

CACD/RHG

Decision 92 10 024 OCT 06 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of ALISAL WATER CORPORATION, )  
dba ALCO WATER SERVICE U-206-W, a )  
corporation, to issue notes in the )  
principal amount of \$785,000. )

**ORIGINAL**  
Application 92-06-007  
(Filed June 12, 1992)

O P I N I O N

Summary of Decision

This decision grants in part and denies in part the authority requested by Alisal Water Corporation (AWC), doing business as Alco Water Service, in Application (A.) 92-06-007.

Pursuant to Sections 817 and 818 of the Public Utilities (PU) Code, AWC requests Commission authorization for the refinancing of certain existing short-term notes and seeks Commission approval for previously negotiated long-term loans, stock repurchases, and leasing arrangements. The original principal of the borrowings is approximately \$785,000. AWC proposes to:

1. Refinance a one year \$250,000 note dated January 30, 1991 from Arcadia Development Co. (Arcadia) and Award Homes (Award) for an additional period of two years to January 30, 1994.
2. Refinance a one year note dated March 15, 1991 with a balance of \$16,782 from Bank of Salinas with a maturity date of March 15, 1992 for an additional period of one year.
3. Convert a 1985 demand note for \$59,327 payable to R.T. Adcock into a 30-month note maturing in July 1994.
4. Have the Commission ratify a promissory note payable to Joanne Adcock Schmidt entered into in January 1, 1981, maturing in December 1995, with an original face amount of \$81,238.62 and an outstanding balance of \$37,025.

5. Have the Commission ratify a promissory note payable to Joanne Adcock Schmidt entered into in April 29, 1985, maturing in January 2000, with an original face amount of \$8,360 and an outstanding balance of \$7,337.
6. Have the Commission ratify a 48-month note payable to Bank of Salinas entered into in December 1989, maturing in December 1993, with a face amount of \$75,000 and a current balance of \$37,387.
7. Have the Commission ratify a \$247,840 lease entered into with Puritan Leasing on December 1986, with maturity date of December 1993.
8. Have the Commission ratify a \$46,213 lease entered into with Bell Atlantic-Tricon Leasing on November 1989, maturing in November 1993.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of June 15, 1992. No protests have been received.

#### Partial Denial of Application

AWC's proposal in the Application for retroactive approval of unauthorized debts is denied. AWC is in violation of the provisions of PU Code Section 825 due to its failure to secure Commission authorization prior to incurring the indebtedness that it now seeks to have approved retroactively.

#### Background

AWC is a California corporation and operates as a water utility under the jurisdiction of this Commission. It was incorporated on May 12, 1950. AWC engages in the retail water business in the eastern portion of Salinas and several small residential communities in nearby rural areas. Virtually, all services are metered.

AWC incurred substantial damage from the Loma Prieta earthquake of October 1989. Subsequently, one of AWC's main wells has been replaced and another 150,000 gallons of water storage has been constructed.

About this same time, developers Arcadia and Award approached AWC with plans to build 500 new homes in the northeasterly section of its service area. AWC concluded it would be most efficient and least costly to replace the earthquake damaged well; construct the new storage facilities; and drill a second well to meet additional demand, all at the same time. In order to finance the second well, AWC accepted \$250,000 from the developers on a short-term loan basis, with the option to extend the term of the loan as construction of the new homes progressed.

For the calendar year 1991, AWC reported it generated total operating revenues of \$1,271,497 and net income of \$68,087, shown as part of Exhibit K to the Application.

AWC's Balance Sheet for the calendar year 1991, shown as part of Exhibit J is summarized below:

<u>Assets</u>	<u>Amount</u>
Net Plant	\$5,083,482
Investments	9,200
Current and Accumulated Assets	553,853
Deferred Charges	<u>335,759</u>
Total	\$5,982,294
<u>Liabilities and Equity</u>	<u>Amount</u>
Capital and Retained Earnings	\$1,054,557
Long-Term Debt	274,485
Current and Accrued Liabilities	1,487,609
Deferred Credits	2,114,462
Contribution in Aid of Construction	<u>1,051,181</u>
Total	\$5,982,294

Debt Securities

AWC acknowledges in the Application that it may have unintentionally violated Commission requirements by failing to obtain prior authorization for certain currently outstanding borrowings. Therefore, AWC is requesting Commission retroactive approval for the following unauthorized borrowings in order to come into compliance with Commission requirements.

