

Decision 88 10 023

OCT 14 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
sale and transfer of 100% of the )  
outstanding shares of stock in )  
Rural Water Company, Inc., a )  
California Corporation, owned by )  
Robert A. Smith and Richard C. Smith )  
to Charles M. Baker, and for a )  
Certificate of Public Convenience )  
and Necessity in the name of )  
RURAL WATER COMPANY, INC. )

Application 88-04-047  
(Filed April 15, 1988)

OPINION

This is an application in which Charles M. Baker (Baker) seeks to acquire control of Rural Water Company, Inc. (Rural) through the purchase of all of the outstanding shares of stock from Robert A. Smith and Richard C. Smith (Smiths).

Notice of the filing of the application was mailed to Rural's customers on May 18, 1988. The period to file comments or protest expired on June 7, 1988. One letter of protest was received. Thereafter, the Water Utilities Branch (Branch) prepared a report on the application, which was served on all parties. The report is designated as Exhibit 1. Branch's report indicates that if the parties agree to certain recommendations therein, it has no objection to an ex parte disposition of the matter. It appears that the parties have agreed to Branch's recommendations.

The Commission makes the following findings and conclusions:

Findings of Fact

1. Rural is a water corporation as defined in Public Utilities Code § 451 subject to the jurisdiction of the Commission. ✓

It was granted a certificate of public convenience and necessity in Decision 83-06-009, dated June 1, 1983.

2. As of June 1, 1988, Rural had 140 metered services, 3 flat rate services, and 24 hydrants on its active system. Its service area is in unincorporated territory on Nipoma Mesa south of the city of Arroyo Grande in San Luis Obispo County. Most of the current customers are concentrated in a few relatively small tracts scattered over a large area. There are currently 25,146 linear feet of 2- to 8-inch mains. With the exception of the old Palo Mesa tract which has about 56 services, the existing system is relatively new and has been designed by an engineer to conform to General Order (GO 103 standards. The design, however, does not include a production meter on a new well and the two existing wells are not individually metered as required by Go 103 although the water is metered when it enters the mains from the storage tanks.

3. The Smiths own 100% of the outstanding capital stock of Rural.

4. Baker is a real estate developer and builder. He has participated in various developments some of which were in the vicinity of Rural's service area. In many of the developments water systems were designed and constructed. Baker has acquired years of practical experience in working with registered civil engineers and has a good working knowledge of what constitutes a water system. Having been involved as owner/developer, he has been a primary decision maker in all his business ventures. Managing a water company is easily within his business capability. Rural has been his special interest. Through his efforts, an expansion of the present water facility has been designed, and will be constructed so as to nearly double the current 128 users to about 200. Baker is ready, willing, and able to take on this responsibility. His plans include having the water company capitalized to complete the water main extension, add a storage tank, pump stations, and appurtenances.

As of January 15, 1988, Baker had a net worth of \$3,097,120.

5. Baker has the ability, including financial ability, to acquire control of Rural and continue its operations. ✓

6. The Smiths have agreed to sell the outstanding capital stock of Rural to Baker for \$300,000, which represents the value the parties have placed on the assets of Rural which are specified in the application. ✓

\$100,000 of the price will be paid in cash and the remainder is by the transfer of two 2.5 acre lots (lots 6 and 7 of Tract 1256), valued at \$100,000 each. Escrow instructions attached to the application in Exhibit A page 4 of 14 indicate that the buyer is to provide flat rate water service to those lots in perpetuity. Rural provides only metered service on new connections and will eventually convert its remaining three flat rate services to meters. The Branch report objects to this condition. It is concerned that under these conditions Rural's other customers would be subsidizing the use of water on the two properties. In response to the Branch objection, the Smiths and Baker have agreed that service will be provided under Rural's metered rate tariff.

7. When Rural was acquired by its present ownership its plant and operation records were either nonexistent or, at best, poorly kept. The status of some water company properties that had been encumbered without Commission approval was in doubt. The new owners had no experience in small water company management and operations and the record keeping did not at first improve significantly. In 1986 Rural approached the Commission regarding procedures for obtaining a rate increase. Branch found that the company's records to be so inadequate that a rate increase at that time could not be processed. Branch undertook to assist Rural in rectifying the situation. Branch collected all available plant information from within the company as well as from the engineering firm that had designed recent plant additions and modifications as ✓

well as from vendors that had supplied materials or submitted bids. The Branch was then able to update the rate base established by Resolution No. W-3067 in connection with the rate increase authorized in 1982. In addition, with two years of data available, for 1986 and 1987, the Branch updated its data and recently recommended a rate increase for Rural in Application 88-01-021 which was converted because of customer protests on January 21, 1988 from a draft Advice Letter filed December 14, 1987 to a formal proceeding. Hearings were held in this matter and a decision is pending.

8. Based upon presently available data, the application indicates that the original cost of plant was \$593,283 and that the depreciation reserve as of December 31, 1987 was \$83,561, resulting in a net book value of \$509,772. The selling price of \$300,000 is therefore less than the net book cost. Branch has informed the parties that the Commission will not allow future ratemaking to be based only on the net book cost stated above or on the purchase price. Future ratemaking will be based on a rate base made up of, among other things, a net book value and a deduction for contributions.

9. Notice of the filing of the application was mailed to Rural's customers on May 18, 1988. The Commission received one letter of protest. The basis of the protest was that Baker was paying more than book value for the stock, which might adversely affect rates. The protest lacks merit for two reasons: (1) Baker is paying less than book value to acquire control of Rural; and (2) the Commission sets rates based on the original cost, less depreciation, of a water system, not the amount paid to acquire control of it.

10. A public hearing is not necessary in this matter.

11. The proposed transfer of control of Rural from the Smiths to Baker, if appropriate conditions are imposed, is not adverse to the public interest.

12. The application states that:

"Buyer proposes to continue with the presently filed tariffs of the Sellers, a copy of which Sellers have available to furnish to Buyer, however, Buyer understands that Seller has applied for a Rate increase, and Buyer desires to review the proposed increase with the Public Utilities Commission staff prior to a final decision. With that one exception, Buyer agrees to be bound by any outstanding Commission decisions and/or directives involving Rural Water Company. Buyer will be furnished the utility's copies of the following or informed of their availability at the Commission's headquarters, 350 McAllister Street, San Francisco, California 94102:

- "(a) General Order No. 96-A, Filing and posting of Tariff Schedules.
- "(b) General Order No. 103, Rules Governing Water Service, Including Minimum Standards for Design and Construction.
- "(c) Uniform System of Accounts for Class D Water Utilities.
- "(d) Rules of Practice and Procedure."

13. Any outstanding customer deposits will remain a responsibility of Rural and the person who has acquired control over it.

14. Rural presently does not hold any advances for construction.

15. Because the public interest would best be served by having the acquisition of control take place expeditiously, the ensuing order should be made effective on the date of issuance.

Conclusions of Law

1. The application should be granted as hereafter provided.
2. The one customer protest does not contain anything which should delay or require disapproval of the proposed transaction.

3. The proposed acquisition of control should be conditioned on Rural's providing service to lots 6 and 7 of Tract 1256 at metered rates.

4. The proposed acquisition of control should be conditioned on Rural equipping each of its wells with a meter to measure the water produced by that well, as required by GO 103.

The number of shares acquired, the total par (stated) value of the shares, and the dividends paid do not determine allowable return on plant investment. This authorization is not a finding of the value of the utility's stock or property, nor does it indicate the amounts to be included in ratesetting proceedings.

#### ORDER

##### IT IS ORDERED that:

1. On or after the effective date of this order, Robert A. Smith and Richard C. Smith (Smiths) may transfer to Charles M. Baker (Baker) all of the outstanding shares of the capital stock of Rural Water Company, Inc. (Rural) in accordance with the terms of the application, except as modified by the following express conditions:

- a. Rural shall provide service to lots 6 and 7 in Tract 1256, San Luis Obispo County only on a metered basis.
- b. Rural shall equip each of its wells with a meter to measure the water produced by that well, as required by GO 103.

2. Within 30 days after the transfer of shares herein authorized Baker shall notify the Water Utilities Branch in writing of that fact.

3. When all of the provisions of Ordering Paragraph 1 have been complied with, the Smiths shall be relieved of any public utility obligations relating to Rural.

4. The authority granted by this order shall expire on October 31, 1989, if it has not been exercised by that date.

This order is effective today.

Dated OCT 14 1988, at San Francisco, California.

STANLEY W. HULETT  
President

DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners

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

*Victor Weissert*  
Victor Weissert, Executive Director

Decision \_\_\_\_\_

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