

CACD/RHG

Decision 92-12-066 December 16, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of CALIFORNIA UTILITIES
SERVICE, INC., a corporation, to issue
notes in the principal amount of
\$406,000.

ORIGINAL
Application 91-10-020
(Filed October 11, 1991)
Amended Application
(Filed June 4, 1992)

O P I N I O N

Summary of Decision

This decision grants in part and denies in part the authority requested by California Utilities Service, Inc. (CUS), in Application (A.) 91-10-020 as amended.

Pursuant to Sections 817 and 818 of the Public Utilities (PU) Code, CUS seeks Commission approval for previously negotiated long-term loans. The original principal of the borrowings is approximately \$406,000. CUS proposes to:

1. Have the Commission ratify a promissory note payable to Lewis S. Kootstra and Lois E. Kootstra (Kootstra) entered into on June 17, 1991, maturing in June 20, 1996, with an original face amount of \$65,000.
2. Have the Commission ratify a promissory note payable to El Toro, Ltd., Emerald Chamberlain Partners, and Palma Grove Associates (referred to herein jointly as "Chamberlain Group") entered into on September 24, 1990, maturing in September 23, 1993, with an original face amount of \$100,000.
6. Have the Commission ratify a 60-month note payable to Bank of Salinas entered into on July 1, 1992, maturing in June 30, 1997, with an original face amount of \$241,000.

Notice of the filing of the Application and the Amended Application appeared on the Commission's Daily Calendar of October 22, 1991 and June 15, 1992, respectively.

Partial Denial of Application

CUS's proposal in the Application for retroactive approval of unauthorized debts is denied. CUS is in violation of the provisions of PU Code Section 925 due to its failure to secure Commission authorization prior to incurring the indebtedness that it now seeks to have approved retroactively.

Background

CUS is a California corporation and operates as a sewer utility under the jurisdiction of this Commission. It was incorporated on February 13, 1985. CUS serves approximately 900 residential sewer customers in an unincorporated area of Monterey County along Salinas-Monterey Highway 68, running westerly for about ten miles from the sewage treatment plant adjacent to the Salinas River.

On June 17, 1991, CUS borrowed \$65,000 from Kootstra for a period of five years at an interest rate of 14%. The monthly principal and interest payment is \$1,512.14. The proceeds of this loan were invested in the sewer system.

On September 24, 1990, CUS borrowed \$100,000 from the Chamberlain Group for a period of three years at an interest rate of 11%. Annual payment (interest only) is \$11,000. The proceeds of this loan were applied to the construction of an effluent storage pond.

On April 1992, CUS negotiated with the Bank of Salinas for the consolidation of three outstanding loans with a combined balance of \$254,749. On July 1, 1992, a \$241,000 note was entered into by CUS with the Bank of Salinas for a period of five years at an interest rate of 9 1/2% with monthly principal payments of \$4,017 plus interest. The proceeds of these loans were used, together with contributions from developers, to construct a new sewage treatment plant and to acquire and improve sprayfields.

For the calendar year 1991, CUS reported it generated total operating revenues of \$165,059 and net loss of \$132,950, shown as part of Attachment C to the Application.

CUS's Balance Sheet for the calendar year 1991, shown as part of Attachment B is summarized below:

<u>Assets</u>	<u>Amount</u>
Net Plant	\$2,894,153
Current and Accumulated Assets	<u>32,548</u>
Total	\$2,926,701
<u>Liabilities and Equity</u>	<u>Amount</u>
Capital and Retained Earnings	\$ 137,207
Long-Term Debt	394,254
Current and Accrued Liabilities	431,095
Deferred Credits	78,819
Contribution in Aid of Construction	<u>1,885,326</u>
Total	\$2,926,701

Debt Securities

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

1. Authorize a 60-month note payable to Kootstra, dated June 17, 1991, maturing in June 20, 1996, with a face amount of \$65,000 and an unpaid balance of \$51,819 as of October 31, 1992. Interest rate is 14% per annum. The proceeds of this loan were invested in the sewer system.
2. Authorize a 36-month note payable to the Chamberlain Group, dated September 24, 1990, maturing in September 23, 1993, with a face amount of \$100,000 and an unpaid balance of \$100,000 as of April 30, 1992. Interest rate is at 11% per annum. The proceeds of this loan were applied to the construction of an effluent storage pond.

3. Authorize a 60-month note payable to Bank of Salinas entered into in July 1, 1991, maturing in June 30, 1997, with a face amount of \$241,000 and an unpaid balance of \$228,982 as of October 31, 1992. Interest rate is at 9 1/2% per annum. These funds have been used to construct a new sewage treatment plant and to acquire and improve sprayfields.

Discussion

The transactions listed above, 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 CUS's unauthorized long-term borrowings in the absence of compelling or emergency circumstances.

However, the Commission Advisory and Compliance Division (CACD) recognizes the voluntary acknowledgement of the unauthorized transactions and recommends authorization for the remaining amounts of the borrowings.

The Commission in Decision (D.) 87-04-012 dated April 8, 1987, authorized Millview 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. In a more recent order, the Commission authorized Alisal Water Corporation in D.92-10-024 dated October 6, 1992, to refinance short-term notes to periods beyond twelve months; and to ratify certain promissory notes, which have been originally executed without prior Commission approval.

In this matter, we will adopt CACD's determination that CUS, 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 CUS on notice that the Commission does not condone acts that violate the PU Code.

