

ORIGINAL

Decision No. 88828

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of WEST MARIN WATER COMPANY, INC., a California corporation, for a Certificate of Public Convenience and Necessity under Section 1001 of the Public Utilities Code, and for Authority to Issue Stock and to Execute a Note.

Application No. 55727
(Filed June 9, 1975; amended April 26, 1977)

Jamie O. Harris, Attorney at Law, for West Marin Water Co., Inc. and David S. Adams & Sons, Inc., applicant.
Harvey M. Freed, Attorney at Law, for Gary J. Near, et al., protestants.
Thomas G. Hendricks, Attorney at Law, for County of Marin, interested party.
Jasper Williams, Attorney at Law, for the Commission staff.

O P I N I O N

David S. Adams & Sons, Inc. (DSA), aka Paradise Estates Water Company (Paradise), requests authority to transfer its public utility water system to West Marin Water Company, Inc. (West Marin); and in the same application West Marin requests authority to issue 6,000 shares of common stock, par value \$10 per share, to DSA as payment in full for the water system. The application was protested by 40 persons who are either customers of Paradise or are owners of unimproved lots within the service area of Paradise. Three owners of unimproved lots within the service appeared and testified in support of the application. A hearing was held on the matter

on August 22, 23, and 24, 1977 before Administrative Law Judge Pilling.

Paradise has 85 customers and its service area encompasses 175 separate lots on 419 acres. Approximately one-half of the practical building sites in the service area have been built upon and some additional development is foreseeable in the future. DSA started the system in 1952 to provide water service to the Paradise Ranch Estates subdivision which DSA was developing. In Decision No. 86677, dated November 23, 1976, the result of a complaint by many customers of the system, the Commission found that no certificate had been issued by the Commission for the construction of the system but that the operation of the system by DSA constituted DSA a public utility water company. That decision also ordered Paradise not to make any new connections to the system until further order of the Commission and to upgrade the approximately 20-year old system. The Marin County Board of Health has also ordered Paradise not to make any new connections until certain deficiencies are corrected.

The principal business of DSA is the ownership, development, and sale of real estate. While the water system is owned directly by DSA, DSA has caused the accounting for the water system operation to be kept in separate accounting records designated as the accounting records of West Marin with fiscal years ending on April 30th. According to the Commission's staff investigation, the system had a net adjusted operating loss in 1976 of \$12,202 and a loss in 1977 of \$8,668 (after elimination of extraordinary legal expenses of \$12,000 in 1976 and \$25,329 in 1977). Its adjusted gross income in 1977 was \$10,162. The system's adjusted balance sheet as of April 30, 1977 showed a minus net worth of \$60,442, the largest liability on the balance sheet being an item of \$110,835 representing advances from DSA. The water system has never shown a profit. During

the year ending April 30, 1977 DSA sold real estate with a recorded book value of \$152,456 for \$259,431 and had a recorded net profit, before federal income tax, of \$52,200 in its real estate operation. DSA currently owns real estate with a recorded book value of \$92,543 subject to a mortgage of \$22,000. Some of the real property is located as far away as Bakersfield. As of April 30, 1977 DSA's real estate business showed a net worth of \$128,458 principally due to its carrying on its books an asset of \$138,554 representing an advance to the water system recorded as \$120,885 and a proprietorship interest in the system of \$17,669.

DSA represented at the hearing that if DSA is allowed to transfer ownership of the water system to West Marin in exchange for 6,000 shares, par value \$10, of West Marin's common stock issued to DSA, DSA will assume all liabilities then chargeable to the system, cancel the indebtedness for the advance of monies to the system, and contribute \$7,500 cash to West Marin. DSA presented a pro forma balance sheet of West Marin as of August 18, 1977 depicting West Marin's financial standing, assuming the transfer was effected on that date, and showed the following:

<u>Assets</u>		
<u>Current</u>		
Cash in Bank	\$7,780	
Accounts Receivable	<u>2,462</u>	
Total Current Assets		\$10,242
<u>Fixed</u>		
Water Plant in Operation	87,084	
Less Account Depreciation	<u>(19,458)</u>	
Net Fixed Plant		67,626
Total Assets		<u>\$77,868</u>
<u>Liabilities</u>		
<u>Current</u>		
Long-Term Debt		-
<u>Stockholder's Equity</u>		
Common Stock 6,000 Shares, \$10 Par Value	60,000	
Surplus	<u>17,868</u>	
		\$77,868

West Marin has applied for a loan under the Safe Drinking Water Bond Law, the proceeds of which are to be used to upgrade the water system.

