

Decision No. 85926**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application
 of ESTHER MONSCHKE for Authority
 to Control the West San Martin
 Water Works, Inc.

Application No. 55851
 (Filed August 4, 1975)

O P I N I O N

Esther Monschke seeks Commission authorization to purchase all of the outstanding shares of stock in the West San Martin Water Works, Inc. for \$50,000. The shares were previously controlled by Eugene and Jeanne Selvage through Lucky Livestock Company (Lucky), a corporation. The system owned by the corporation serves 75 customers in an unincorporated area in the county of Santa Clara. The certificate for the system was issued by Decision No. 74296 in Application No. 50225 (1968). The purchaser proposes to engage a professional engineer with substantial experience in water supply activities to manage and operate the system.

A document attached to the application shows that the Selvages, Lucky, and the Monschkes, husband and wife, are parties to a civil action. Lucky was indebted to the Bank of America and the Monschkes were indebted to Lucky; the latter obligation was secured by a trust-deed which had been pledged by Lucky to the bank. Lucky is in turn the owner of all the capital stock of West San Martin Water Works, Inc. As a part of the settlement of the lawsuit, Lucky agreed to sell the water company to the Monschkes for \$50,000 which sum was to be used to reduce Lucky's debt to the bank. At the same time the Monschkes agreed to pledge the stock to the bank as additional security for the Monschke debt which was previously owed to Lucky and which has now been acquired by the bank.

Exhibit 1

A financial examiner from the Commission staff investigated and prepared a memorandum on the proposed transaction. A copy of the memorandum was supplied to applicant Monschke. No response was made. The document is hereby received as Exhibit 1. The exhibit reveals that the transfer actually took place in 1972 and that Roy Monschke, originally co-owner of the corporate stock, has since died, being succeeded as sole owner by Esther Monschke, the applicant herein.

The system's engineer performs numerous additional functions for Mrs. Monschke in managing non-utility property. While no part of his remuneration is charged to the utility, at least \$250 of his total monthly compensation could reasonably be allocated to utility functions. If this sum were charged to the utility, its revenues would not meet out-of-pocket expenses. The system will eventually be changed from a pressure to a gravity system. From an engineering point of view, the system could beneficially be integrated with the San Martin Water Works, a nearby utility. However, that company is not now financially able to make any substantial investment.

All of the Monschke properties are now for sale. The utility would be sold with the surrounding land. Zoning restrictions currently limit the possibility for further development within the service area. The exhibit recommends that the application be granted and that the decision disclose that the \$50,000 valuation will not necessarily be recognized in future rate proceedings and that the Commission at one time refused to grant a full return on investment to this company.

Discussion

The Commission has several times adverted to the inherent problems which a small water company faces and which may in time seriously detract from its ability to give acceptable service at reasonable rates. This company has the problems typical of such a utility. It is no longer owned by the persons who profited from the development of the lands which it serves. Its revenues are apparently insufficient to cover out-of-pocket costs including management services. Fortunately, the Selvages and now Mrs. Monschke have been willing to subsidize its operation out of non-utility revenues, even though there is little likelihood that the system will ever fully compensate its owner for the true cost of operations, much less pay a full return. In light of the utility's financial insufficiency, Mrs. Monschke should be especially complimented on her responsible actions in retaining a professionally qualified operator.

Since the sale is a fait accompli, and since the present owner is demonstrably willing to see that the utility's obligations are performed, we can see no reason to refuse to ratify the transaction. However, that does not mean that all elements of the transaction are entirely satisfactory. The \$50,000 value placed on the system is plainly unrealistic. Regardless of whether it represents depreciated actual cost, it is almost certainly not a reflection of earning power. The Commission has previously decided that this utility will not be allowed to earn a full return and/or to recover all of certain categories of costs.^{1/} If we were to allow the \$50,000 valuation to go unchallenged, a

^{1/} Decision No. 65286 in Application No. 43450 found that because of the first owners' failure to seek certification the original system was improperly constructed; most of the rate base was generated by construction ordered by the Commission to replace the original plant. Applicant, in Application No. 46775, alleged that expenses were being held to a minimum, and that he charged only \$50 per year for management salary and office rental of \$90 per year.

subsequent purchaser, who committed himself without knowledge of that decision, might seek to assert equitable defenses against enforcement of utility obligations.