In the Application, CUS acknowledges that "...it may unintentionally violated Commission requirements by failing to obtain authorization for certain borrowings currently outstanding." As we have noted, CUS has indeed violated the PU Code by its earlier actions, and the offending transactions are thereby void under Section 825. While we cannot authorize CUS to execute these documents retroactively, we can and will require it to execute replacement notes on substantially the same terms and conditions to be effective prospectively. We expect CUS henceforth to be aware of its legal and regulatory obligations, and to obtain expert advice from outside sources, if necessary.

CUS is placed on notice, by this decision, that the Commission may review the reasonableness of these borrowings in conjunction with a future ratemaking proceeding to the extent that they affect rates. We will not make a finding in this decision as to the reasonableness of the interest rates.

Accordingly, for the above mentioned borrowings, CUS should make immediate arrangements to execute and deliver new agreements or promissory notes in substantially the same forms as previously issued using the outstanding balances as the principal amounts of notes and the remaining terms as the loan terms.

Capitalization Ratios

CUS's capitalization ratios at December 31, 1991, recorded, and at December 31, 1991, pro forma after giving effect to 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	\$ 394,254	74.2%	\$ 411,799	140.0%
Equity Capital	137,207	25.8%	(117,695)	(40.0%)
Totals	\$ 531,461	100.0%	\$ 294,104	100.0%

Note: Recorded Equity Capital includes a capital surplus of \$258,677 which, as a result of a rate base adjustment ordered in D.91-10-017, is not included in the pro forma capitalization.

CUS is placed on notice, by this decision, that capital structures are normally subject to review in general rate case proceedings. We will not, therefore, make a finding in this decision on the reasonableness of the projected capital ratios for ratemaking purposes.

Construction Budget

CUS states in the Application that all major utility plant constructions, including the new sewage treatment plant, effluent holding pond and sprayfields have been completed. No additional borrowings are planned for 1992 or 1993.

CUS is placed on notice, by this decision, that construction expenditures and any resulting plant balances in rate base are issues which are normally addressed in ratemaking proceedings.

Findings of Fact

1. CUS, a California corporation, operates as a sewer utility subject to the jurisdiction of this Commission.
2. CUS needed external funds to construct a new sewage treatment plant, effluent holding pond, and sprayfields.

3. CUS issued a 60-month note to Kootstra with a principal amount of \$65,000 and an unpaid balance of \$51,819 as of October 31, 1992 without Commission approval.

4. CUS issued a 36-month note to the Chamberlain Group with a principal amount of \$100,000 and an unpaid balance of \$100,000 as of April 30, 1992 without Commission approval.

5. CUS issued a 60-month note to Bank of Salinas with a principal amount of \$241,000 and an unpaid balance of \$228,982 as of October 31, 1992 without Commission approval.

6. The execution of promissory notes to Kootstra, the Chamberlain Group, and Bank of Salinas would not be adverse to the public interest.

7. The proceeds from the outstanding debts were used for plant construction.

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

9. The principal amount of the notes requested in the Application is \$406,000. This amount should be used in calculating the application fee due from CUS.

10. 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 promissory note to Kootstra dated June 17, 1991, in the principal amount of \$65,000 was issued by CUS without prior Commission authorization and is therefore void.

4. The promissory note to the Chamberlain Group dated September 24, 1990, in the principal amount of \$100,000 was issued by CUS without prior Commission authorization and is therefore void.

5. The promissory note to the Bank of Salinas dated July 1, 1992, in the principal amount of \$241,000 was issued by CUS without prior Commission authorization and is therefore void.

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

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

8. The following order should be effective on the date of signature and payment of a fee 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, California Utilities Service, Inc. (CUS) shall, for the purposes specified in the Application, execute and deliver promissory notes to the following:

- a) Lewis S. Kootstra and Lois E. Kootstra (Kootstra) in the principal amount of \$65,000 or such adjusted amount net of any actual payments made from the date of the Application to the date of this decision.
- b) El Toro, Ltd., Emerald Chamberlain Partners, and Palma Grove Associates (Chamberlain Group) in the principal amount of \$100,000 or such adjusted amount net of any principal payments made from the date of the Application to the date of this decision.
- c) Bank of Sainas in the principal amount of \$241,000 or such adjusted amount net of actual monthly payments made from the date of the Application to the date of this decision.

2. 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 forms as that attached to the Application as Exhibits B, E, and F accordingly.

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

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4. Within 15 days of execution, CUS shall file with the Commission Advisory and Compliance Division (CACD) copies of the executed promissory notes authorized by this order.

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

Lewis and Lois Kootstra
14028 Reservation Road
Salinas, CA 93908

El Toro Ltd.
11420-A Commercial Parkway
Castroville, CA 95012

Emerald Chamberlain Partners
655 Skyway, Suite 220
P.O. Box 970
San Carlos, CA 94070

Palma Grove Associates
9740 Scranton Rd., Ste. 300
San Diego, CA 92121

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

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

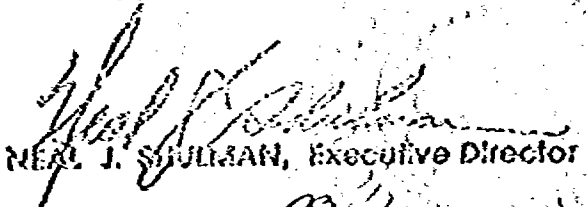
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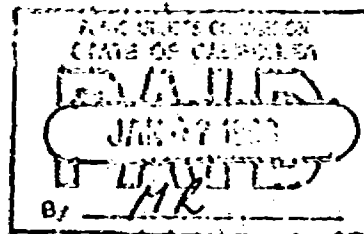
7. The authority granted by this order shall become effective when CUS pays \$812, the fee set forth by Public Utilities Code Section 1904(b). In all other respects this order is effective today.

Dated December 16, 1992, 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. SULLIVAN, Executive Director



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\$812.00