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Decision 93587 OCT 6 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of LAGUNA HILLS WATER COMPANY for an order authorizing an increase in rates.	Application 58440 (Filed October 27, 1978; amended January 4, 1979 and May 29, 1979)
Arthur H. Burnett, Complainant, vs. Rossmoor Water Company, a corporation, Defendant.	Case 10578 (Filed May 23, 1978)
Lawrence T. Solomon, Complainant, vs. Rossmoor Water Company, Defendant.	Case 10595 (Filed June 12, 1978)
A. L. Leyva Trust, Complainant, vs. Rossmoor Water Company, Defendant.	Case 10604 (Filed June 26, 1978)

Lawrence Solomon and Stanley Solomon, Complainants, vs. Rossmoor Water Company, Defendant.	Case 10605 (Filed June 26, 1978)
Greenville Development Company, Complainant, vs. Rossmoor Water Company, Defendant.	Case 10606 (Filed June 26, 1978)
Syd Carnine, Complainant, vs. Rossmoor Water Company, Defendant.	Case 10607 (Filed June 26, 1978)
Stanley Solomon, Complainant, vs. Rossmoor Water Company, Defendant.	Case 10610 (Filed June 27, 1978)

Lloyd E. Rigler, individually, and Lloyd E. Rigler as executor of the estate of Lawrence E. Deutsch, deceased, Complainants, vs. Laguna Hills Water Company, a corporation, Defendant.	Case 10757 (Filed June 15, 1979)
Holstein Industries, Complainant, vs. Laguna Hills Water Company, Defendant.	Case 10764 (Filed July 30, 1979)
Application of LAGUNA HILLS WATER COMPANY for an interpretation of, or a deviation from, the Commission's uniform main extension rule.	Application 59023 (Filed July 26, 1979)
Application of LAGUNA HILLS WATER COMPANY to incur a long-term debt in the principal amount of $1.4 million and to service such debt through a surcharge on its rates and charges for water resulting in an increase in applicant's rates and charges for water.	Application 59032 (Filed July 30, 1979)

Application of LAGUNA HILLS WATER COMPANY to deviate from the provisions of the uniform main extension rule.	Application 59051 (Filed August 7, 1979)
Application of LAGUNA HILLS WATER COMPANY for a deviation from the Commission's uniform main extension rule.	Application 59748 (Filed June 20, 1980)
In the Matter of the Application of LAGUNA HILLS WATER COMPANY, for modification of Decision No. 91236.	Application 58861 (Petition filed October 30, 1980)
Application of LAGUNA HILLS WATER COMPANY to deviate from the provisions of the uniform main extension rule.	Application 60149 (Filed December 17, 1980)

(Appearances are listed in Appendix A.)

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DECISION ON APPLICATIONS 58861, 59023, 59051, 59748, AND 60149

I. GENERAL

Background

In recent years Laguna Hills Water Company (LHWC) has suffered a severe liquidity deficiency. Of the combination of factors responsible for this deficiency, which is a result of unmet demands placed on LHWC's cash flow, the predominant ones are:

1. The large share of LHWC's utility plant financed by advances under the main extension rule;
2. Rapid occupancy of subdivisions and other developments in LHWC's service area;
3. Numerous increases in response to LHWC's rapidly rising cost of purchased water and its other cost increases making the refund provisions of the main extension rule far more onerous than intended; and
4. LHWC's undercapitalization and its inability to obtain external financing.

In the general rate proceeding phase (Application (A.) 58440) of the originally consolidated matters (A.58440 and Cases (C.) 10578, 10595, 10604, 10605, 10606, 10607, and 10610) we issued two interim decisions. In Decision (D.) 90006 dated February 27, 1979 we found that LHWC was confronted by a financial emergency and authorized an interim increase in rates. In the second interim decision (D.91915 dated June 17, 1980) we resolved the rate case issues other than fair rate of return. Instead of making a final determination on the latter issue, we established a provisional rate of return for LHWC pending further

hearing. This was done because the fair rate of return issue was inextricably linked to the outcome of the then newly filed A.59023, A.59032, and A.59051 by which LHWC was seeking to alleviate its financial problems.

Further Consolidations and Hearing

Before hearings were resumed earlier this year, the number of consolidated matters doubled. Formal complaints were increased from 7 to 9 (C.10757 and C.10764 being added), and applications were increased from 1 to 7 (A.59023, A.59032, A.59051, A.58861, A.59748, and A.60149 being added). LHWC's serious financial condition affects all of the 16 consolidated matters.

Since the issuance of the second interim decision (D.91915, supra), public hearings were held January 26-30, 1981 and March 11-13, 1981 in Los Angeles before Administrative Law Judge Main. On March 13, 1981 A.58861, A.59023, A.59051, A.59748, and A.60149 were submitted pending briefing.

Opening briefs were due 20 days following the later of the filing of transcripts or the service on the parties of a letter from LHWC regarding (1) the results of an application to United California Bank (UCB) for a loan of $500,000 and (2) the intent of LHWC to issue stock through LHWC's parent corporation, Laguna Hills Utility Company (LHUC), to LHUC's principal shareholder to raise $500,000. On March 26, 1981 that letter was served upon parties. The transcripts were filed March 24, 1981. Opening briefs were mailed for filing by April 15, 1981 and reply briefs by April 30, 1981.

The other consolidated matters were not submitted at the conclusion of the March 1981 hearings. The resolution of these remaining matters will depend upon the determinations made in this decision on the 5 applications submitted and upon the outcome of the foregoing debt and equity financing proposals totaling $1 million.

Summary of Decision

This decision provides a basis for resolving the financial difficulties of LHWC. The decision:

1. Stabilizes, in response to A.59023, future in-tract main extension refunds on currently outstanding contracts by basing refunds on constant rate (January 1, 1981) levels for water service, thereby making the refunds independent of the continuing upward spiral in the cost of purchased water;
2. Stretches out, by granting A.59051, A.59748, and A.60149, the period for refunds on special facilities which have recently come on line, or which are about to come on line, making the timetable for the refunds manageable; and
3. Provides for, in conjunction with separate decisions to be issued concurrently with this decision, more adequate capitalization through authorizing LHWC's proposals for additional debt (A.60490 filed April 29, 1981) and equity (A.60491 filed April 29, 1981) financing.