Short-Term Debt

1. Refinance a one year \$250,000 note dated January 30, 1991, from Arcadia and Award for an additional two-year period to January 30, 1994. Interest rate is set at 11.0% per annum. These funds have been used to construct a portion of the AWC's Northeast Project.
2. Refinance a one year note, dated March 15, 1991, maturing on April 15, 1992, with a balance of \$16,782 from Bank of Salinas for an additional period of one year with the following terms and conditions:

Original Note Amount: \$25,754.08  
Interest Rate: 9% Base Rate + 2%  
Loan Term: 12 months  
Monthly Payment: \$1,200.90  
Guarantor: Robert T. Adcock, Patricia Adcock

The proceeds of this loan have been used to purchase two stand-by diesel generators for emergency water pumping.

3. Convert a demand note in the amount of \$59,327 payable to R.T. Adcock into a 30-month note maturing in July 1994. The funds were used to pay off the balance of a loan from Pacific Mutual Life Insurance Company.

Long-Term Debt

1. Authorize two promissory notes issued in order to repurchase stock under AWC's ESOP from Joanne Adcock Schmidt. One note is dated January 1, 1981 with a maturity date of December 1995. The second note is dated April 29, 1985 with a maturity date of January 2000. The current total balance of these notes is \$44,362, with monthly payments of \$975.00 and \$100.34, respectively.
2. Authorize a 48-month note payable to Bank of Salinas entered into in December 1989, maturing in December 1993, with a face amount of \$75,000 and a current unpaid balance of \$37,387. The monthly payment is \$1,562.50.
3. Authorize a capital lease agreement, dated December 1986 with a maturity date of December 1993, with Puritan Leasing. The original amount of the lease is \$247,840 with a monthly payment of \$4,268. The outstanding balance is \$90,874. The proceeds have been used to equip a new well.

4. Authorize a capital lease agreement, dated November 1989 with a maturity date of November 1993, with Bell Atlantic-Tricon Leasing. The original amount of the lease is \$46,213 with a monthly payment of \$1,269.70. The outstanding balance is \$23,978. The proceeds have been used to acquire computer equipment.

Discussion

AWC requests Commission authorization to refinance a one year \$250,000 note, dated January 30, 1991, from Arcadia and Award developments for an additional two-year period to January 30, 1994; and to refinance a one year note dated March 15, 1991 maturing March 15, 1992 for an additional one year period.

Section 823(b) of the PU Code states that:

"A public utility may issue notes, for proper purposes and not in violation of any provision of law, payable at periods of not more than 12 months after the date of issuance of the notes without the consent of the Commission."

Further, Section 823 (d) of the PU Code provides that:

"No note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the Commission."

The Commission Advisory and Compliance Division (CACD) recommends approval of the two refinancing transactions based on AWC's current financial position and the willingness of the lenders to extend the term of the loan. As a small water company, AWC is beset with the limited availability of long-term debt providers. However, retroactive approval cannot be granted. On or after the effective date of this decision, AWC should make immediate arrangements to issue and deliver new promissory notes.

The Commission has considered CACD's recommendations, and finding them reasonable, will adopt them as stated above.

AWC is placed on notice, by this decision, that the Commission will review the reasonableness of the interest rates of these refinancing transactions in conjunction with AWC's next cost of capital proceedings.

The Commission in Decision (D.) 87-04-012 dated April 8, 1987, authorized Hillview Water Company to execute a promissory note for \$30,000, which had been originally executed without prior Commission approval and for which proceeds had been expended for emergency construction work.

The Commission further authorized Southern California Water Company in D.87-08-017 dated August 12, 1987, to execute a note in the amount of \$334,750, which had been originally executed without prior authorization and for which proceeds had been expended for a steel water reservoir, land rights and appurtenant equipment.

The transactions listed below, having terms of more than 12 months are void under the provisions of PU Code Section 825 since they were consummated without an order from the Commission.

Section 825 of the PU Code states that:

"All stock and every stock certificate or other evidence of interest or ownership, and every bond, note, or other evidence of indebtedness, of a public utility, issued without an order of the Commission authorizing the issue thereof then in effect or not conforming in its provisions to any of the provisions which it is required by the order of authorization to contain, is void. No failure in any other respect to comply with the terms or conditions of the order of authorization of the Commission shall render void any stock or stock certificate or other evidence of interest or ownership, or any bond, note, or other evidence of indebtedness, except as to a corporation or person taking it otherwise than in good faith and for value and without actual notice."

The Commission cannot retroactively approve AWC's unauthorized long-term borrowings in the absence of compelling or emergency circumstances.

