ALJ/ec

Decision 84 05 099 May 16, 1984

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Donner Lake Utility Company, a California Corporation, for authority to borrow $300,000 and to issue a note under Sections 816-830 of the Public Utilities Code.	Application 83-07-25 (Filed July 15, 1983)
The Application of Donner Lake Utility Company, a California corporation, to borrow funds under the Safe Drinking Water Bond Act and add a surcharge to water rates to repay the principal and interest on such loan.	Application 84-04-011 (Filed April 2, 1984)

Jack Williams and Reg Knaggs, for Donner Lake Utility Company, applicant.
Charles E. Luckhardt, Jr., Attorney at Law, for ratepayers of Donner Lake Utility Company, interested parties.
James Pretti and Harry Aubright, for the Commission staff.

OPINION

By Decision (D.) 92446 dated December 2, 1980, the Commission ordered Donner Lake Utility Company (Donner) to make improvements to its water system and to pursue an application for a state loan of $395,000 to cover the cost of the improvements. Donner received a letter of commitment for a loan of $669,800 to construct improvements from the Department of Water Resources (DWR) on March 19, 1981. That commitment required Donner to meter all of its customers; it now meters only business customers.

When Donner was ready to go ahead with the improvements in 1982, there were no funds available from the Safe Drinking Water Bond Act (Water Bond) and Donner sought and received a commitment for private financing. On July 13, 1983, Donner filed Application (A.) 83-07-25 for approval of a $300,000 private loan to be repaid over a ten-year period at three points above prime. A proposed Commission decision approving A.83-07-25 was on a Commission Agenda in September 1983; but it was withdrawn at the urging of the staff so that Donner could pursue the Water Bond funds which could be obtained at a lower interest rate. In order to make the Water Bond loan a reasonable venture, Donner sought and obtained from DWR a waiver of the metering requirement which reduced the loan commitment from the $669,800 to $480,400. Donner prefers to finance its improvements with the private loan and made this known to the Commission staff and the assigned Commissioner and Administrative Law Judge (ALJ). So that a hearing could be held to allow the owner to make its case, Donner reluctantly filed A.84-04-011 for approval of the Water Bond loan. A.83-07-25 and A.84-04-011 were consolidated for hearing by ALJ Ruling and a hearing was held on April 19, 1984 before ALJ Albert . Porter. In addition to Donner, the Commission staff (staff) and a repressentative of a group of Donner's customers appeared.

<u>Donner's Presentation</u>

Donner called two witnesses in support of A.83-07-25, John D. Williams, III, President of Donner and Reg Knaggs, General Manager of Hydro Tech, a consulting firm retained by Donner. Williams is a Registered Civil Engineer in California and Nevada who has had 14 years' experience in the construction industry, primarily with Teichert Construction Company of Sacramento. Williams is now managing Donner on a full-time, salaried basis after taking over the company in 1982 after the death of his father; he owns 84% of

Donner's stock. Williams believes the improvements required, which are detailed in both applications, can be done for $368,000. He plans to make the improvements in phases and stated that a $300,000 loan as requested in A.83-07-25 would be all that is required to start the needed projects. He claims he can do the total job much cheaper if allowed to use private financing because he would not have to put all jobs out to bid. He also believes the improvements could be completed at an earlier time than if Water Bond financing were used. Williams testified he is willing to accept a 10% or 10-1/2% rate of return on the total rate base of the company in spite of the fact that the private loan will be at an interest rate of three points above prime which would currently be 14% or 15%. Williams stated he is willing to forego any dividends until the private loan is paid off and would expect to finance another $68,000 out of cash flow or additional borrowings. He stated that the bidding procedures, administrative fee, and fiscal agent fees required if water bonds are used, would add considerably to the costs of construction. Williams is emphatic that he does not want or need, at this time, public bond assistance; he wants to own and run his company entirely with private sector support.

Knaggs testified concerning the depreciation for the improvements, the current rate base, which he estimates at approximately $300,000, and the total cost of each loan. He recommends approval of the private loan.

Staff Presentation

Staff called two witnesses: Becky Hoepcke, an Associate Government Analyst with DWR and John Gibbons, Assistant Director of the Commission's Revenue Requirements Division, who is head of the financial analysis function. Hoepcke testified that DWR does not require the bidding procedure for work which is less than $10,000, including work that might be phased in $10,000 increments. She would expect the fiscal agent costs to be no more than a $150-to-$175 set-up charge plus $25 per month maintenance. This would be in addition to the normal 3% administrative fee required by DWR. She stated that bonds issued by the state are at a low interest rate because of the favorable bond market for state bond issues; however, the 8-1/2% currently quoted could fluctuate depending on the market. She stated that the improvements could be done by Donner provided DWR were satisfied that the person in charge was qualified. She agreed that a registered civil engineer with construction experience, such as Williams, would be acceptable to DWR as manager of the construction.

