

Decision 88 11 031 NOV 9 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Margot C. Wells)	
and Mark Steve Downard, doing)	
business as Riverside Water Works,)	Application 88-06-045
Inc., to sell and transfer control)	(Filed June 27, 1988)
to buy the water system in Humboldt)	
County.)	

OPINION

I. History of the Utility

On September 5, 1950, Riverside Water Works, a sole proprietorship, was transferred to the Bank of America as trustee under the will and last testament of Joseph A. Shaw. This company had been a public utility since prior to 1934. (Decision (D.) 63828, unpublished.)

In 1971, the Bank of America incorporated the sole proprietorship and continued to manage the company. (D.79326 and D.83239, unpublished.)

In 1983, the Bank of America, trustee, applied to dispose of company assets and cease operations. (Application (A.) 54332.) Several months later, the Commission issued an Order To Show Cause why the company should not be held in contempt based upon the trustee's imminent intention to cease water operations without making any preparation for continued water service. (D.82-06-103.) Subsequently, the trustee requested that the application to cease operations be dismissed. (D.83-018-001.)

In 1984, Riverside Water Works, Inc. was sold and transferred to David and Margo Wells. (D.84-01-044.)

In 1985, the customers of Riverside Water Works, Inc. were awarded a settlement judgment in a 1984 civil action for property damage due to water contamination and outages. Part of

the settlement was \$50,000 which was placed in an express, irrevocable trust for the purpose of matching funds used for future water system improvements. (Hubner et al. v Bank of America et al., Humboldt County Superior Court, Case No. 70361.)

II. Background

On June 27, 1988, a joint application was filed by Margot C. Wells, owner of all outstanding shares of Riverside Water Works, Inc. (seller) and Mark S. Downard (buyer), requesting ex parte approval of a sale of all outstanding stock and assets of the water system located in Humboldt County for \$5,000 cash. Attached to the application were copies of a purchase agreement (with a list of company property), the settlement trust agreement, a corporation grant deed, the 1987 Annual Report, the buyer's financial statement, a letter from the Department of Public Health (DPH) regarding certification, and seller's stock certificates.

Applicants describe the location of the water system as two miles west of the community of Ferndale. Prior to 1964 this water system also served the community of Port Kenyon. The distribution system still extends to the Port Kenyon area, but due to floods in 1934 and 1958 the residences were destroyed or abandoned. The system currently serves 81 customers, yet has 90 total connections installed. The system originally cost \$56,000. The book value of the system as of December 31, 1988 is approximately \$21,362. The water system consists of a plot of land approximately 75 feet square, one reservoir with a 15-17,000 gallon capacity, five artesian wells, water treatment equipment and 28,450 feet of water mains. The system's water supply is obtained from five artesian wells and a cave that feed into the concrete and brick storage tank. The distribution system consists mostly of four-inch, two-inch and under two-inch water mains of various materials.

The seller desires to sell all outstanding shares (17,370) of capital stock in the company which were inherited from her late husband. Mrs. Wells indicated that she is unable to manage the system.

The buyer desires to buy the system because of the investment opportunity it presents. Mr. Downard resides in Ferndale. He has operated the system from March, 1988 to the present time.

For the past four years, Mr. Downard has been employed by Louisiana Pacific Corporation, a lumber company in the area. He is presently an assistant recovery firemen whose responsibility is to operate a water treatment facility of mill and potable water. His duties include setting chlorine residuals, monitoring turbidity, blending hard and soft water, regulating water flow and monitoring and maintaining the equipment. Mr. Downard indicates that he is pre-enrolled for a water treatment course at the College of the Redwoods and is awaiting confirmation of the Department of Health Service's Class 1 exam schedule. (The letter from DPH attached to the application authorizes Mr. Downard to operate the system based upon his qualifications and prior experience in operating chlorinators for the local lumber company, but indicates that state law requires an operators certificate of at least grade I and preferably grade II for system operation.)

The buyer proposes to adopt seller's present tariffs. The buyer and seller warrant that there are no outstanding customer credits or main extension advance payments; however, the system is in need of repairs in an unknown amount.

Both buyer and seller accept joint responsibility of informing the community of customers about the application. The Commission's Advisory and Compliance Division-Water Branch (CACD) received a letter from Mrs. Wells representing that a notice of this application in the form previously provided by CACD had been mailed to all customers on July 27, 1988.

CACD's investigation of the application consisted of an inspection of the system, a noticed public meeting, an interview with the trustee appointed to oversee a settlement trust fund, and an interview with both the buyer and seller. CACD concludes that this transfer poses no adverse effects on existing or future customers, nor is it adverse to the public interest. CACD recommends that the request be granted ex-parte.

On September 22, 1988, a CACD report was issued containing a summary of its investigation, conclusions and recommendations. On the same date this report was mailed to all interested parties. No protests to the application or comments on CACD's report have been received.

