

Decision No. 87710 AUG 16 1977

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's
own motion into the operations,
practices, service, equipment,
facilities, rules, regulations,
contracts, and water supply of the
MONTEREY PENINSULA DISTRICT OF
CALIFORNIA-AMERICAN WATER COMPANY,
a corporation, and of RANCHO DEL
MONTE DIVISION OF WATER WEST
CORPORATION.

Case No. 9530
(Filed April 3, 1973)

(See Decision No. 86807 for appearances.)

OPINION ON REHEARING

Cal-Am Ordered not to Pay Dividends

On January 5, 1977 by Decision No. 86807, this Commission issued its Seventh Interim Opinion and Order in this investigation. Among other things, Decision No. 86807 ordered that:

- "1. Until further order of this Commission, California-American Water Company shall pay no dividends, nor otherwise transmit any funds to American Water Works Company, Inc., or to any subsidiary, officer, or employee of American Water Works Company, Inc., except in payment for value received."

Limited Rehearing Granted

A petition for rehearing directed toward the above ordering paragraph was filed by California-American Water Company (Cal-Am) on January 14, 1977. The petition was followed by a supplementary petition filed by Cal-Am on January 19, 1977 and by a request for a further stay of Decision No. 86807 filed by Cal-Am on March 3, 1977.

By Decision No. 87082 issued March 9, 1977, the Commission granted rehearing of Ordering Paragraph 1 of Decision No. 86807 and suspended that paragraph pending decision on rehearing. The rehearing was held before Examiner J. F. Haley in San Francisco on April 18 and 19, 1977.

Background

Among the findings in the Commission's Seventh Interim Opinion were the following:

- "2. Cal-Am, by not financing and constructing the necessary production, storage, and transmission plant, has failed to furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities as are necessary to promote the safety, health, comfort, and convenience of its patrons and the public, as required by Section 451 of the Public Utilities Code.
- "3. The Commission has, acting under the authority contained in Section 701 of the Public Utilities Code, taken together with its responsibility under Sections 451, 816, 817, and 851, the power, and in this instance the duty, to direct Cal-Am to cease the payment of dividends or other transmission of funds to American Water Works, its employees or subsidiaries, except in payment for value received. Under the circumstances as developed in the record of this case, this power should be exercised and such payments be prohibited until such time as the Commission shall find it prudent to permit their restoration."

In arriving at the above findings, the Commission stated that it specifically had considered that:

- "1. We permitted American Water Works, through its newly organized subsidiary, Cal-Am, to acquire the Cal. Water & Tel. water properties at a cost far in excess of their earning capacity. Such authorization was granted only after the president of American Water

Works assured the Commission, under oath, that capital funds would be provided as needed. He further assured the Commission that 99.9 percent of the decision to commit funds for capital improvements would be made in the necessity to maintain a proper standard of service.

- "2. American Water Works has not, despite the assurances of its president, made any cash investments in Cal-Am's securities since Cal-Am acquired Cal. Water & Tel's. water properties.
- "3. Cal-Am has, by maintaining a dividend payment ratio higher than the ratio of American Water Works' dividend to its consolidated net income, caused Cal-Am to send up-stream to the holding company, funds that were then invested in American Water Works' other operating subsidiaries or were used to retire the holding company's stock and debt.
- "4. By financing the Sweetwater condemnation exclusively through Cal-Am, American Water Works has, to protect the holding company's equity investment, depleted Cal-Am's treasury of an amount in excess of \$4,100,000. Should this debit be written off, Cal-Am would have a negative earned surplus. By failing to fund the Sweetwater condemnation costs, American Water Works has placed Cal-Am in a very precarious financial condition.
- "5. Because of its failure to finance and construct the facilities necessary to produce and deliver the water directly or indirectly available to Cal-Am by virtue of its rights to water from the Carmel River, Cal-Am has persistently overdrafted the Seaside aquifers, thus risking salt water intrusion and loss of that water source to the community for an indefinite period in the future.