Gibbons testified that it has been the Commission policy to favor state Water Bond loans because of the low interest rate, which results in a low cost to customers, and because state supervision of projects is desirable. He stated that if the company were to receive a Water Bond loan, it would be reasonable to include some fee for Donner to manage the additional facilities installed with the proceeds of the loan because such facilities are not included in rate base for ratemaking purposes. He noted that Donner's present rate base is approximately $300,000. Gibbons further testified that the amortization of a 25-year, 8-1/2%, $379,000 loan ($368,000 plus 3% administrative fee) would be about $37,000 per year.

Interested Parties

Charles E. Luckhardt, Jr., an attorney from San Jose, appeared for a group of homeowners who have properties in Donner's service area and who have participated extensively in previous Commission hearings concerning other applications of Donner. In addition to participating in cross-examination, in his closing statement, Luckhardt was emphatic that the homeowners favored approval of the Water Bond loan. He stated they believed administration of the improvements would be better under a Water Bond loan than if private financing were used.

Discussion

This is the first time we can recall that a water company has come before us ready and willing to use private financing for improvements of this magnitude relative to its present rate base instead of using Water Bond funds. It would seem there could be little doubt that an 8-1/2% loan would produce a lesser cost to customers than private financing at 14% to 15%. However, there are several circumstances in this situation which, as will be seen later when taken together, result in no advantage for public over private financing. These circumstances are:

1. The willingness of Donner management to accept a 10-1/2% return on its total rate base under private financing.
2. The payback of the private loan over ten years versus the public loan over 25 years.
3. The inclusion of a management fee for Donner for those assets which would be added to the system by public financing.
4. The fact that Donner should receive a higher return than 10-1/2% on that portion of its present rate base, if public financing were used.
5. The additional costs of public financing over private financing caused by the 3% DWR administrative charge and an allowance for the efficiency described by Williams if private financing is used.

Also, all parties stipulated there would be no income tax effects for at least the next five years because of losses Donner has suffered in the past.

We are disappointed that none of the parties made a complete analysis of the cost to customers of private versus Water Bond financing. However, that can be done with the information in this record. The results are shown on Table 1. For the comparison shown on Table 1, the following assumptions were made:

1. The present plant rate base equals $300,000.
2. The costs of required improvements equals $368,000 under private financing and, $386,000 under public financing. The $386,000 is obtained by adding 5% to the $368,000 which allows for the 3% administrative management fee required by DWR, and a two-percentage-point efficiency allowance for privately financed construction.
3. The $368,000 would be paid back over ten years at 15% interest and the $386,000 over 25 years at 8-1/2%.
4. The remaining life on the present plan and the total life on any improvements equals 25 years.
5. If financed by Water Bonds, a 1% allowance for managing the plant financed by the bonds is allowed. (See West San Martin Water Works, Inc. (1980) 3 CPUC 2d 435, 457.)
6. No income taxes are considered.
7. If Water Bond financing is used, the rate of return on the present plant is 11-1/2%.

As shown on Table 1, under the assumptions adopted above, there is a $177,000 advantage to ratepayers over the 25-year period if private financing is used. Discounted at 11-1/2%, that advantage is negligible. There is a disadvantage in the first seven years of $22,500 on a discounted cash flow basis which amounts to about $21 per customer on a total basis, or about $3 per year based on about 1,080 customers. Repayment of the private loan at $73,700 per year