The decision also resolves the remaining aspects of A.58861. In that application LHWC was authorized by Interim D.91236 dated January 15, 1980 to issue 3,440 shares of its capital stock to its parent corporation, LHUC, in order to repurchase and terminate main extension contracts (MECs) held by LHUC as well as repay overdue amounts on those MECs. By this decision, the requests for increases in the number of shares of LHWC's stock authorized by D.91236, supra, are denied.

The formal complaints and the other pending matters in this consolidated proceeding will be the subject of future decisions, probably to be rendered upon LHWC's obtaining the new financing under A.60490 and A.60491.

The Submitted Matters

This decision is determinative of the 5 applications summarized below:

A.59023 - LHWC seeks authority to repay sums due MEC holders in a manner different than that provided for in Section C.2.b. of the main extension rule. Rather than repaying advanced sums to MEC holders based upon 22% of the prior year's revenue from the extension for which construction sums were advanced, the application seeks to base each annual year's repayment upon the revenues derived from that extension as though the rates in effect on the date the MEC was entered into were still in effect. The application does not seek to reduce the existing contract balances.

The application also seeks, with respect to the manner of valuing terminated MECs, a determination that in fixing the maximum contract repurchase price under Section C.3.a. of the main extension rule, consideration shall be given to the refunds required under Section C.2.d. during the 21st through 25th year of the MEC.

A.59051 - LHWC seeks authority to repay $1.5 million advanced by LPD Associates (LPD) for special facilities as follows: Rather than repaying that sum to LPD under the special facilities provisions of Rule 15, the main extension rule, LHWC proposes to repay those sums to LPD under the 22% of revenue method employed in Section C.2.b. of Rule 15 provided, however, that no annual payment shall exceed 5% of the original $1.5 million on a cumulative basis. In effect, this application seeks authority to repay the $1.5 million to LPD in $75,000 per year annual payments for a period of 20 years.

A.59748 - LHWC seeks to add amounts presently overdue on MECs held by Laguna Village, Inc. (Laguna Village) (plus interest) to the presently outstanding contract balances of those contracts and to repay the resulting contract balance over a period of 20 years from the dates of execution of the contracts. The repayment period would commence on the earlier of (1) July 1, 1986 or (2) July 1 of the calendar year immediately following the calendar year in which LHWC's outstanding MEC balance is equal to or less than 30% of LHWC's capitalization. Upon commencement of payments, the amount of each annual payment will be determined under Section C.2.b. of the main extension rule (the 22% of revenue provision) provided that for purposes of determining each annual payment the water rates employed shall be those in effect on January 1 of the calendar year prior to the calendar year in which the payments commence. Moreover, the agreement places a ceiling on each annual payment so that in no instance will the amounts advanced under any MEC be fully repaid in a period less than 20 years following the original execution of the individual MEC.

In addition, A.59748 seeks authority to execute new MECs with Laguna Village. The new MECs shall be limited to an amount of $500,000. The repayment of the sums advanced under the new MECs shall commence at the same time as the repayments of the sums due under the older MECs commence (i.e., July 1, 1986 or July 1 of the calendar year immediately following the calendar year during which LHWC's outstanding MEC balance is equal to or less than 30% of LHWC's capitalization). Moreover, the computation of the payment due each year shall be the same as that described above for the payment of sums due under existing MECs. Finally, once payments commence, no annual payment shall exceed 5% of the amounts advanced. Therefore, repayment of the new MECs could not occur over a period less than 20 years.

Finally, A.59748 seeks to convert the $62,428 unrefunded balance of a special facilities contract (S-211) into a promissory note. The note will bear interest at 10% per annum. With respect to sums presently due and unpaid, interest at 10% shall be computed from May 31, 1980 to December 31, 1984. With respect to sums which, but for this application, would become due under the provisions of Rule 15, interest at 10% per annum shall be computed from the date those sums are expected to become due under the main extension rule through December 31, 1984. The full amount of the principal and accrued interest on the note is due and payable on December 31, 1984.

A.60149 - LHWC seeks to execute promissory notes to the Mathis Ranch Land Company (Mathis) and Warmington Development, Inc. (Warmington) in the amount of $386,586.90. LHWC proposes to repay this sum to Mathis and Warmington under the terms of these notes rather than under the special facilities contract provisions of Rule 15. The entire advanced amount will be due on October 1, 1984. Interest at 10% will be paid annually.

A.58861 - LHWC seeks authority to issue a sufficient number of shares of $100 par value stock to its parent corporation, LHUC, in order to repurchase and terminate MECs held by LHUC as well as repay overdue amounts on those MECs.

By Interim D.91236 issued January 15, 1980, the Commission authorized LHWC to issue 3,440 shares of $100 par value stock to LHUC to repurchase MECs held by LHUC. Whether additional shares should be issued for this purpose was to be determined after public hearing.

Four of these applications (A.59023, A.59051, A.59748, and A.60149) are intended to alleviate LHWC's present cash-flow dilemma. A 2-pronged strategy is employed for that purpose:

1. LHWC seeks through A.59023 to reduce its annual obligation to repay amounts due under the "22% of revenue" provision of the MECs, which has been a predominant element in LHWC's liquidity deficiency; and

2. LHWC seeks to shift presently due obligations and obligations which will be due during the early 1980s to the later 1980s or beyond. A.59051, A.59748, and A.60149 represent LHWC's principal efforts in this regard.

Positions of the Parties

Each of the following parties urged the unconditional granting of the application in which approval of its individual agreement with LHWC is sought:

Mathis and Warmington, parties to the agreement with LHWC for which approval is sought in A.60149.

LPD, a partnership consisting of the William Lyon Company, Pacesetter Homes, and Sterling Homes. A.59051 seeks approval of an agreement between LPD and LHWC.

Laguna Village, the party to the agreement with LHWC for which approval is sought in A.59748.

LHWC's position is that A.59023, A.59051, A.59748, and A.60149 should be approved as filed. In addition, A.58861 should be approved with the valuations of LHUC's MECs determined by employing 1979 revenues.

Lawrence T. Solomon, A. L. Levva Trust, Stanley Solomon, Greenville Development Company, Syd Carnine, and Holstein Industries, complainants in C.10595, C.10604, C.10605, C.10606, C.10607, C.10610, and C.10764, and General Development Company, an MEC holder, all represented by Frederick Simmons (The Simmons Group), oppose the relief sought in A.59023. Professional Community Management, Inc., Golden Rain Foundation, and Mutual Housing Corporations Inside Leisure World (PCM) support the granting of A.59023 and A.59051. PCM opposes the granting of A.59748 and A.60149 and supports the staff position on A.58861.

Commission staff's original recommendation on A.59023 was that it be granted to the following extent: Future MEC payments should be based upon water rates in effect on January 1, 1981 and amounts presently overdue to MEC holders should be repaid over a period of 5 years with interest at 12%. After the possibility of additional financing was raised at the March hearings, the staff position on A.59023 was modified.

It then became: If LHWC is able to raise $500,000 in debt and $500,000 in equity, the loan should be used to repurchase MECs and the stock issuance to repay amounts presently overdue on MECs. If a lesser amount of funds is available, those funds should be employed to repurchase MECs rather than repay overdue amounts. However, whether LHWC obtains $1 million in financing or some lesser amount, the staff remains of the view that A.59023 should be granted to the extent that MEC repayment levels should be based on the rates in effect on January 1, 1981.

For A.59051, A.59748, and A.60149, 2 sets of recommendations are offered by the staff. In the event that LHWC is able to obtain a $500,000 loan and raise an additional $500,000 through the issuance of equity, the staff recommends the granting of A.59051, A.59748, and A.60149 as filed, with one exception. As the exception, the staff recommends that the refunds on $500,000 in new MECs under A.59748 commence not earlier than July 1, 1986.

In the event that LHWC is unable to obtain both debt and equity funding in the amounts specified, the staff position with respect to A.59748 and A.60149 reverts to that set forth in Exhibit 42 (i.e., the unrefunded balance of $62,428 in the special facilities contract (S-211) referenced in A.59748 would be contributed to LHWC rather than converted to a promissory note; the $386,000 note for which approval is sought in A.60149 would be reduced to $300,000 with the $86,000 difference becoming a contribution), and with respect to A.59051 reverts to that set forth in Exhibit 63 (i.e., the repayment period for the $1.5 million is reduced from 20 to 10 years and the first annual payment becomes due in 1985 instead of 1981).

The staff position in A.58861 is that LHWC should not be authorized to issue stock additional to that already authorized to compensate LHUC for the termination value of the MECs it held.

II. 1984 REFINANCING

In assessing LHWC's present financial difficulties and the remedial measures required, it is important also to have 1984 as a focal point. In 1984 LHWC will have to refinance its Series A first mortgage bonds. The Series A bonds have a balance of $999,300 and are due October 1, 1984. In addition to the Series A bonds, LHWC will have to refinance in 1984 $452,367 in notes payable if A.59748 and A.60149 are granted and the $500,000 loan, now contemplated from UCB, if obtained.

The few years remaining until 1984 are critical. During this period LHWC should develop a record of not only meeting its obligations when due but of adequate earnings, cash flow, and interest coverage, which are the essentials to carrying out the 1984 refinancing.

Pacific Mutual Life Insurance Company (Pacific Mutual) is the lender on the Series A bonds (as well as LHWC's Series B bonds, presently having a balance of $1,365,000 but not becoming due until 1991). According to the staff witness, Pacific Mutual has made known that it views the present high level of LHWC's MEC refunds and the effects of inflation as causes for serious concern, presumably with reference to its potential role in the 1984 refinancing.

III. THE CASH-FLOW DEFICIENCY AND ITS CAUSES

At December 31, 1980, LHWC was in default under MEC refund obligations aggregating $512,000;[1/] advances for construction, including the overdue refunds, were $3,955,674, or 30.2% of net utility plant; and net utility plant was $13,090,341. Moreover,

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1/ Exclusive of the refund obligations which led to A.59051 (LPD contract) and A.59748 (Laguna Village contract).

$3,195,201 of the net utility plant was financed by contributions in aid of construction, which provide neither earnings nor cash flow as they are excluded from rate base and depreciation expense in the determination of rates. In light of the portions financed by advances and contributions, it is seen that less than one-half of the net utility plant is funded by debt and equity capital.

The primary cause of the cash-flow deficiency is LHWC's burgeoning annual refund obligation on the advances for construction. Under the main extension rule refunds of advances for in-tract facilities are based on 22% of gross revenues received from the development served by the extension, and refunds for special facilities are made on a pro rata basis as the units of the development served by the special facilities are occupied.

Under the "22% of revenue" provision (Section C.2.b. of the rule) LHWC's MECs are projected to be repaid over an average period of 14.2 years rather than 20 years nominally contemplated by the rule. This speedup in the refunding is a product of numerous rate increases, mostly in response to rapid increases in the cost of purchased water. However, while LHWC may recover the increased costs of water on a dollar-for-dollar basis through the purchased water balancing account, that balancing function is neither intended nor does it operate to authorize an increase in net operating revenues. Thus, net operating revenues simply do not grow along with LHWC's MEC repayment obligation.

Similarly, LHWC cannot generate sufficient funds through depreciation to meet the MEC payment, since the life of the asset built with the funds obtained from an MEC is substantially longer for depreciation purposes than the repayment period of the MEC. The funds to meet the MEC repayment obligations must then come from an infusion of capital or out of net operating revenues, which are normally employed to meet sinking fund and interest obligations on outstanding long-term debt, replace existing plant, and in the case of some utilities, but not LHWC, pay dividends.

The pattern of growth in "22% of revenue" refund obligations of LHWC under the present rule is shown in the tabulation below. Refunds are accrued during the revenue year shown and are payable in the following year.

Revenue Year	Refunds (22% of Revenue Basis)	
1977 Adjusted	$176,227	
1978 "	186,477	
1979 Estimated	250,000)	
1980 "	302,600)	
1981 "	337,500)	Exhibit 35
1982 "	328,000)	
1983 "	319,200)	
1984 "	330,300)	

Under Section C.2.c. of the main extension rule, refunds of advances for special facilities are determined on a per-unit-served basis as follows:

> "...the amount so advanced shall be divided by the number of lots to be served by the special facilities. This advance per lot shall be refunded for each lot on which one or more bona fide customers are served by those facilities."

As a newer, fast-growing utility with less than one-half of its net utility plant funded by debt and equity financing, LHWC has found the special facilities refund provisions particularly burdensome. Applying that refund requirement to the developments involved in A.59051, A.59748, and A.60149 is illustrative of this burden: The rule requires that LPD's $650,000 advance be repaid over a 5-year period with the bulk of the repayments due in a 4-year period; the bulk of the $65,000 due to Laguna Village would be due within a 3-year period; and the $386,000 advanced by Mathis and Warmington would be due over a 4-year period with over $300,000 of that sum due prior to 1981.

IV. CASH-FLOW PROJECTIONS

In this proceeding projections of LHWC's earnings and cash flow have been made for a number of different scenarios. In Exhibits 63, 64, and 65 the projections are for the period 1981 through 1990 under 6 scenarios. The earnings projections assume that attrition will be limited, through timely rate relief, to one-half of 1% in authorized rates of return. In projecting the authorized rates of return, the return on equity is held constant at the presently authorized level of 12.85%, while rate of return itself can otherwise vary to accommodate changes in capital ratios and cost of debt.

The starting point of the cash-flow projections is the cumulative cash deficiency at December 31, 1980. This initial deficiency ranges from $229,700 (Exhibit 63, Table IIIB) to $1,168,400 (Exhibit 63, Table IB), depending on the scenario. The scenarios are:

Exhibit 63, Table IB - No Deviation From Main Extension Rule (i.e., denial of A.59023, A.59051, A.59748, and A.60149).

Exhibit 63, Table VB - Limited Deviations From Main Extension Rule (i.e., approval of A.59051, A.59748, and A.60149 and denial of A.59023).

Exhibit 63, Table IIB - LHWC-Proposed Deviations From Main Extension Rule (i.e., approval of A.59023, A.59051, A.59748, and A.60149).

Exhibit 63, Table IIIB - Staff-Proposed Deviations From Main Extension Rule. "This projection is to reflect the assumption that main extension refund payments will be frozen at tariff rates in effect at January 1, 1981. Currently overdue main extension refund payments will be deferred with interest at 12% to be paid in five equal annual installments beginning in 1981. Refunds for 1980 and subsequent years will be repaid as they become due. Special facilities contract amounts are reduced."

Exhibit 64 - $350,000 Loan to Pay Overdue MEC Refunds; approval of A.59051, A.59748, and A.60149; and approval of A.59023 to the extent that MEC refund payments will be based on revenues computed at tariff rates in effect at January 1, 1981.

Exhibit 65 - $500,000 Loan to Buy Back MECs; approval of A.59051, A.59748, and A.60149; approval of A.59023 to the extent that MEC refund payments will be based on revenues computed at tariff rates in effect at January 1, 1981; and overdue main extension refund payments will be deferred with interest at 12% to be paid in 5 equal annual installments beginning in 1981.

Exhibit 65 Modified - Same as Exhibit 65 above except cumulative cash deficiency at December 31, 1980 is recast to be consistent with Exhibit 63, Table IIIB.

In part A of the comparative summaries tabulated below, the cumulative cash-flow deficiency at December 31, 1980 under each of the 7 scenarios is developed and in part B the results of the projections under the 7 scenarios through 1984, a critical year because of refinancing, are shown.

A - Development of Cumulative Cash-Flow Deficiency at December 31, 1980
(Dollars in Thousands)

Scenario (1)	Cumulative Deficiency at 12/31/79 (2)	Adjustments (3)	1980 Net Cash Flow (4)	Cumulative Deficiency at 12/31/80 (5)=(2)+(3)+(4)
Exhibit 63, Table IB	$(767.2)	$90.3 a/	$(491.5)	$(1,168.4)
Exhibit 63, Table VB	$(767.2)	$249.1 b/	$(55.0)	$(573.1)
Comment: Comparing the above 2 scenarios indicates cumulative deficiency at 12/31/80 would be reduced by $1,168.4 - $573.1 = $595.3 if A.59051, A.59748, and A.60149 are approved.				
Exhibit 63, Table IIB	$(767.2)	$249.1 b/	$(55.0)	$(573.1)
Exhibit 63, Table IIIB	$(767.2)	$592.5 c/	$(55.0)	$(229.7)
Comment: The staff proposal to defer currently overdue main extension refund payment (Exhibit 63, Table IIIB) would reduce the cumulative deficiency at 12/31/80 by a further $412.1 (i.e., $573.1 - $229.7 + $68.7 = $412.1).				
Exhibit 64	$(767.2)	$249.1 b/	$(55.0)	$(573.1)
Exhibit 65	$(767.2)	$249.1 b/	$(55.0)	$(573.1)
Exhibit 65 Modified*	$(767.2)	$592.5 c/	$(55.0)	$(229.7)

(Red Figure)

a/ Partial payment on overdue MEC refunds made in 1980.

b/ Note a/ above plus $158.8 reflecting approval of A.59051, A.59748, and A.60149 which was included in cumulative deficiency at 12/31/79.

c/ Note b/ above plus $343.4 balance of overdue MEC refunds included in cumulative deficiency at 12/31/79.

* Modified to accord same treatment to $343.4 balance of overdue MEC refunds included in cumulative deficiency at 12/31/79 as that given it in Exhibit 63, Table IIIB.

B - Results of Cash-Flow Projections
(Dollars in Thousands)

Scenario	Cash Flow Net or Cumulative	1981	1982	1983	1984
Exhibit 63, Table IB	Net for Year	$163.4	$(10.7)	$345.1	$417.1
	Cumulative	$(1,005.0)	$(1,015.7)	$(670.6)	$(253.5)
Exhibit 63, Table IIB	Net for Year	$298.3	$358.6	$405.4	$384.9
	Cumulative	$(274.8)	$83.8	$489.2	$874.1
Exhibit 63, Table IIIB	Net for Year	$212.3	$131.5	$225.6	$252.7
	Cumulative	$(17.4)	$114.1	$339.7	$592.4
Exhibit 63, Table VB	Net for Year	$287.0	$188.1	$262.3	$264.3
	Cumulative	$(286.1)	$(98.0)	$164.3	$428.4
Exhibit 64	Net for Year	$253.3	$129.7	$226.0	$301.5
	Cumulative	$30.2 a/	$159.9	$385.9	$687.4
Exhibit 65	Net for Year b/	$282.1	$127.3	$203.2	$294.3
	Cumulative	$(222.3)	$(26.3)	$245.6	$608.6
Exhibit 65 Modified*	Net for Year	$282.1	$127.3	$203.2	$294.3
	Cumulative	$52.4	$179.7	$382.9	$677.2

(Red Figure)

a/	
Cumulative deficiency at 12/31/80	$(573.1)
Bank loan to pay overdue MEC refunds	350.0
1981 net cash flow	253.3
Cumulative net cash flow at 12/31/81	$ 30.2

b/ Understated by $68.7 each year because installment payment on overdue refunds already reflected in cumulative deficiency at 12/31/80.