CACD also noted that the principal amount on the demand promissory note payable to Robert T. and Patricia Adcock, as shown in Exhibit D to the Application is inconsistent with AWC's Schedule

of Outstanding Debt as of December 31, 1991, Exhibit N. The demand promissory note which was executed on March 4, 1985 (Exhibit D) indicates \$59,327 as the principal consideration. Exhibit N indicates that the principal of the subject demand note was \$166,785 and has an outstanding balance of \$59,327 as of December 31, 1991.

However, CACD recognizes AWC's voluntary acknowledgement of the unauthorized transactions and recommends authorization for the remaining amounts of the borrowings.

Accordingly, for the following borrowings, AWC should make immediate arrangements to execute and deliver new agreements or promissory notes in substantially the same form as previously issued using the outstanding balance as the amount of consideration.

1. Promissory Note payable to R.T. Adcock with the following terms and conditions:

Original Note Amount: \$166,785  
Interest Rate: 12%  
Loan Term: On demand  
Note Date: April 1985  
Outstanding Balance: \$59,327  
Interest payable monthly

2. Loan # 01 821529 from Bank of Salinas with the following terms and conditions:

Original Note Amount: \$75,000.00  
Interest Rate: 10.5% Base Rate + 2.5%  
Loan Term: 48 months  
Note Date: December 6, 1989  
Outstanding Balance: \$37,387  
Monthly Payment: \$1,562.50  
Guarantor: Robert T. Adcock, Patricia Adcock

3. Promissory notes payable to Joanne Adcock Schmidt with the following terms and conditions:

	<u>Note #1</u>	<u>Note #2</u>
Original Note Amount:	\$81,238.62	\$8,360.00
Loan Term:	15 yrs.	15 yrs.
Note Date:	January 1981	May 1985
Outstanding Balance:	\$37,025.00	\$7,337.00
Monthly Payment:	\$975.00	\$100.34

In this matter, we will adopt CACD's determination that AWC, having recognized the need to rectify its past omissions, can be granted partial authorization in accordance with the authority vested in the Commission by Section 816 of the PU Code. However, we place AWC on notice that the Commission does not condone acts that violate the PU Code.

In the Application, AWC acknowledges that, "...it may unintentionally have violated Commission requirements in prior years by failing to obtain authorization for certain borrowings currently outstanding." As we have noted, AWC has indeed violated the PU Code by its earlier actions, and the offending transactions are thereby void under Section 825. While we cannot authorize AWC to execute those documents retroactively, we can and will require it to execute replacement notes on substantially the same terms and conditions to be effective prospectively. Our CACD staff informs us that AWC, while not classified as a major water company, is part of a family of water utility affiliates that exhibits considerable sophistication in its financing and operations. As such, we expect it henceforth to be aware of its legal and regulatory obligations, and to obtain expert advice from outside sources, if necessary.

AWC opines that capital leases do not require Commission approval, but nonetheless includes its existing leases in the Application.

Section 851 of the PU Code states partly that:

"No public utility other than a common carrier ....shall sell, lease, assign, mortgage, or otherwise dispose of or encumber in whole or any part of its...plant, system, or other property necessary or useful in the performance of its duties to the public..., without first having secured from the Commission an order authorizing it so to do. Every such sale, lease, assignment ...made other than in accordance with the order of the Commission authorizing it is void." (Emphasis added.)

After reviewing the provisions of PU Code, Article 6, Transfer or Encumbrance of Utility Property, CACD concurs with AWC that capital leases whereby the utility is the lessee (one who leases or rents something from someone) do not require



authorization from the Commission. It is only when the utility acts as the lessor (one who leases or rents something to someone) that the issue becomes of public interest and Commission approval is required.

CACD proposes that the following leasing transactions do not require Commission approval and should be excluded from the authority requested in the Application:

1. Lease Agreement with Puritan Leasing dated December 1986 with a maturity date of December 1993. The original amount of the lease is \$247,840 with a monthly payment of \$4,268. The outstanding balance is \$90,874.
2. Lease agreement with Bell Atlantic-Tricon Leasing dated November 1989 with a maturity date of November 1993. The original amount of the lease is \$46,213 with a monthly payment of \$1,269.70. The outstanding balance is \$23,978.

The Commission has considered CACD's recommendations and, finding them reasonable, will adopt them as stated above.

Capitalization Ratios

AWC's capitalization ratios at December 31, 1991, recorded, and at December 31, 1992, pro forma after giving effect to the \$600,000 issuance of notes (D.92-05-067) and the debt securities in this Application are as set forth below:

	<u>Recorded*</u>		<u>Pro Forma</u>	
	<u>Amount</u>	<u>Percentage</u>	<u>Amount</u>	<u>Percentage</u>
Long-Term Debt	\$ 758,636	35.7%	\$ 711,235	34.3%
Short-Term Debt	312,109	14.7%	270,665	13.0%
Equity Capital	1,054,557	49.6%	1,094,657	52.7%
Totals	\$2,125,302	100.0%	\$2,076,557	100.0%

\*Includes all the debts requested in this application since these were incurred prior to 1991. There are no proceeds to be derived from the restructuring of debts under this Application. Decreases in long-term debt and short-term debt are due to current monthly payments on these accounts.