TABLE 1

DONNER LAKE [hole] ILITY COMPANY

COMPARISON OF WATER BOND [hole] NCING WITH PRIVATE FINANCING

	Water Bond Financing							Private Financing					Comparison			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)
Year	Beginning of Year Plant Investment	Depreciation	Rate Base	(4)x0.115 Return at 11.5%	Water Bond Loan Plant	(6)x0.01 Management Allowance	(3)+(5)+(7) +$37,700* Cost to Ratepayers	Beginning Of Year Plant Investment	Depreciation	Rate Base	(11)x.105 Return at 10.5%	(10)+(12) Cost to Ratepayers	Col. (8) Cost to Ratepayers Water Bonds	(13)-(14) Saving to Rate-Payers	11-1/2% Present Worth Factor	(15)x(16) Present Worth of Difference
1	$300,000	$ 12,000	$294,000	$ 33,800	$378,300#	$ 3,800	$ 87,300	$668,000	$ 26,700	$654,700	$ 68,700	$ 95,400	$ 87,300	$ 8,100	.897	$ 7,300
2	288,000		282,000	32,400	362,900	3,600	85,700	641,300		628,000	65,900	92,600	85,700	6,900	.805	5,600
3	276,000		270,000	31,100	347,500	3,500	84,300	614,600		601,300	63,100	89,800	84,300	5,500	.721	4,000
4	264,000		258,000	29,700	332,100	3,300	82,700	587,900		574,600	60,300	87,000	82,700	4,300	.647	2,800
5	252,000		246,000	28,300	316,700	3,200	81,200	561,200		547,900	57,500	84,200	81,200	3,000	.580	1,700
6	240,000		234,000	26,900	301,300	3,000	79,600	534,500		521,200	54,700	81,400	79,600	1,800	.520	900
7	228,000		222,000	25,500	285,900	2,900	78,100	507,800		494,500	51,900	78,600	78,100	500	.467	200
8	216,000		210,000	24,200	270,500	2,700	76,600	481,100		467,800	49,100	75,800	76,600	-800	.419	-300
9	204,000		198,000	22,800	255,100	2,600	75,100	454,400		441,100	46,300	73,000	75,100	-2,100	.375	-800
10	192,000		186,000	21,400	239,700	2,400	73,500	427,700		414,400	43,500	70,200	73,500	-3,300	.337	-1,100
11	180,000		174,000	20,000	224,300	2,200	71,900	401,000		387,700	40,700	67,400	71,900	-4,500	.302	-1,400
12	168,000		162,000	18,600	208,900	2,100	70,400	374,300		361,000	37,900	64,600	70,400	-5,800	.271	-1,600
13	156,000		150,000	17,300	193,500	1,900	68,900	347,600		334,300	35,100	61,800	68,900	-7,100	.243	-1,700
14	144,000		138,000	15,900	178,100	1,800	67,400	320,900		307,600	32,300	59,000	67,400	-8,400	.218	-1,800
15	132,000		126,000	14,500	162,700	1,600	65,800	294,200		280,900	29,500	56,200	65,800	-9,600	.195	-1,900
16	120,000		114,000	13,100	147,300	1,500	64,300	267,500		254,200	26,700	53,400	64,300	-10,900	.175	-1,900
17	108,000		102,000	11,700	131,900	1,300	62,700	240,800		227,500	23,900	50,600	62,700	-12,100	.157	-1,900
18	96,000		90,000	10,400	116,500	1,200	61,300	214,100		200,800	21,100	47,800	61,300	-13,500	.141	-1,900
19	84,000		78,000	9,000	101,100	1,000	59,700	187,400		174,100	18,300	45,000	59,700	-14,700	.126	-1,900
20	72,000		66,000	7,600	85,700	900	58,200	160,700		147,400	15,500	42,200	58,200	-16,000	.113	-1,800
21	60,000		54,000	6,200	70,300	700	56,600	134,000		120,700	12,700	39,400	56,600	-17,200	.102	-1,800
22	48,000		42,000	4,800	54,900	500	55,000	107,300		94,000	9,900	36,600	55,000	-18,400	.091	-1,700
23	36,000		30,000	3,500	39,500	400	53,600	80,600		67,300	7,100	33,800	53,600	-19,800	.082	-1,600
24	24,000		18,000	2,100	24,100	200	52,000	53,900		40,600	4,300	31,000	52,000	-21,000	.073	-1,500
25	12,000		6,000	700	8,700	100	50,500	27,200	27,200	13,900	1,500	28,700	50,500	-21,800	.066	-1,400
	Total	$300,000		$431,500		$48,400	$1,722,400		$668,000		$877,500	$1,545,500	$1,722,400	$-176,900		$-5,500

\# Depreciation = $386,000 ÷ 25 = $15,400 per year

$$\$386,000 - \frac{\$15,400}{2} = \$378,300$$

* Uniform Annual Payment to fully amortize water bond loan of $386,000 at 8-1/4% for 25 years.

Note: Cash flow required to amortize a loan of $368,000 at 15% for 10 years = $73,200 per year. Cash flow generated is shown in Col. (13).

for ten years would be more than covered by depreciation and return on investment.