* Cumulative deficiency at 12/31/80 of $229.7 consistent with Exhibit 63, Table IIIB.

In part A of the above tabulations, it was noted that the $1,168,400 deficiency at December 31, 1980 would be reduced by $595,300 if A.59051, A.59748, and A.60149 are approved. It was also noted that the deficiency would be further reduced by $412,100, or to $229,700, under the staff proposal (Exhibit 63, Table IIIB) to defer payment of currently overdue refunds and provide for the repayment of that obligation in 5 equal installments beginning in 1981. A similar result was obtained in Exhibit 64 where, instead of the deferral, a $350,000 bank loan provides funds to repay the overdue refunds (i.e., the $573,100 cumulative cash deficiency at December 31, 1980 under the Exhibit 64 scenario adjusts to $573,100 - $350,000, or $223,000, upon giving effect to the loan).

Comparing the projected results in part B of the above tabulations for the Exhibit 63, Table IIB scenario with either the Exhibit 63, Table VB or Table IIIB scenarios gauges the impact on cash flow of LHWC's A.59023 proposal of basing prospective refunds on the rate level in effect at the time the MEC was executed: In relation to Exhibit 63, Table VB, which reflects denial of A.59023, the projected cumulative cash flow by the end of 1984 is $709,800 greater in Exhibit 63, Table IIB; in relation to Exhibit 63, Table IIIB, which reflects basing MEC refunds on rate levels in effect January 1, 1981, the projected cumulative cash flow by the end of 1984 is $281,700 greater in Exhibit 63, Table IIB.

In the scenarios of Exhibits 64 and 65, the projections reflect outside financing being applied to paying overdue refunds and to buying back MECs, respectively. The Exhibit 65 projections can also serve as a guide in approximating the impact of LHWC's current proposals to obtain a $500,000 loan and to issue $500,000 of capital stock on its cumulative cash flow or working capital. The approximation is:

	1981	1982	1983	1984
Exhibit 65 Cumulative Cash Flow	$(222.3)	$(26.3)	$245.6	$ 608.6
Adjustment for $500.0 Stock Issue	500.0	500.0	500.0	500.0
Resultant Cumulative Cash Flow	$ 277.7	$473.7	$745.6	$1,108.6

(Red Figure)

V. UNDERCAPITALIZATION

The submitted matters (A.59023, A.59051, A.59748, and A.60149) address LHWC's financial problem as it relates to:

1. Stabilizing future in-tract main extension refunds on currently outstanding contracts by basing refunds on constant rate levels for water service in order to avoid the continuing upward spiral in refund obligations resulting from the increases in the cost of purchased water and other expenses; and

2. Stretching out the period for refunds on special facilities which have recently come on line, or which are about to come on line, to make the timetable for refunds manageable.

The submitted matters do not address LHWC's undercapitalization.

Although more debt and equity capital are essential both to having adequate working capital and to improving a capital structure presently containing about 50% advances for construction, obtaining funds in either form appeared unlikely until very recently. In fact, the staff report (Exhibit 42), which was presented during the January 1981 hearings, stated:

> "Because of inadequate cash flow and LHWC's inability to meet its obligations as they become due, the utility finds itself in a 'Catch 22' situation, i.e., to solve its present financial problems, the utility needs massive sums of new capital, but lenders are unwilling to loan additional funds because of the utility's precarious financial condition. With its parent company stock presently selling at one-third of book value, the utility is likewise unable to raise additional equity capital. (The parent company stock is the only publicly traded stock.)"

However, as the January hearings progressed, it became clear that LHWC's financial statements for 1980 would show substantially improved earnings and a reduction in the working capital deficit, making a renewal of efforts toward obtaining outside financing appear worthwhile. In due course, LHWC's financial statements showed the anticipated improvement: Net income for 1980 was $533,779 and the working capital deficit was reduced from $1,214,360 at December 31, 1979 by $658,396 to $555,964 at December 31, 1980. The latter improvement was attributable, in large part, to $452,367 in notes payable under the renegotiated main extension and special facilities contracts in A.59748 and A.60149, which are yet to be approved, being accounted for in 1980 as long-term debt.

Before the March 1981 hearings, the staff urged LHWC to renew its attempts to secure outside financing. As a result, LHWC's vice president-controller Sakai testified at those hearings that LHWC had applied to UCB for a $500,000 loan and that in the event the loan application to UCB was denied, the principal shareholder of LHWC's parent corporation, LHUC, would consider providing $500,000 in equity funding through the parent corporation. Sakai stressed that funding from either of these two sources would largely depend upon the results of this proceeding in that LHWC's loan application to UCB was premised specifically upon (1) approval of the staff position in A.59023, (2) granting of A.59051, A.59748, and A.60149 as applied for, and (3) timely incorporation of both the promissory notes referenced in A.59748 and A.60149 and the debt to UCB into LHWC's capitalization structure for ratemaking purposes.

In this testimony by Sakai the staff saw a possibility of obtaining $1 million in external funds to further alleviate LHWC's financial problems. In that vein staff witness Nagao testified that a stock issue of $500,000 could be used to pay the overdue main extension refunds and that $500,000 of debt money, if obtained, could be used to buy back MECs outstanding. He further testified that, if the $1 million in additional financing is obtained, the staff recommends the complete granting of A.59051 and A.60149 and the granting of A.59748, provided that repayment under the revised agreement does not commence before July 1, 1986.

On April 29, 1981 LHWC filed:

A.60490 for authority to incur a long-term indebtedness of $500,000; and

A.60491 for authority to issue 5,000 shares of its $100 par value common stock.