DSA contends that placing the system in a business entity organized exclusively to own and operate the system is in the best interest of the system from the point of view of efficient management, financing, and accounting. In support of its requested transfer DSA states that there will be no change in the physical system or service area itself; that there will be no lessening or escape from public utility service obligations; that the water system will continue to have the same management; that the transfer will have no effect, in and of itself, on rates and will allow no potential for discrimination between customers; that the transfer will not create any indebtedness of the system; that the transfer will tend to protect the water system assets

from losses, obligations, and potential liabilities of DSA^{1/}; that the proposed transfer would minimize the rate base in future ratemaking proceedings; that public convenience will be served by having only one set of books and financial records for the water system which are not entangled with those of a company involved in the other nonutility operations; that present service is reasonably adequate; and that public interest would not be harmed since the transfer will result in no different impact on the customers than would result if DSA simply exercised its legal rights and transferred out of DSA all of its nonutility property.

In support of their objection to the transfer, protestants contend that the transfer would substitute an insolvent corporate shell in lieu of a highly profitable realty development corporation; would permit DSA, now that most of the lots have been sold and substantial land sale profits accumulated, to spin off the water operation to escape from its burdensome liability and to divest itself of its responsibilities to the subdivision lot purchasers; would prevent the Commission, in future rate setting proceedings, from taking into account the land development income derived by DSA, even though the realty and water operations have been financially interwoven for the past 25 years; and would not authorize West Marin to supply water because neither DSA nor West Marin has a water purveyor permit.

The staff opposes the transfer contending the transfer would be adverse to the public interest because West Marin would not have sufficient revenue to meet its operating expenses and West Marin's credit position would be impaired. Additionally, since no offsetting provision has been made for the predictable

^{1/} Some property owners who bought lots from DSA and are unable to get water service from Paradise because of the ban on new connections have suits against DSA totaling over \$1,000,000.

negative cash flow which West Marin would experience, the transfer would result in the company's insolvency. While a proposed rate increase may offer some relief in this respect, the length of time it would take to put the company on a sound financial footing is unknown.

Discussion

Three of DSA's contentions in support of the transfer warrant discussion. The first contention is that the proposed transfer would tend to protect the water system's assets from losses, obligations, and potential liabilities incurred by DSA in its real estate ventures. We do not agree. The stock which will be issued by West Marin to DSA representing ownership of the corporation which owns the system would be a DSA asset reachable by any of DSA's judgment creditors, hence changing the form of ownership of the system from direct ownership to stock ownership would not tend to protect the water system's assets from losses, obligations, or potential liabilities incurred by DSA in its real estate ventures. The second contention is that the transfer would minimize the rate base in future ratemaking proceedings. We again disagree. Since rate base by general definition is the capital employed which is necessary to provide the utility service, the form of ownership of a water system should have little or nothing to do with its rate base. The third contention is that the transfer will result in no different impact on the customers than would result if DSA simply exercised its alleged legal rights and transferred out of DSA all of its nonutility property to a corporation owned 100 percent by DSA leaving in DSA only utility related property. Again we disagree. Left in DSA the nonutility property, at least in part, when converted to cash represents a source of interest free capital readily available for use by the water system for maintaining adequate service

and for meeting the requirements prescribed in our Decision No. 86677 and the requirements of the County Board of Health. With this source of capital available DSA can avoid further financially burdening the water system, already in poor financial shape, with interest payments, which might be the result if DSA did not use the available capital which was within its corporate framework and instead borrowed any needed money at whatever interest rate DSA could obtain. Separating the utility property from the nonutility property at this time would be an imprudent business practice from the point of view of the public utility water system, as the use of the nonutility property or the borrowing power it affords would be lost to the system, and could result in the Commission's future disallowance as an expense item in the rate base of interest payments on unneeded monies borrowed by the system to the extent the value of the nonutility property would have covered those needs.

Findings

1. DSA requests authorization to transfer its water system to DSA's subsidiary corporation, West Marin, in exchange for 6,000 shares of West Marin's common stock.
2. The water system, constructed in 1952 to service a residential real estate subdivision which DSA was developing, has never shown a profit.
3. The proposed transfer would not result in converting the water system into a profitable operation.
4. The proposed transfer would cause the water system, which is badly in need of capital now, to lose borrowing power in securing loans to continue business.
5. The proposed transfer would not result in the system being covered by a County Board of Health water purveyor permit.
6. The proposed transfer is not in the best financial interest of the water system.

Conclusions

1. The proposed transfer is not in the public interest.
2. The application should be denied.

O R D E R

IT IS ORDERED that Application No. 55727 is denied.

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

Dated at San Francisco, California, this 16th day of MAY, 1978.

I abstain
Robert Batistoni

President
William S. ...

Robert D. ...

Walter J. ...
Commissioners