III. Discussion

Mr. Downard is qualified to operate the system. CACD verified Mr. Downard's present job title and duties as well as representations in the application that he was pre-enrolled to obtain permanent DPH water treatment facility operator's certification. The trustee indicated its confidence in the buyer's ability to operate the system. It indicated that the water supply was better since Mr. Downard became the system's operator and that the system now runs 24 hours a day. (The two customers attending the public meeting confirmed that recent service was very satisfactory.) This verification by CACD of Mr. Downard's prior experience in operating water facilities, his pursuit in obtaining permanent operator authority, the confidence in his capability to operate the system shown by the trustee and customer satisfaction with his recent operations satisfies our concerns of a capable buyer.

CACD's inspection of the system revealed low pressure. Mr. Downard believes that there may be leaks in the distribution system in the Port Kenyon area. He also found that

small diameter pipe feeding water into larger ones across meters and the small water reservoir may be the source of low pressure problems. He indicated that he will continue to search the system and correct the problem. He has secured a backup person to monitor the system in his absences. Mr. Downard indicates a willingness to abide by Commission filing requirements necessary for public utility operations.

CACD inquired about Mr. Downard's ability to purchase the system and pay half of the costs to bring the system pressure up to General Order (GO) 103 standards. They found that Mr. Downard had personal credit at a bank to purchase the system. He had formulated a three- to four-year improvement plan financed from withholding his salary and using annual company profits. In 1987, profits were \$2,477. He had plans to purchase and install a used 20,000 - 40,000 gallon storage tank and new feed lines to increase water pressure and supply by June, 1989. These improvements were estimated at \$30,000. He planned to continue his job at Louisiana Pacific.

Given the existence of trust funds for improvements and Mr. Downard's personal credit for the purchase, we agree with CACD that he is financially capable of purchasing and financing improvements to this system.

Mr. Downard's cooperation with our staff in their investigation, his willingness to comply with Commission requirements and his independent effort of inspecting the system in an attempt to diagnose the cause of the pressure problem, show his willingness to adequately serve the customers. His intentions to correct, rather than continue to patch and repair system problems will vastly improve service.

We take official notice of the Hubner case and ensuing trust agreement because the trust terms involve rate base issues regulated by this Commission. The pertinent trust terms are these:

"§ 2.03. Distribution for Water System Improvements. In the event the Trustees, in

exercise of their reasonable discretion, shall determine that the 'conditions for distribution' have occurred, then the Trustees shall distribute the Trust Estate to contractors, subcontractors, suppliers, materialmen, engineers, and any other persons who, in their reasonable discretion, furnished labor, material, or equipment used or consumed in works of improvement of the water collection, purification, storage, or distribution systems of the Riverside Water Works. The conditions for distribution are:

- "1. Riverside Water Works, Inc., shall deliver to Trustees an Advice Letter from the Public Utilities Commission approving the expenditure of a sum in at least the amount of the Trust Estate for improvements to the Riverside Water Works' system.
- "2. Trustees determine, in exercise of their reasonable discretion, that the maximum 'matching funds' are available for use in conjunction with the Trust Estate distribution. As used herein the term 'matching funds' shall mean nonrepayable moneys paid for improvements of the Riverside Water Works through the Clean Water Bond Law of 1984, Water Code § 13999, et seq. as a result of an application in conjunction with improvements paid whole or in part by the Trust Estate.
- "3. A letter shall be delivered to the Public Utilities Commission and to the Trustees from Riverside Water Works, Inc., stating that: no works of improvement of the Riverside Water Works paid for from the Trust Estate or 'matching funds' shall be transferred, sold, or encumbered at any time by the Riverside Water Works, Inc., or its successors or representatives without the prior written approval of the Trustees or their successors; and that no amount of the Trust Estate or any 'matching funds' shall be considered at any time.

in calculating the rate base for service charges to customers of the Riverside Water Works."

In ratemaking terms, any distribution from the trust is required to be categorized as a "contribution" to the financial operations of this water system, meaning, these funds will not be included in calculating the rate base from which customer rates are determined. Likewise, under the trust agreement, "matching funds" obtained from 1984 Clean Water Bond Act grants¹ (called "nonrepayable" in the trust agreement) must also be labelled as a contribution to rate base and excluded from rates. This mandatory exclusion from rate base of non-repayable government grants and trust distributions obtained to finance system improvements is consistent with this Commission's ratemaking policy. For ratemaking purposes, without these mandatory trust terms, these items would be considered by this Commission as "contributions" to rate base and placed into the appropriate account to be excluded from rates. Therefore, these trust terms do not violate this Commission's ratemaking policy.

In addition, it is certainly in the customer's interest to use these trust funds and/or non-repayable Clean Water Bond Act grants to finance system improvements. The use of such low interest funds keeps customer rates at a minimum while improving service, a task which is most desirable, but generally not possible for a small water utility.