- "6. Because of inadequate production, storage, and transmission plant, Cal-Am has not been able to meet the ordinary demands and requirements of the water consumers of its Monterey District, resulting in the necessity of the Commission imposing a connection ban and water rationing.
- "7. The connection ban has caused financial hardship and emotional distress to those lot owners affected.
- "8. Water rationing has caused serious inconvenience to the customers of Cal-Am's Monterey District.
- "9. Cal-Am's board of directors has, by formal resolution, used the urgent necessity for additional capital investment in the Monterey District as a bargaining ploy in a unilateral attempt to negotiate with this Commission over Cal-Am's authorized rate of return.
- "10. Cal-Am has informed the Commission through its vice president finance, treasurer, and secretary that Cal-Am has no intention of issuing equity securities.
- "11. Should Cal-Am continue to pay dividends, it will not, absent an issue of equity securities, be able to finance its needed capital additions and still maintain the 50 percent debt limitation established by the Commission."

Petition for Rehearing

Cal-Am petitioned the Commission for rehearing and reconsideration of Decision No. 86807 upon the following grounds:

1. The Public Utilities Act does not empower the Commission to prohibit dividend payments authorized by the utility's board of directors and by the California Corporations Code.
2. The Commission's order interdicting dividend payments violates the provisions of both the United States and the California constitutions relating to due process and to confiscation of property without just compensation.

3. The Commission's attempt to distinguish cited legal precedent governing the dividend issue is factually and legally erroneous.
4. No necessity exists which justifies the prohibition of dividend payments; factually and practically no such prohibition is necessary.
5. The decision insofar as it relates to the dividend issue contains erroneous statements of fact and inaccurate factual premises and, based thereon, reaches improper conclusions, including the following:
 - (a) That Cal-Am's directors are in the process of liquidating the utility.
 - (b) That Cal-Am will not proceed with the construction of the Canada de la Segunda and Begonia Iron Removal Plant projects.
 - (c) That Cal-Am's parent company refuses to invest additional capital into Cal-Am under any circumstances.
 - (d) That Cal-Am has contributed a disproportionate share of dividends to its parent company.
 - (e) That Cal-Am will have a negative earned surplus due to unrecovered costs of the Sweetwater condemnation.
6. Decision No. 86807 does not contain, separately stated, findings of fact and conclusions of law by the Commission on several issues which are material to its dividend withhold order including:
 - (a) The assertion that Cal-Am is in the process of liquidating; and
 - (b) That the Commission has approved, in Decision No. 86850, Cal-Am's application for authority to borrow \$4,000,000 with which to construct the Canada de la Segunda Pipeline and the Begonia Iron Removal projects.

7. The decision is void as lacking in due process and equal protection of the laws in that it fails either to specify for how long Cal-Am is to be prohibited from paying dividends or what steps are required of Cal-Am to remove that burden.
8. Ordering Paragraph 1 of Decision No. 86807 was not approved by a majority of the Commission and is therefore invalid.

Subsequent Developments

Two significant developments bearing upon the issues in this rehearing have occurred since Decision No. 86807 was issued: (1) Cal-Am reached a settlement agreement with the South Bay Irrigation District and the city of National City on the purchase price and certain conditions of the settlement of the condemnation proceedings relating to Cal-Am's Sweetwater District, and (2) Cal-Am was able to obtain a \$4,000,000 line of credit from Bank of America.

Sweetwater Condemnation

Following negotiations throughout recent months, Cal-Am and the two condemnor agencies executed a formal agreement on April 5, 1977 agreed to by all parties to the litigation. On April 6, 1977 the trial court entered its order approving that agreement of settlement. The substantive highlights of that agreement are as follows:

1. The condemnors must hold bond elections on or before May 31, 1977 and, if successful, will pay Cal-Am \$19,000,000, plus court costs, on or before September 1, 1977. If unsuccessful in that first election, the condemnors may hold a second such election on or before November 8, 1977 and, if successful, will pay Cal-Am \$20,000,000, plus court costs, on or before December 27, 1977. If the second bond election fails, that will constitute an "irrevocable abandonment" of the condemnation proceedings and "judgment shall be forthwith entered dismissing the proceeding and awarding Cal-Am its recoverable costs and disbursements."

2. Cal-Am will cooperate in suspending consideration of its appeal to the U.S. Supreme Court which appeal will become moot due to this agreement. That will eliminate continuing legal expenses in connection with the appeal.

The staff has been informed by Cal-Am that the bond election on May 31, 1977, was successful and that the condemnor agencies will deposit \$19 million with the Superior Court by September 1, 1977, for disbursement to Cal-Am after satisfaction of all other claims against the property.