CACD observes that the \$250,000 Northeast Project indebtedness for the Arcadia and Award developments could have been avoided if AWC had required the amount as contribution-in-aid-of-construction or as an advance from the developers. AWC's decision to drill the second well at its own expense has placed AWC, in effect, at the limit of its borrowing capacity. Without this expenditure, AWC's estimated capitalization ratios for 1991 would have been more favorable as estimated below:

Long-Term Debt	\$ 758,636	40.1%
Short-Term Debt	76,109	4.1%
Equity Capital	1,054,557	55.8%
Totals	\$1,889,302	100.0%

AWC is placed on notice, by this decision, that the Commission does not find that its capital ratios are necessary or reasonable for ratemaking purposes. These are issues which are normally tested in general rate cases or cost of capital proceedings.

#### Construction Budget

A summary of AWC's construction budget for the Northeast Project as appearing in its Exhibit F of A.92-03-042, (D.92-05-067) follows:

<u>Item</u>	<u>Amount</u>
Land and Land Rights	\$ 37,200
Structures and Improvements	255,500
Wells	155,200
Storage	104,900
Equipment	<u>297,200</u>
Total	\$850,000

Part of AWC's northeast construction budget is the construction cost for the Arcadia and Award developments which includes the following:

<u>Construction</u>	
1 water well	\$ 81,500
1 pump house	42,500
Installation of pipe, valves, tank, etc.	<u>17,000</u>
Total Construction	\$141,000

Equipment

1 150 HP VHS electric motor/pump	\$ 31,300
1 Onan automatic transfer switch	5,300
1 10,000 gallon pressure tank	23,900
1 Comings diesel generator	39,000
Electrical installation/miso.	<u>9,500</u>
Total Equipment	\$109,000

Total Project Cost \$250,000

CACD has reviewed the Application and AWC's construction program and concludes that the debts were necessary for the construction of facilities and refinancing of AWC's past years' construction borrowings. However, AWC is placed on notice, by this decision, that the Commission does not find that its construction budget is necessary or reasonable for ratemaking purposes. These are issues which are normally tested in general rate cases or rate base offset proceedings.

Findings of Fact

1. AWC, a California corporation, operates as a water utility subject to the jurisdiction of this Commission.
2. AWC needed external funds to rebuild one of its main wells and build 150,000 gallons of water storage after the Loma Prieta earthquake.
3. Section 823(d) of the PU Code requires Commission authorization for the refinancing of AWC's \$250,000 note to Arcadia and Award developments and the refinancing of a loan from Bank of Salinas with an outstanding balance of \$16,782.
4. AWC issued a demand note with an outstanding balance of \$59,327 payable to R.T. Adcock to pay off the balance of a loan from Pacific Mutual Life Insurance Company without Commission approval.
5. The amount of the demand promissory note listed as Exhibit D to the Application, dated March 4, 1985, payable to Robert T. and Patricia Adcock is inconsistent with the Schedule of Outstanding Debt as of December 31, 1991, Exhibit N to the Application.
6. AWC issued two notes to Joanne Adcock Schmidt with a total unpaid balance of \$44,362 without Commission approval.

7. AWC issued a 48-month note to Bank of Salinas with a current unpaid balance of \$37,387 without Commission approval.

8. The execution of promissory notes to R.T. Adcock, Joanne Adcock Schmidt, and Bank of Salinas would not be adverse to the public interest.

9. The proceeds from the outstanding debts were used for plant construction and equipment; for the discharge or lawful refunding of its obligations; and for the repurchase of stock.

10. The money, property, or labor paid for by the transactions stated in the Application are reasonably required for the purposes specified in the Application.

11. The total outstanding amount of the notes requested in the Application excluding the two leasing transactions is \$407,858. This amount should be used in calculating the application fee due from AWC.

12. There is no known opposition and there is no reason to delay granting the authority requested.

#### Conclusions of Law

1. A public hearing is not necessary.

2. The Application should be granted to the extent set forth in the order which follows.

3. The refinancing transactions are for lawful purposes and the money, property, or labor obtained are required for these purposes. Proceeds from the notes which have already been disbursed may not be charged to operating expenses or income.