This record shows that Williams is well qualified to manage the construction required by either private or Water Bond financing. His demeanor at the hearing convinces us he is a person who is interested in doing a good job at Donner, and has the will and vigor to do it. If it is the utility's choice to use private financing, we see no reason to force it to use public financing. Moreover, in this instance, there is no difference to ratepayers either from the standpoint of cost or function.

We will authorize the private financing. So that adequate oversight can be maintained, we will require that Donner file with the Commission and other interested parties a schedule of construction and quarterly reports on construction progress and private financing commitments. These will be in addition to any requirements of DWR and state and local health departments.

It is obvious that additional funds from Donner's customers will be required by way of a surcharge in rates. From this record we cannot determine that exactly because Donner is presently operating at a loss and indicates it is considering applying for rate increases to become profitable. Therefore, we will hold further hearings on the rate increase that will be required. Donner is admonished to file with the Commission and parties as early as possible its proposals for a rate increase for a rate year beginning July 1, 1984.

Because the construction season in the area Donner operates is limited because of weather conditions, this decision should be effective as soon as possible.

Findings of Fact

1. Donner is a public utility water company under the jurisdiction of this Commission.

2. By D.92446 the Commission ordered Donner to make improvements to its system and pursue a loan from the state to cover the cost of the improvements.

3. Donner has a commitment from private sources for a $300,000 loan and from DWR for a $480,400 loan.

4. Donner prefers to make improvements to its system using private financing.

5. Table 1 and the assumptions used to make the calculations on Table 1 currently reflect the comparative costs to Donner customers of using private and public financing to make the required improvements to Donner's system.

6. Donner management is capable of administering the construction of the required improvements whether public or private financing is used.

7. There is no appreciable difference to Donner's customers whether private or public financing is used.

8. In the absence of any extenuating circumstances, if it is a utility's choice to use private financing in lieu of public financing to make improvements to its system, private financing is preferable, and in particular when public funds are limited.

9. The Commission may impose reasonable reporting requirements to assure construction of the improvements to Donner's system are carried out on a timely basis.

10. Because the construction season at Donner is beginning this decision should be effective on the date signed.

11. The execution of a secured note and a security agreement would be for a proper purpose.

12. The money, property, or labor to be procured or paid for by the proposed note is reasonably required for the purposes set forth in A.83-07-25.

13. Donner has paid the fee set by PU Code § 1904.1.

Conclusion of Law

Under PU Code §§ 816-830 the Commission may authorize Donner to enter into the indebtedness provided by the following order.

O R D E R

IT IS ORDERED that:

1. On or after the effective date of this order, and on or before June 30, 1986, and for the purpose specified in the application, Donner Lake Utility Company (Donner) may enter into a security agreement with the Union Safe Deposit Bank of Stockton, California and may execute and deliver a secured Promissory Note in the aggregate principal amount of up to $300,000.

2. Donner shall apply the net proceeds from the sale of its secured Note for the purposes set forth in A.83-07-25.

3. Donner shall file the reports required by General Order Series 24.

4. On or before July 1, 1984 Donner shall file with the Commission's Docket Office an original and 12 copies and shall serve on all parties a schedule of construction on the projects outlined in A.83-07-25.

5. On July 1, 1984, and quarterly thereafter until the completion of the projects named in Ordering Paragraph 4, Donner

shall file with the Commission's Hydraulics Branch a progress report on construction of the projects and a report of the amount borrowed and repaid on the loan authorized by this order.

6. Application 84-04-011 is dismissed.

7. Application 83-07-25 is granted in part and is held open for further hearing on appropriate changes in Donner's rates for service.

This order is effective today.

Dated MAY 16 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
Commissioners

Commissioner William T. Bagley being necessarily absent, did not participate.

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz, Executive Director

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Decision 84 05 099 MAY 16 1984

ORIGINAL

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James Pretti and Harry Aubright, for the Commission staff.

~~INTERIM~~ OPINION

By Decision (D.) 92446 dated December 2, 1980, the Commission ordered Donner Lake Utility Company (Donner) to make improvements to its water system and to pursue an application for a state loan of $395,000 to cover the cost of the improvements. Donner received a letter of commitment for a loan of $669,800 to construct improvements from the Department of Water Resources (DWR) on March 19, 1981. That commitment required Donner to meter all of its customers; it now meters only business customers.

When Donner was ready to go ahead with the improvements in 1982, there were no funds available from the Safe Drinking Water Bond Act (Water Bond) and Donner sought and received a commitment

Donner's stock. Williams believes the improvements required, which are detailed in both applications, can be done for $368,000. He plans to make the improvements in phases and stated that a $300,000 loan as requested in A.83-07-25 would be all that is needed to start the needed projects. He claims he can do the total job much cheaper if allowed to use private financing because he would not have to put all jobs out to bid. He also believes the improvements could be completed at an earlier time than if Water Bond financing were used. Williams testified he is willing to accept a 10% or 10-1/2% rate of return on the total rate base of the company in spite of the fact that the private loan will be at an interest rate of three points above prime which would currently be 14% or 15%. Williams stated he is willing to forego any dividends until the private loan is paid off and would expect to finance another $68,000 out of cash flow or additional borrowings. He stated that the bidding procedures, administrative fee, and fiscal agent fees required if water bonds are used, would add considerably to the costs of construction. Williams is emphatic that he does not want or need, at this time, public bond assistance; he wants to own and run his company entirely with private sector support.

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Staff called two witnesses: Becky Hoepcke, an Associate Government Analyst with DWR and John Gibbons, Assistant Director of the Commission's Revenue Requirements Division, who is head of the financial analysis function. Hoepcke testified that DWR does not require the bidding procedure for work which is less than $10,000, for ten years would more than be covered by depreciation and return on investment.

This record shows that Williams is well qualified to manage the construction required by either private or Water Bond financing. His demeanor at the hearing convinces us he is a person who is interested in doing a good job at Donner, and has the will and vigor to do it. If it is the utility's choice to use private financing, we see no reason to force it to use public financing. Moreover, in this instance, there is no difference to ratepayers either from the standpoint of cost or function.

We will authorize the private financing. So that adequate oversight can be maintained, we will require that Donner file with the Commission and other interested parties a schedule of construction and quarterly reports on construction progress and private financing commitments. These will be in addition to any requirements of DWR and state and local health departments.

It is obvious that additional funds from Donner's customers will be required by way of a surcharge in rates. From this record we cannot determine that exactly because Donner is presently operating at a loss and indicates it is considering applying for rate increases to become profitable. Therefore, we will hold further hearings on the rate increase that will be required. Donner is admonished to file with the Commission and parties as early as possible its proposals for a rate increase for a rate year beginning July 1, 1984.

Because the construction season in the area Donner operates is limited because of weather conditions, this decision should be effective as soon as possible.

Findings of Fact

1. Donner is a public utility water company under the jurisdiction of this Commission.

2. By D.92446 the Commission ordered Donner to make improvements to its system and pursue a loan from the state to cover the cost of the improvements.

3. Donner has a commitment from private sources for a $300,000 loan and from DWR for a $480,400 loan.

4. Donner prefers to make improvements to its system using private financing.

5. Table 1 and the assumptions used to make the calculations on Table 1 currently reflect the comparative costs to Donner customers of using private and public financing to make the required improvements to Donner's system.

6. Donner management is capable of administering the construction of the required improvements whether public or private financing is used.

7. There is no appreciable difference to Donner's customers whether private or public financing is used.

8. In the absence of any extenuating circumstances, if it is a utility's choice to use private financing in lieu of public financing to make improvements to its system, private financing is preferable. [illegible] to draft [illegible]

9. The Commission may impose reasonable reporting requirements to assure construction of the improvements to Donner's system are carried out on a timely basis.

10. Because the construction season at Donner is beginning this decision should be effective on the date signed.

11. The execution of a secured note and a security agreement would be for a proper purpose.

12. The money, property, or labor to be procured or paid for by the proposed note is reasonably required for the purposes set forth in A.83-07-25.

13. Donner has paid the fee set by PU Code § 1904.1.

Conclusion of Law

Under PU Code §§ 816-830 the Commission may authorize Donner to enter into the indebtedness provided by the following order.

~~INTERIM~~ ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, and on or before June 30, 1986, and for the purpose specified in the application, Donner Lake Utility Company (Donner) may enter into a security agreement with the Union Safe Deposit Bank of Stockton, California and may execute and deliver a secured Promissory Note in the aggregate principal amount of up to $300,000.

2. Donner shall apply the net proceeds from the sale of its secured Note for the purposes set forth in A.83-07-25.

3. Donner shall file the reports required by General Order Series 24.

4. On or before July 1, 1984 Donner shall file with the Commission's Docket Office an original and 12 copies and shall serve on all parties a schedule of construction on the projects outlined in A.83-07-25.

5. On July 1, 1984, and quarterly thereafter until the completion of the projects named in Ordering Paragraph 4, Donner