Loan Agreement

Throughout late 1976, Cal-Am conducted active negotiations with the Bank of America for a construction loan on the Canada de la Segunda Pipeline and Begonia Iron Removal projects. These negotiations were successfully concluded, and on December 13, 1976 Cal-Am filed Application No. 56936 for approval of a \$4,000,000 construction loan from the Bank of America. By Decision No. 86850 dated January 11, 1977 the California Public Utilities Commission authorized Cal-Am to borrow \$4,000,000 from the Bank of America. The final papers for that loan were executed by Cal-Am and the Bank of America on March 16, 1977. A copy of that loan agreement was received as Exhibit 113 in these proceedings. The loan is now in effect and Cal-Am is obligated to pay interest thereon. Since March 16, 1977 Cal-Am has been in a position to draw down and expend those loan funds on the Canada de la Segunda Pipeline and Begonia Iron Removal projects.

Cal-Am's president testified that, since January 11, 1977 when the Commission authorized Cal-Am to borrow construction funds for the two projects from the Bank of America, and except for completion of the environmental review process, Cal-Am has been and is today ready in every respect to commence the construction of both

the Canada de la Segunda Pipeline and Begonia Iron Removal projects. He stated that, barring unforeseen calamities, and once the Final EIR is certified, Cal-Am will be able to commence and complete the two projects well within the time restrictions imposed by Ordering Paragraph 6 of Decision No. 86807, Ordering Paragraph 1 of Decision No. 86249, and Ordering Paragraph 1 of Decision No. 86359. He further testified that in 1976 alone, Cal-Am expended approximately \$259,000 to bring the projects to their present state of development.

Staff Proposal

The witness for the Commission staff testified that the loan agreement will allow Cal-Am to finance, on an interim basis, up to \$4,000,000 of the \$5,200,000 in new plant additions that the utility will have to make over the next 24 months. He expressed the opinion, however, that the acquisition of this line of credit does not, standing alone, obviate the need for the dividend restriction imposed by Ordering Paragraph 1 of Decision No. 86807. In his testimony, he stated that: "If Ordering Paragraph 1 were eliminated based solely on the ability of Cal-Am to substitute, via the interim bank loan, a substantial portion of the funds that would accrue to Cal-Am because of the dividend restriction, Cal-Am would still have the problem of complying with Ordering Paragraph 4 of Decision No. 86249. That is, Cal-Am would still be required to fund these new plant additions so as to maintain a recorded capital structure consisting of 50 percent debt and 50 percent equity."

The staff witness stated, however, that considering both the loan agreement and the settlement agreement reached among the parties to the Sweetwater District condemnation, that a modification of Ordering Paragraph 1 of Decision No. 86807 is justified. He was of the opinion that Ordering Paragraph 1 of Decision No. 86807 should be changed to read as follows:

"Until further order of this Commission California-American Water Company shall not transmit to American Water Works, Inc. or any subsidiary or employee of American Water Works, Inc., any funds received from the condemnation of its Sweetwater District or funds recovered from plaintiffs and/or intervenors for costs incurred in opposing the Sweetwater condemnation unless and until the total costs of the Monterey near-term phase projects are permanently financed."

Cal-Am/Staff Stipulation

With the testimony of the staff witness as a basis, the attorney for Cal-Am and staff counsel stipulated and agreed as follows:

- "1. The staff of the California Public Utilities Commission ('staff'), through the prepared direct testimony of Raymond J. Czahar, Financial Examiner in the Finance Division, which testimony is now Exhibit 118 in Case No. 9530, has proposed a modification to Ordering Paragraph 1 of Decision No. 86807. Because that recommended modification essentially imposes conditions which have already been imposed upon the Company pursuant to a private contract between California-American Water Company ('Cal-Am') and the Bank of America, NT&SA, and in the interest of expediting the conclusion of this proceeding and thereby materially reducing the Company's ongoing costs in connection therewith, Cal-Am is willing to enter into this Stipulation without prejudice to its legal position and subject to the reservations hereinafter set forth.
- "2. By entering into this Stipulation Cal-Am does not agree that the California Public Utilities Commission has the legal authority to restrict the use of such funds in the manner described in said Exhibit 118 and Cal-Am has not agreed to or accepted the staff's position regarding the right or authority of the California Public Utilities

Commission to restrict such funds and Cal-Am hereby reserves the right to dispute any such effort to restrict such funds in any subsequent California Public Utilities Commission proceeding.