The Accounting and Financial Branch of the Commission Advisory and Compliance Division has indicated that funds distributed from the trust to the utility may be interpreted as a contribution subject to federal income tax under the new tax laws.² We agree with the Water Branch's observation that the

¹ California Water Code, Section 13999 et seq.

² 1986 Tax Recovery Act.

impact on rates that may result from this utility accepting government or private contributions is an issue for a future rate proceedings. However, for the purposes of this proceeding, we can safely speculate that any tax assessment on a future distribution of the entire trust fund (\$60,000 plus future accrued interest) and any similar assessment on matching government grants, should this occur, would be less of a financial burden on the customers than financing system improvements of \$120,000 or more from rates. Furthermore, it may be possible for the trust fund to bear any future tax liability arising from this distribution.

During the course of CACD's investigation, the Commission's Accounting and Financial Branch indicated that it was possible that funds derived from the trust may be deemed taxable revenues under the 1986 Tax Recovery Act. In a meeting with the trustee of the settlement trust (customers), CACD explored the alternative of the trustee purchasing the system and hiring an operator. This option would allow the trustee to maintain maximum control over the system and avoid any potential federal taxes on trust fund contributions. However, the trustee had already investigated and rejected this option. It had previously discussed on several occasions whether the community desired to form a mutual water company. There was no community support for this proposal.

We caution the buyer that under the trust terms, should improvements be made from trust funds and he later desires to sell the system, written consent from the trustee must be obtained as well as authorization from this Commission.

Our discussion of proposed system improvements in this decision does not constitute Commission approval of these improvements which would serve to release trust funds or approve a change in rates. We applaud the buyer's incentive to put this system in better operating condition. The voluntary act of preparing an improvement plan and following through by locating reasonably priced replacement equipment indicates a positive

attitude toward serving the customers of this water system which is most desirable. However, as this plan is implemented, should a change in rates be needed, the buyer must comply with the Commission's procedures for Advice Letter filings contained in GO 96-A.

Based upon CACD's findings in their investigation, we agree that this application should be approved ex-parte.

Findings of Fact

1. Seller, Margot C. Wells owns all outstanding shares of capital stock in Riverside Water Works, Inc., a California corporation and a public utility under this Commission's jurisdiction.

2. Seller does not desire to manage or operate Riverside Water Works, Inc. Buyer desires to purchase the system for \$5,000.

3. Buyer, Mark S. Downard has operated the water system since March 1988 and has four years experience in operating water facilities.

4. Buyer has been certified to operate the system by the Department of Public Health.

5. Buyer is financially capable of purchasing the system and make needed improvements.

6. The water system pressure is currently below GO 103 standards; however, customers are satisfied with service.

7. Buyer plans to install a used storage tank, new mains and continue to research and repair the low pressure problem.

8. The customers of this system are beneficiaries of a trust established as settlement of Hubner et al. v Bank of America et al., Superior Court of the State of California, County of Humboldt, No. 70361, for the purpose of making improvements. This trust fund is presently \$60,000 with interest accruing on the balance.

9. On March 18, 1988 the buyer and seller executed an agreement for the purchase and sale of all outstanding shares (17,370) of capital stock for \$5,000 cash, subject to the approval

of this Commission. A description of company property was attached to this agreement as Exhibit A.

10. There are no outstanding customer credits or main extension advances due.

11. Buyer proposes to adopt the existing tariffs.

12. The proposed purchase and sale of utility property is not adverse to the public interest.

13. No protest to this transfer have been received.

14. A public hearing is not necessary.

Conclusions of Law

1. The terms of the express, irrevocable trust established by the Superior Court of the State of California, County of Humboldt, in Huber et al. v Bank of America et al. are consistent with this Commission's ratemaking policy.

2. This application should be granted.

ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, Margot C. Wells may sell and transfer control to Mark S. Downard all of the capital stock and assets of Riverside Water Works, Inc. in accordance with the purchase agreement attached to the application.

2. Thereafter, Mark S. Downard shall comply with the pressure standards contained in GO 103 within a reasonable time.

3. Within 30 days of the transfer of shares hereby authorized, seller shall notify the Commission in writing of that fact.

4. Buyer is placed on notice that the number of shares outstanding, the total par value of the shares, and any 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.

This order is effective today.

Dated NOV 9 1988, at San Francisco, California.

STANLEY W. HULETT
President

DONALD VIAL

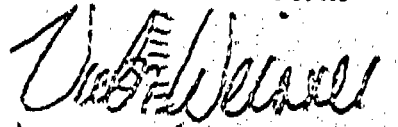
FREDERICK R. DUDA

G. MITCHELL WILK

JOHN B. OHANIAN

Commissioners

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


Victor Wenzel, Executive Director

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5. Buyer is financially capable of purchasing the system and make needed improvements.
6. The water system pressure is currently below GO 103 standards; however, customers are satisfied with service.
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