With the above 2 financing applications supplementing the submitted applications, the principal components of an adequate solution to LHWC's financial problems are now in place. We will therefore turn to an examination of the opposition by The Simmons Group to the A.59023 component of the solution, which is to be followed by an examination of the opposition by PCM to the A.59748 and A.60149 components. Later in this decision there will be a discussion of the financing applications in some depth.

VI. A.59023

Under Section C.2.b. of the main extension rule, refunds are made to each MEC holder based upon 22% of the prior year's revenue from the extension for which construction sums were advanced. By this application, LHWC seeks authority to deviate from Section C.2.b. in order to base each year's repayment upon the revenues derived from the extension as though the rates in effect on the date the applicable MEC was entered into were still in effect. The application does not seek, however, to reduce the existing contract balances. The Commission staff supports a modified version of the deviation. Under the staff modification, repayments on existing MECs would be based upon water rates in effect on January 1, 1981 instead of those in effect at the time the MEC was entered into.

The Simmons Group opposes both the deviation as requested and the staff-supported modified version of the deviation, contending that A.59023 "cannot as a matter of law be granted as to any MECs entered into before July 26, 1979", the date of filing of A.59023. Section A.8. of the main extension rule, which was cited in the application as the authority under which the relief is sought, appears to underly this contention on what is not lawful. Section A.8. reads:

> "8. Interpretations and Deviations
>
> In case of disagreement or dispute regarding the application of any provision of this rule, or in circumstances where the application of this rule appears unreasonable to either party, the utility, applicant or applicants may refer the matter to the Commission for determination." (Emphasis added.)

Apparently, it is the view of The Simmons Group that Section A.8. cannot apply to existing MECs. Clearly, this view is too restrictive to be tenable even as a procedural deficiency. It fails to recognize that (1) the rule itself is made an integral part of, and attached to, each MEC and (2) each MEC contains the Commission jurisdictional clause which reads:

> "This contract shall at all times be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may from time to time direct in the exercise of its jurisdiction."

The Constitutional Issue

The Simmons Group further contends that the authority sought in A.59023 would violate the constitutional prohibitions against impairment of contract and those against the taking of property without due process of law.

The Simmons Group recognizes that the Commission, in the exercise of its police power, may make any reasonable orders which affect the "contractual relationship between a regular utility and its users."[2/] However, it asserts that the Commission's power in this regard does not extend to contracts between a utility and "third party creditors".

In its reply brief, LHWC responded to the assertion concerning "third party creditors" as follows:

> "By attempting to include themselves within the phrase 'third party creditors' under such an analysis, their argument paints with too broad a brush. The contracts before the Commission with respect to Application No. 59023 are not contracts by which Applicant contracts for janitorial services at its office, leases office equipment, or purchases tires for its service vehicles. None of the referenced type of contracts are governed by Applicant's tariffs filed with and approved by the Commission. None of those contracts contain an express provision stating that they are in fact subject to modification by the Commission. Main Extension Contracts, on the other hand, are (1) essentially for the extension of utility service, (2) filed as part of the company's approved tariffs with the Commission, and (3) contain a standard provision that:
>
> > "'This contract shall at all times be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may from time to time direct in the exercise of its jurisdiction.'

2/ See, e.g., Lamb v Calif. Water and Tel. Co. (1942) 21 Cal 2d 33, 42; Law v Railroad Commission (1921) 184 Cal 737; Limoneira Co. v Railroad Commission (1917) 174 Cal 232.

> "The Simmons Group cites no basis for distinguishing between (1) the contractual relationship between the utility and its retail commodity customers, and (2) any other type of contractual relationship which arises out of, and is prescribed by, the utility's filed Commission-approved tariffs. In fact, no basis for arriving at such a distinction exists..."

LHWC's foregoing response is consonant with the view expressed by the California Supreme Court on the nature of main extensions:

> "The extension of a water utility's mains in preparation for the actual delivery of water is <u>no less a public utility service than the water deliveries themselves</u>. The cost of installing mains for the delivery of water is a part of the cost of the water deliveries. . . ." (<u>Cal. Water & Tel. Co. v PUC</u> (1959) 51 Cal 2nd 478, 501.) (Emphasis added.)

The Simmons Group also argues that "to grant the relief requested by Application No. 59023, without compensating the complaining MEC holders would simply lead to a mere circuitry of action—a series of inverse condemnation actions, probably in the form of a class action, to be tried in the Superior Court of Orange County to recover the diminution in value of the vested MECs." This surely would not be the traditional action in inverse condemnation that is premised upon a governmental acquisition of real property without compensation to the property owner.

Be that as it may, the inverse condemnation is inapplicable here. The Commission's long-standing jurisdiction to modify public utility contracts (see footnote 2) eliminates any basis for such an action.

In summary, the Commission has the authority and the continuing jurisdiction to regulate the relationship between parties to a main extension agreement. Not only are the very existence, substance, and form of that relationship products of Commission regulation, but the contents of form contracts creating and defining the scope of the relationship are also prescribed by the Commission.

A Proper Exercise of the
Commission's Police Power

As a prerequisite to modifying the repayment terms of a utility's MECs, the Commission should have before it a record demonstrating that (1) serious cash-flow problems exist which could threaten the existence of the utility; (2) the terms of the utility's existing MECs combined with increased rates have contributed to the problems; and (3) modifying the terms of the MECs will alleviate those problems.

A $556,000 working capital deficit at December 31, 1980, $512,000 in overdue refunds on MECs at December 31, 1980, and the 9 formal complaints in this consolidated proceeding, resulting from LHWC's failure to pay overdue refunds, clearly demonstrate LHWC's perilous financial condition. As noted earlier, the "22% of revenue" refund provision of the main extension rule plays a major role in LHWC's financial problems. It has contributed heavily to the inordinate level of LHWC's MEC repayment obligations

through the following combination of factors: LHWC, while a relatively young water company, underwent rapid growth, exposing it to burgeoning main extension refund obligations, made especially burdensome because of numerous increases in authorized revenues. Many of these increases were in response to rapidly increasing costs of purchased water and other out-of-pocket costs. These cost increases were offset on a dollar-for-dollar basis but, by virtue of the "22% of revenue" provision, they also caused LHWC's main extension refund obligations to increase by 22% of the cost offset revenue increase generated in subdivisions served by main extensions.