"3. Ordering Paragraph 1 of Decision No. 86807 shall be stricken and of no force or effect.

"4. The following order shall be entered by the California Public Utilities Commission in the place and stead of said Ordering Paragraph 1 of Decision No. 86807:

"In the event of a successful condemnation of the Sweetwater District of Cal-Am by the South Bay Irrigation District and/or the City of National City, Cal-Am shall, from the amounts received therefrom, immediately credit the Sweetwater condemnation costs recorded in Account 146, Other Deferred Debits, subject to any liens or encumbrances on such property, and subject to payment on the Master Note of the Loan Agreement entered into between California-American Water Company and the Bank of America, NT&SA on March 16, 1977.

"In addition, Cal-Am shall use such proceeds to finance at least one-half ($\frac{1}{2}$) of the capital costs associated with the construction of the Canada de la Segunda Pipeline and the Begonia Iron Removal Plant Projects in Cal-Am's Monterey District.

"In the event the condemnation proceeding of Cal-Am's Sweetwater District by the South Bay Irrigation District and/or the City of National City is abandoned, any proceeds received therefrom as recoverable litigation costs shall be immediately credited to the Sweetwater condemnation costs recorded in Account 146, Other Deferred Debits.

"In addition, Cal-Am shall use such proceeds, to the extent possible, to finance at least one-half ($\frac{1}{2}$) of the capital costs associated with the construction of the Canada de la Segunda Pipeline and Begonia Iron Removal Plant projects in Cal-Am's Monterey District.

- "5. Entry of the foregoing order by the California Public Utilities Commission shall conclude the rehearing of Ordering Paragraph 1 of Decision No. 86807 as ordered by Decision No. 87082."

Findings

1. The rescinding of Ordering Paragraph 1 of Decision No. 86807 and its replacement with the ensuing order is prudent and justified in the circumstances. The replacement order will provide an equivalent safeguard to the financial integrity of Cal-Am.
2. In all other respects, Decision No. 86807 should remain unchanged, subject to further order of this Commission.
3. The Commission reaffirms its finding in Decision No. 86807 that under the circumstances developed in the record of this case it has, acting under the authority contained in Section 701 of the Public Utilities Code, taken together with its responsibility under Sections 451, 816, 817, and 851, the power to direct a California public utility to cease the payment of dividends or other transmission of funds to an affiliate, except in payment for value received.

O R D E R

IT IS ORDERED that:

1. Ordering Paragraph 1 of Decision No. 86807 is rescinded.
2. In the event of a successful condemnation of the Sweetwater District of California-American Water Company by the South Bay Irrigation District and/or the city of National City, California-

American Water Company shall, from the amounts received therefrom, immediately credit the Sweetwater District condemnation costs recorded in Account 146, Other Deferred Debits, subject to any liens or encumbrances on such property, and subject to payment on the Master Note of the loan agreement entered into between California-American Water Company and the Bank of America, NT&SA on March 16, 1977. California-American Water Company shall use such proceeds to finance at least one-half of the capital costs associated with the construction of the Canada de la Segunda Pipeline and the Begonia Iron Removal Plant projects in its Monterey District.

3. In the event the condemnation proceeding of California-American Water Company's Sweetwater District by the South Bay Irrigation District and/or the city of National City is abandoned, any proceeds received therefrom as recoverable litigation costs shall be immediately credited to the Sweetwater District condemnation costs recorded in Account 146, Other Deferrad Debits. California-American Water Company shall use such proceeds, to the extent possible, to finance at least one-half of the capital costs associated

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with the construction of the Canada de la Segunda Pipeline and Begonia Iron Removal Plant projects in its Monterey District.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 16th day of AUGUST, 1977.

~~Richard B. ...~~

~~William ...~~

I will concur
William Squous J.

Robert B. ...
President

Region 2 ...
Richard B. ...
Chairman ...
Commissioners

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MONTEREY PENINSULA DISTRICT OF
CAL-AMERICAN WATER CO.

COMMISSIONER WILLIAM SYMONS, JR., Concurring

I concur in Findings #1 and #2, but not in
Finding #3. None of the ordering paragraphs are
dependent on Finding #3, and I concur in each one:
Ordering Paragraphs #1, #2 and #3.

San Francisco, California
August 9, 1977

William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner