of gross revenues as the number of services increase. At the end of the fifteenth year, the annual revenues would be $11,000 and the accumulated deficit would nearly reach its peak of approximately $48,000. Projecting his results further, it would appear that the company would begin to experience an annual surplus shortly thereafter, thus reducing the accumulated deficit. The accumulated deficit would continue to shrink until it was time to replace the original plant. There was no indication that the system would ever show a cumulative surplus.

Applicant's witness developed two alternate models projecting growth rates and development with estimates of costs and revenues. Under the most optimistic model (which nevertheless does not assume any sales to out-of-tract customers), applicant would have 53 customers during the fifth year and would assertedly be able at that time to cover operating expenses and depreciation (but not a manager's salary). By the tenth year, the projection shows 135 customers and sufficient revenue to cover operating expenses, depreciation, and a $6,000 surplus which could be viewed either as a manager's salary or a 5.14 percent return on investment.

The alternate model assumes no development of Unit Three and that neither the mobile home park nor multiple development would be constructed; instead, individual residences would be substituted. The total potential development would be 125 lots of which 109 would be developed at the end of the tenth year. At that point the estimate shows that revenues would be insufficient to cover operating expenses plus depreciation. The expense projections, as with the first assumption, make no provision for compensation for the owners' time and effort. This model, like the first, assumes that there are no customers outside of the tract.

Analysis

The feasibility of the proposed utility operation is totally dependent on the ultimate level of sales and construction in various segments of the planned development. If there is a permanent, severe setback to the developer's plans, the utility may well be locked into a position where it has no chance to become fiscally self-sustaining.

On the other hand, if applicant's plans are not frustrated and if the company is able to attract significant numbers of outside customers, the utility may well be able to generate enough revenues to cover depreciation, owner's salary, and even generate a return. In that eventuality it would be fully feasible.

The Hydraulic Branch's growth model did not purport to be a projection of actual growth, but was more in the nature of a hypothetical framework for the staff's cost and revenue projection. The Finance and Accounts' contentions on this point were based on information of the progress of recreational subdivisions, which is of doubtful applicability to a residential subdivision. We would normally be compelled to pursue this matter further; however, in light of the District's offer, the findings set forth below (Nos. 3 through 8) are a sufficient resolution of the issue.

Alternatives

A. Type of Service

We will consider only two alternative types of water supplies as being feasible: the present wells or treated water from PG&E's pipeline. [If PG&E's Application No. 55059 (supra, footnote 1) is denied the pipeline would not be constructed and in its stead we would consider a system using untreated ditch water. That alternative would require a substantial capital investment for a treatment plant.] Either type of system would theoretically be compatible with any of the three forms of ownership and management - i.e., by applicant, by PG&E, or by the District. In practice, however, the District has a policy against owning or operating a system supplied by wells. This policy is based on a belief that the local geological formations are such that wells are not reliable long-term water sources. Thus, if the subdivision is served by the District, the system will have to be modified to use PG&E water; the wells would be abandoned or used as standby facilities.

Conversely, Mr. Cowden has a firm conviction, based on long residence in the county and experience in real estate, that wells are a reliable source of water and that prospective home purchasers would prefer untreated well water to treated PG&E water. He believes that having a system supplied by wells would help him sell lots, but he would convert the system to use PG&E-supplied water if we grant a certificate which included such a condition. The capital cost and difficulty of converting the system should be minimal, with one possible exception. The reservoir which Mr. Cowden constructed is not ideally situated for use in connection with PG&E's pipeline or ditch.

Applicant suggests that the possible need for reservoir relocation is material in choosing between alternative types of water supply and between public and private ownership. However, one of the principal reasons for requiring advance certification is to obtain the best possible system without the necessity of wasteful reconstruction. A person who frustrates that objective by constructing without a certificate cannot be permitted to obtain a procedural advantage thereby.

The evidence presented by the District indicates that wells in local geological formations are not a reliable source of water for water service to community water systems. Applicant's engineer was more optimistic concerning the suitability of these particular geological formations as a water service.

We will adopt the position of the District's witness and find that a PG&E-supplied system would be reliable and that a system supplied by wells would not be.

It has been suggested that we should hold that service by the District is infeasible since the District's opposition to using wells, even as a temporary source of supply, will delay development of the subdivision.

This feature of the District's offer does not make its service infeasible. We have no power to review or reverse the decisions of a local agency such as the District; if it views the public disadvantages of relying on wells as outweighing the advantages, public and private, of immediate development, it is responsible for those decisions to the local electorate, not to this Commission.

If we were to assume the power to decide such questions under the guise of deciding whether an alternative is feasible, we would soon be inundated by applications of developers who want a certificate of public convenience and necessity, not because they are best fitted to serve, but simply because their development plans are frustrated by the policies of local agencies which purvey water.

Our power to certificate water utilities was not intended to allow developers to challenge the policies of publicly owned utility systems regardless of whether those policies are justified or unjustified. If a local agency is best fitted to serve and unreasonably refuses to do so, or insists on unreasonable conditions, we should not, in an attempt to provide a remedy, saddle the future residents of the tract with a second-best public utility. Where the reluctance of a local agency is well-founded, its reasons will in most cases also be reasons for denying a public utility certificate.

B. Serving Party

Mr. Cowden would perform most of the daily routine tasks necessary to operate the system. Mr. Cowden's only experience in operating a utility comes from a short period of operations in his mobile home park which provides all utility service. The utility would have to compete for Mr. Cowden's time and energies with other nonutility enterprises which presumably show a profit.

The District has a professional full-time staff to operate its retail water systems. There is no reason to believe its costs to operate a comparable system would be any greater than Mr. Cowden's. The District, like Mr. Cowden, will be able to experience savings by sharing overheads with other enterprises. In Mr. Cowden's case, the other enterprises are not public utilities; he is free to dispose of them separately from the utility or to stop operating them. The District's other enterprises are utility operations, and there is no reason to believe that any of the individual systems will be disposed of.

Applicant's future as a viable business enterprise is closely tied to the success of this single subdivision. In contrast, there is no indication that the District's capabilities would be significantly impaired by difficulties in this single subdivision. Mr. Cowden mentioned plans to use this system as a base from which to build a multi-district utility enterprise. A practical plan to end or at least ameliorate the extreme service area fragmentation existing in this county would certainly be in the public interest and might, if successful, improve the cost-revenue balance in the base system. Nevertheless, we cannot find that Mr. Cowden is committed to such a venture, or that these plans are definite, realistic, or likely to be put into execution in the near future.

The District, on the other hand, has an established record of volunteering to rescue the customers of small systems, either by absorbing the system or by operating and managing it. It is willing now to take over and operate the Cuesta Serena system. (There is no evidence that it would be willing to hold the offer open during a trial period.)

Because of PG&E's position, we can form no opinion whether retail service from PG&E would offer an alternate preferable to the District. However, given the circumstances of this case, it is not necessary to pursue this question further.

In summary, the record shows no reason to doubt the permanence or the long-term reliability of the District. The record leaves some significant doubt regarding applicant's ability to render acceptable economical service. The public would be better served if Mr. Cowden were to accept the District's offer. None of the parties made an attempt on the record to compare a mutual system with the other alternatives available. However, despite this defect in the record, we can make at least a limited comparison.

The following discussion assumes a mutual composed primarily of the same persons who would be customers of applicant's proposed service. Regardless of the type of management and ownership, the small size of such a mutual system would preclude it from having a full-time staff of professionals to administer and operate the system. However, such a mutual could, if needed, contract for part-time help with Mr. Cowden, the District, or elsewhere. A mutual should be no less, and no more feasible, than a utility of the same size.

A mutual has two tactics not available to utilities useful for coping with the disadvantages of small size. They can often rely on voluntary labor by consumers for many administrative and operational tasks. Secondly, they have power to require payments from all members, and these payments need not be proportional to water usage; therefore, the question of economic feasibility is of less moment when considering a mutual than it is with a public utility.

If a mutual is decided upon, there is a further advantage: there will be full disclosure of the company's status at the time lots are purchased, and presumably each lot owner will know that the success or failure of a mutual service is solely up to him and his neighbors. On the other hand, if the subdivision report indicates that water is provided by a regulated public utility, it may lead many into believing that this small utility is as capable and reliable as the larger urban and suburban systems we regulate. They may also have unrealistic expectations concerning this Commission's ability to provide a regulatory remedy for economic infeasibility.

Our contacts with mutuals would lead us to believe that the worst of them is no worse than the worst small water utilities. It also suggests that it may be less difficult for the customers of an unsatisfactory mutual to find a way to extricate themselves than it would be for the customers of an unsatisfactory privately owned utility. Our experience also indicates that the best small utilities often perform satisfactorily, only as long as the original owner lives or as long as the related subdivision has lots to sell. In contrast, the successful small mutual is less likely to depend on the life-span or the interests of a single individual. In the absence of an acceptable record we would assume that a small mutual would be less satisfactory than any organization large enough to provide full-time professional.

Assuming that delay and resulting private injuries could be material in this proceeding, we note that the developer has taken the least likely course to a quick solution. Mr. Cowden has the unilateral and unreviewable power to select a mutual as the type of organization to control the water system. If he had exercised that option at any period before or during these proceedings, he could have protected himself from any injury from either PG&E's or the District's reluctance to serve or from the delays which occurred during hearing and consideration by this Commission.

Service Area Fragmentation

Neither the staff nor applicant made any direct showing on this vital issue. We have, from other sources,[6/] discovered that real estate development in this county has recently followed a pattern in which many, if not most, subdivisions have been developed with a separately owned and managed water system.

The majority of these systems are mutuals and beyond our concern. However, 14 of the nearly 40 systems are public utilities, most having fewer than 100 customers. There is nothing in this record which would justify disregarding our stated policy against fragmentation by adding to this already overlong list of mini-utilities.

6/ Exhibit 19, Application No. 54199, supra.

Our anti-proliferation policy can best be stated as a rebuttable presumption that any well-established nearby water utility will give more reliable and economical service to a new subdivision than would a utility owned and organized primarily or wholly to serve the subdivision. This presumption would apply with equal force regardless of whether the established utility is publicly or privately owned. The presumption would, of course, be weakened, but not necessarily rebutted, if physical connection between the two systems is not feasible.

Expansion of District No. 2's retail water service area to include Cuesta Serena would not conflict with our anti-proliferation policy; certification of applicant would conflict.

Findings

1. Robert Cowden has constructed a public utility water system without first having obtained a certificate of public convenience and necessity from this Commission.

2. Robert Cowden, at the time of construction, intended to operate the system as a public utility.

3. The individual residence portion of the tract will develop more rapidly than recreational or second home subdivisions.

4. If a trailer park is constructed in the tract, it will develop more rapidly than either residential or recreational subdivisions.

5. The record offers no basis for predicting the rate of growth of a multiple unit development in this tract.

6. If the whole tract is developed as a single family residence subdivision, if there is no service outside of the tract, and if Unit Three remains undeveloped, the utility will require a permanent subsidy in order to tender reliable service at reasonable rates.

7. If the tract is developed as planned, including a mobile home park and multiple unit development, and, if all or substantially all of the available lots or dwellings are occupied, or, if the utility makes main extensions outside of the subdivision and thereby attracts additional customers, it may ultimately be capable of generating sufficient revenue to cover operating expenses, depreciation, return, and compensation for the owner-manager's time and effort.