Also as noted earlier, projections under the present rule indicate:

1. LHWC's MECs will require payment over a period of 14.2 years rather than the 20 years nominally contemplated by the rule; and

2. In the years 1981 through 1984, refunds are expected to run from $300,000 to $340,000 per year, or roughly 40% of net operating revenues.

The impact of granting A.59023 would be to extend LHWC's average payout time from the present average of 14.2 years to 21.8 years and to add a projected $709,800 to LHWC's working capital by the end of 1984, the critical year because of refinancing. The impact of granting A.59023 to the extent advocated by the staff would be to extend LHWC's average payout time from the present average of 14.2 years to 17.4 years and to improve LHWC's working capital by a projected $281,700 by the end of 1984.

We have also pointed out that the filing of the new financing applications (A.60490 and A.60491) completed the framework, started by 4 of the submitted applications (A.59023, A.59051, A.59748, and A.60149), of an indicated solution to LHWC's financial problems. This new financing is contingent upon approval of the staff position in A.59023.

Setting other reasons aside, that approval is clearly essential because it is a prerequisite to obtaining the new financing. The new financing is necessary if LHWC is to achieve a degree of financial stability that will enable it (1) to pay past-due MEC refunds, (2) to meet current and future obligations as they fall due, and (3) to have adequate earnings, cash flow, and interest coverage to put it in a position to refinance long-term debt and other obligations that will fall due in 1984.

Almost one-half of LHWC's outstanding MECs are held by individuals or corporations other than the original developers who made the advances. To those holders, basing future repayment obligations as requested in A.59023 on rates in effect at the time the agreement was entered must seem completely detached from the realities of the marketplace, since the price of an MEC upon being acquired probably reflected the most recent refund level at the time of the purchase and perhaps some allowance for refunds increasing in the future because of inflation. Conversely, for those holders to have projected, in quantifying future refund levels, an escalation in rates near the levels actually experienced by LHWC would appear most unlikely. On balance, basing future refunds on rates in effect January 1, 1981 as advocated by the staff, rather than as requested in A.59023, is an adequate and more appropriate level of relief. We will grant A.59023 to that extent.

The remaining aspect of A.59023 which we must resolve concerns whether the 5-year extension of an MEC refund period from 20 to 25 years, under Section C.2.d. of the rule, should apply to the termination or buyback of MECs by LHWC. The termination factors for the buybacks are tabulated in Section C.3.a. of the rule, cover the years remaining of the 20-year contract period, are uniform series present-worth factors at an interest rate of 12%, and establish a ceiling price. In this part of A.59023, LHWC seeks to have the series of termination factors extended to cover the additional 5-year period.

In our view, sufficient need has not been shown to justify a departure from the ceiling price calculated in the manner prescribed in Section C.3.a. of the rule. It appears there presently exists sufficient latitude, because the ceiling price is established on present value based on a 12% interest rate, for LHWC to accommodate the 5-year extension period when negotiating with MEC holders to terminate their contracts. Notably, the prime interest rate and the interest rate on AA-rated bonds were in the 7% range when the 12% interest rate applied in Section C.3.a. of the rule was established (D.75205 dated January 21, 1969 in C.5501).

We will not authorize a deviation from Section C.3.a. of the main extension rule as requested in A.59023 to establish termination factors corresponding to the 5-year extension of the contract period.

VII. A.58861

By Interim D.91236 dated January 15, 1980 in A.58861, LHWC was authorized to issue 3,440 shares of its capital stock to its parent corporation, LHUC, in order to repurchase and terminate MECs held by LHUC as well as repay overdue amounts on those MECs. The interim determination fixing the number of shares to be issued at 3,440 was premised on valuing the terminated MECs at the ceiling level prescribed in Section C.3.a. of the main extension rule pending resolution of LHWC's request, parallel to the one in A.59023, to establish termination factors corresponding to the 5-year extension of the contract period. That request was opposed by the staff. Our discussion and determination set forth in the preceding 3 paragraphs, addressing the parallel request in A.59023, are equally applicable here.

There is a further issue concerning A.58861. On October 30, 1980 LHWC filed a petition to modify D.91236, supra, in order to use 1979 water revenues, instead of those for 1978, in determining the value of the terminated LHUC MECs. The Commission staff opposed the petition, contending that the May 14, 1979 filing date of A.58861, not the January 15, 1980 issuance date of Interim D.91236, governs the water revenue year to be used (i.e., the revenues to be employed in determining the value are, according to the staff witness, those from the calendar year immediately prior to the year in which A.58861 was filed).

In our view a proper resolution of this matter should not turn on which revenue year governs a ceiling price, especially where the ceiling price is probably inflated because of the 12% interest rate used in determining present value. In that light and giving consideration to the thrust of A.59023, which was filed July 26, 1979, to eliminate the burgeoning growth in annual refund obligations because of rate increases, we fail to see any justification for the issuance of more shares of LHWC's capital stock under A.58861.

VIII. A.59748

Laguna Village presently holds 5 MECs (R-210, R-247, R-253, R-258, and R-268), together with the special facilities contract (S-211). Under the terms of the contracts there is presently due and unpaid approximately $113,000 as of January 1, 1981, and the total amount subject to refund is approximately $408,500.

In an effort both to cooperate with LHWC in addressing the latter's cash-flow problems and to secure service through new MECs, Laguna Village negotiated the terms of A.59748. The application defers the past-due and future amounts beyond the time of payment contemplated by the contracts presently held: Under the application, the special facilities contract (S-211) would be paid in full plus accrued interest in 1985 and the payments on the MECs would commence in 1986. LHWC and Laguna Village agree that under any possible combination of approval or disapproval of the other submitted applications, the deferment of payments called for by A.59748 will benefit LHWC.

As a condition to this deferral, LHWC seeks, as set forth in A.59748, approval for an additional $500,000 in future MECs to cover Laguna Village's Tracts 9610, 9611, 9612, and 9613. All of the facilities for these tracts, except approximately 60% of those for Tract 9613, have been installed. When completely finished, the estimated costs of these facilities will be approximately $630,000. Laguna Village has agreed to waive any excess over $500,000. Refund payments on these new MECs would not commence until 1986.