4. The demand note issued by AWC to R.T. Adcock on April 1985, in the principal amount of \$166,785 was issued without prior Commission authorization and is therefore void.

5. The promissory note issued by AWC to Joanne Schmidt on January 1981, in the principal amount of \$81,239 was issued without prior Commission authorization and is therefore void.

6. The promissory note issued by AWC to Joanne Schmidt on May 1985, in the principal amount of \$8,360 was issued without prior Commission authorization and is therefore void.

7. The 48-month note issued by AWC to Bank of Salinas on December 1989, in the principal amount of \$75,000 was issued without prior Commission authorization and is therefore void.

8. Retroactive approval of the unauthorized debts should be denied.

9. The proposed execution of promissory notes based on the outstanding balances are appropriate and for lawful purposes. Proceeds from the notes may not be charged to operating expenses or income.

10. A leasing transaction whereby the utility is the lessee does not require Commission approval.

11. The following order should be effective on the date of signature and payment of a fee of \$816.00 as set forth by Section 1904(b) of the PU Code.

ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, Alisal Water Corporation (AWC), doing business as Alco Water Service may prospectively refinance a one year \$250,000 note described in the Application as dated January 30, 1991 from Arcadia Development Co. and Award Homes for an additional period of up to two years, in substantially the same form as set forth in Exhibit B to the Application.

2. On or after the effective date of this order, AWC may prospectively refinance the one year note described in the Application as dated March 15, 1991 with a balance of \$16,782 from Bank of Salinas with a maturity date of March 15, 1992, for an additional period of up to one year, in substantially the same form as set forth in Exhibit C to the Application.

3. On or after the effective date of this order, AWC shall, for the purposes specified in the Application, execute and deliver promissory notes to the following:

- a) R.T. Adcock in the principal amount of \$59,327 or such adjusted amount net of any actual payments made from the date of the Application to the date of this decision.

- b) Bank of Salinas in the principal amount of \$37,387 or such adjusted amount net of actual monthly payments made from the date of the Application to the date of this decision.
- c) Joanne Adcock Schmidt in the principal amount of \$37,025 or such adjusted amount net of actual monthly payments made from the date of the Application to the date of this decision.
- d) Joanne Adcock Schmidt in the principal amount of \$7,337 or such adjusted amount net of actual monthly payments made from the date of the Application to the date of this decision.

These instruments shall be effective prospectively only and shall replace the corresponding documents which were issued and executed without authorization from the Commission. They should be in substantially the same form as that attached to the Application as Exhibit D, Exhibit G, and Exhibit E accordingly.

4. On or before the 25th day of each month, AWC shall file the reports required by General Order Series 24.

5. AWC shall file with the Commission Advisory and Compliance Division (CACD) copies of the refinancing documents and copies of the executed promissory notes authorized by this Order, within 15 days of execution.

6. CACD is directed to mail a certified copy of this decision to:

Arcadia Development Co.  
1500 E. Hamilton Ave. #212  
Campbell, CA 95008

Award Homes, Inc.  
P.O. Box 3886  
Salinas, CA 93912-3886

Bank of Salinas  
301 South Main Street  
P.O. Box 450  
Salinas, CA 93902

Robert T. Adcock  
249 Williams Rd.  
Salinas, CA 93905

Joanne A. Schmidt  
856 River Road  
Salinas, CA 93908

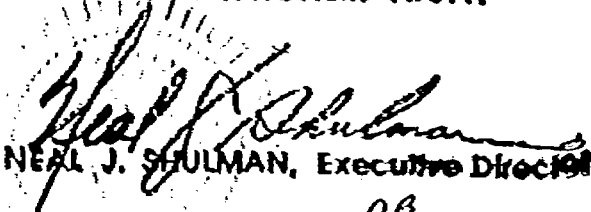
7. The Application is granted in part as set forth above.

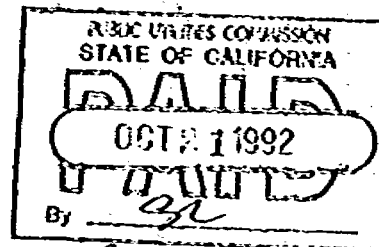
8. The authority granted by this order shall become effective when AWC pays \$816.00, the fee set forth by Public Utilities Code Section 1904(b). In all other respects this order is effective today.

Dated OCT 06 1992 .e., at San Francisco, California.

DANIEL Wm. FESSLER  
President  
JOHN B. OHANIAN  
PATRICIA M. ECKERT  
NORMAN D. SHUMWAY  
Commissioners

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

  
NEAL J. SHULMAN, Executive Director  
PB



Rec. #35823  
\$816.00