It is therefore desirable that any subsequent purchaser should have notice that future rate adjustments granted by this Commission will not likely be sufficient to allow an attractive rate of return on the net book value of the utility plant. Allowed rates will probably not exceed those charged by other nearby utilities, except to reflect qualitative differences in service. We believe prospective purchasers should be aware of these caveats and we will require that such purchasers be furnished with a copy of this decision.

The second difficulty lies in the prospect of another sale of the utility. Even if the utility is sold as a package with Mrs. Monschke's other property, the customers will have no positive assurance that the new owner will continue to subsidize the utility's operations. The customers will also have no assurance that a new owner will not sell the other local property separately from the utility.

The system's original owners created this public utility without approval by the Commission and in such a manner that reasonable rates will not fully support reasonable levels of service.

It is likely that if a certificate had been applied for at the time that this utility originally was formed that it would have been denied because of the absence of economic feasibility. Another alternative at that time would have been to obtain service under the water main extension rule from another nearby utility. Since the present owner took title, presumably with knowledge of these defects, she cannot claim immunity if extraordinary procedures are necessary to overcome their potential effect on consumers, including conditions to ensure that the power to resell is exercised primarily for the protection of consumers. The most desirable ultimate outcome would be an acquisition of this utility by another water utility or public water agency, assuming, of course, that the merged system is large enough to be economically self-sustaining.

Even tacit acceptance of the \$50,000 value by this Commission might be a major stumbling block to any merger. Therefore, this order will provide a new realistic valuation for this utility. Since the present owner is the successor of the subdividers, she will be treated as a subdivider. Just as an actual subdivider is required to construct and build the utility facilities for service to his tract, receiving in exchange a main extension agreement from the utility, the present owner should receive nothing more.

In this extraordinary situation we think it necessary to do what we can to affirmatively achieve a resolution which will improve the prospects of the consumer, rather than accept the traditional role of passively considering transactions arranged by and for the benefit of private interests.

We will therefore request the Director of our Finance and Accounts Division to:

1. Participate actively in any negotiations concerning sale of the utility property to ensure that the consumer's interests are protected.
2. Actively promote any sale, purchase, transfer, or merger which is in his opinion feasible and likely to improve the situation of the customers.

We find that:

1. Esther Monschke is the sole owner of the stock of West San Martin Water Works, Inc. It is not alleged that she took title to the stock in ignorance of the fact that the Commission had previously found that the utility was unlawfully constructed and would not have been granted a certificate if application had been made before construction.

2. Approval of the transfer and pledge of stock would not be adverse to the public interest if the new owner is willing to recognize that protection and furtherance of the consumer interest should be the primary consideration in any future disposition of the property.

We conclude that the transfer should be approved subject to the conditions set forth in Ordering Paragraphs 2 and 3 below.

The authorization granted shall not be construed as a finding of the value of the rights and properties authorized to be transferred.

O R D E R

IT IS ORDERED that:

1. The purchase and pledge by Esther Monschke of all of the outstanding shares of stock of West San Martin Water Works, Inc. is hereby ratified, subject to the provisions of Ordering Paragraphs 2 and 3, upon performance of which this authorization is conditioned.


2. Esther Monschke shall agree in writing, in a form satisfactory to the Director of the Finance and Accounts Division:

- (a) To promptly inform the director of any negotiations for the sale of the utility system or stock and of the contents of any offer or counter-offer.
- (b) To accept any offer for the sale of the system to any person, corporation, or governmental entity which the Commission shall find better suited to render water service if the offer will provide cash proceeds to her equivalent to the amount she might receive under a 22 percent of revenue - 20-year water main extension agreement, with the 20-year period commencing on the effective date of this order.

3. Esther Monschke shall furnish a copy of this decision to any serious prospective buyer.

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

Dated at San Francisco, California, this 8th day of JUNE, 1976.

 President
William Synow Jr.
Vernon L. Johnson
Donald R. Coz
Robert Bateman Commissioners