8. Findings 6 and 7 are based on an assumption that the utility will share overheads with Mr. Cowden's other trailer park and his real estate operations.

9. We cannot estimate how long the utility and Mr. Cowden's other businesses will remain under common ownership and control.

10. Applicant has no firm plans to render service to a significant number of customers outside of the Cuesta Serena subdivision.

11. The utility's administration and physical plant cannot operate without attention or effort by Mr. Cowden.

12. Applicant will be controlled by Robert E. Cowden. Robert E. Cowden also controls and will profit from the sales of lots and dwellings in Cuesta Serena subdivision.

13. Cuesta Serena is intended as a residential rather than a second home or recreational subdivision.

14. The county has completed an Environmental Impact Report on the subdivision which covers the impact of public water service. The project will have no significant adverse effect on the environment.

15. The wells drilled by applicant have not been shown to provide an adequate, reliable source of water for Cuesta Serena subdivision.

16. There has been no showing that it would be economically or physically infeasible for PG&E to serve Cuesta Serena subdivision using either the present wells or by interconnection with PG&E's pipeline.

17. PG&E will not voluntarily extend retail service to Cuesta Serena subdivision. It will provide water at wholesale but not at a sufficient rate for fire-flow requirements. It will as a condition of service require adequate storage for fire-flow and for outages in the source of supply.

18. Tuolumne County Water District No. 2 has offered to accept the responsibility for providing water service to Cuesta Serena subdivision; there is no showing that it would be willing to hold this offer open for a trial period long enough to demonstrate the subdivision's potential as a utility service area.

19. Tuolumne County Water District No. 2 has offered to provide retail water service subject to the conditions that:

a. PG&E provides treated water at wholesale.

b. There be a method for providing fire-flow and emergency storage without capital cost to the District.

c. The system be donated to the District.

d. A loss reimbursement fund be provided by the subdivision.

20. Water District No. 2 has a professional full-time staff with substantial experience in operating retail water systems.

21. Mr. Cowden has one employee with limited experience in operating a utility water system; Mr. Cowden has experience in constructing water systems. Mr. Cowden would provide most of the day-to-day operational services required by the utility.

22. If the water District were to operate this system, its additional costs would be shared with other water systems.

23. The District has an established practice of assuming the service responsibilities of water systems which do not provide satisfactory service.

24. The public will not benefit from certification of another water utility designed and built primarily to promote sales of lots in a single subdivision.

25. In Tuolumne County a system wholly supplied by well water is less reliable than a system which uses water supplied by PG&E.

26. The public would be better served if the District's offer were accepted than if applicant were certificated.

27. We cannot precisely rate a mutual as an alternative.

Conclusions

1. The Commission may not consider an application for a water company certificate in isolation or to grant it simply because there has been no protest; it must sua sponte, consider, alternative feasible methods of serving the public need.

2. It is adverse to the public interest to certificate a utility which will require a permanent subsidy in order to remain in operation.

3. Mr. Cowden could voluntarily or by operation of law dispose of the businesses which would otherwise share costs with the utility.

4. Insofar as § 1001 of the Public Utilities Code is concerned, an individual or entity becomes a public utility when he or it commences construction of a utility system which will be dedicated to a public use.

5. No person who has built a utility system without a certificate should be heard to claim that he should be granted a certificate to operate it on the ground that otherwise certain portions of the system will have to be reconstructed.

6. Service by a nearby district is a feasible alternative unless there is a legal or physical impediment which prevents it from rendering service.

7. No certificate should be awarded to a public utility water system without a showing that it is economically feasible.

8. The proponent of a water system designed to permit and promote sales in a single subdivision must affirmatively prove that no nearby utility system will provide as economical and reliable service, or that there is some other reason, in the public interest, not to prefer the existing utility service, public or private.

O R D E R

IT IS ORDERED that the relief requested is denied.

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

Dated at San Francisco, California, this 29th day of APRIL, 1975.

President

Commissioners