PCM opposes the granting of A.59748, contending that:

"(i) App. 59748 was engendered when Applicant's financial situation appeared much worse to it; (ii) at that time Applicant was grasping at any deferral; and (iii) assuming any implementation of 59023, 59748 is not in the interests of the Company or ratepayers and involves a higher 'present value'. It is a giveaway of $500,000 in new MECs where the facilities are already in the ground or being placed therein. . . ."

Contrary to PCM's view, the agreement underlying A.59748 hardly represents a "giveaway" to Laguna Village. As stated earlier, in return for the $500,000 in new MECs, Laguna Village agreed to a substantial deferment of not only amounts presently due Laguna Village but, also, additional amounts which would be due Laguna Village during years 1980 through 1985. It is noted that the present value of $500,000 in the form of 20 annual payments of $25,000 beginning in 1986 is approximately $86,000 employing a 14% interest rate.

To address PCM's contention that approval of A.59748 involves a higher present value of refund obligations than its rejection does, we have summarized below from Exhibits 37B and 50 the pertinent comparisons of LHWC's refund obligations on a present-worth basis. The present value of LHWC's refund obligation of $408,577, under the original contracts with Laguna Village, is compared with the present value of its refund obligation of $934,574, adjusted to $884,574 on a net of investment tax credit benefit basis, under A.59748. In addition, the present worth of LHWC's refund obligation of $408,577 is cast in terms of basing refunds on rates in effect as of January 1, 1981, consistent with the staff approach to A.59023.

	Original Contracts		
	Uniform Main Extension Rule Basis	A.59023 Implemented on Staff Basis	A.59748
Total Through			
1991	$408,577		
1997		$408,577	
2005			$884,574
Present Value			
at 10%	$282,005	$261,634	$282,142
at 11%	273,549	252,968	255,715
at 12%	265,623	244,971	232,279
at 14%	251,194	230,726	192,828
at 16%	238,429	218,453	161,245

At interest rates above 11%, the present value of refund obligations under A.59748 is less, and substantially less at current borrowing rates, than that of either of its counterparts shown for the original contracts. Clearly, PCM's contention that A.59748 is more costly to LHWC on a present-worth basis is not borne out.

With reference to PCM's allegation that A.59748 is not in the interest of the ratepayer, PCM has once again made a conclusional statement without showing just how the ratepayer would be adversely affected. And once again, our analysis, which follows, does not bear out PCM's contention.

In Exhibit 63 the impact of the approval of A.59748 on rates, although not shown separately, was included as part of the combined impacts of A.59051, A.59748, and A.60149 on rates. In Tables VA and IA of Exhibit 63, the cumulative total gross revenues of LHWC projected for the 11-year period 1980 through 1990 were $70,566,300 with the 3 applications granted and $71,440,900 with their denial. An examination of the work papers for Table VA indicates that A.59748 would account for about 25% of the $874,600 reduction in cumulative revenue requirements over the 11-year period. Such a reduction in revenue requirements as the result of A.59748 is consistent with a slightly lower rate base, one which was evidenced by the following recapitulation of projected payments to Laguna Village contained in Exhibits 37A and 50:

	Cumulative		
	Original Contracts		
Year	Uniform Main Extension Rule Basis	A.59023 Implemented on Staff Basis	A.59748
1980	$ 68,378	$ 68,378	
1981	107,463	107,463	
1982	150,435	147,656	
1983	179,623	171,618	
1984	211,566	195,580	$ 91,777
1985	246,308	219,542	91,777
1986	284,617	243,504	150,041
1987	320,200	267,466	208,305
1988	350,875	291,428	266,569
1989	380,679	310,585	324,833
1990	399,228	329,129	383,097

In addition to resulting in a lower rate base, A.59748 will provide a reduction in income taxes in the early 1980s through investment tax credits and accelerated depreciation made available by plant additions financed by the new MECs.

In the light of A.59748's (1) providing a deferral of refund obligations from the early 1980s to later periods; (2) having a lower present value than the alternatives; and (3) not imposing any unreasonable burden on the ratepayer, we conclude that this application should be granted in all respects except, as recommended by the staff, payment of refunds on MECs should not commence until July 1, 1986.

IX. A.60149

In early 1976 Mathis began to develop a 169-acre parcel in Laguna Hills known as the Mathis Ranch. At that time, Mathis also began negotiations with Rossmoor Water Company (Rossmoor), the predecessor of LHWC, for the provision of water services to the property. Mathis was informed by Rossmoor that the facilities necessary to provide water service to Mathis Ranch would consist of a booster station and a 16-inch water line. Rossmoor apprised Mathis that the cost of these facilities would have to be advanced by Mathis in accordance with Rule 15. It was further explained to Mathis both orally and in writing, according to Exhibit 55, that the advanced cost of the construction of the facilities would be refunded to Mathis as the project was occupied.

In a letter dated May 7, 1976, Rossmoor stated that a special facilities contract would be prepared and executed at such time as the total cost of the backbone system had been determined and that the special facilities contract amount would be paid back to Mathis on the basis of occupancy. It was agreed that Rossmoor would invoice Mathis for 10% of the estimated cost of the facilities. At such time as bids were received, Rossmoor would invoice Mathis the hard costs consisting of labor, material, administrative overhead, engineering, and inspection charges less the amounts previously advanced. Upon completion of the work and acceptance of the facilities by Rossmoor, the total amount advanced would be adjusted to actual costs.

During the course of the construction of the Mathis Ranch development, Mathis paid to LHWC $217,353.40 as advances for the special facilities and constructed $50,862.50 of special facilities in Phase 2:

	Amount	Date
	$ 24,344.00	June 4, 1976
	50,102.00	December 16, 1976
	712.00	February 14, 1977
	69,935.00	April 18, 1977
	4,697.00	May 27, 1977
	67,063.40	October 12, 1977
Subtotal	$217,353.40	(Phase 2 facilities constructed by developer were completed December 1977.)
	50,862.50	
Total	$268,215.90	

Payments of advances were made on the estimated costs presented by LHWC to Mathis. The total amount of $268,215.90 was adjusted to a final audited amount of $273,503.90 in early 1980.

Prior to May 1978, LHWC could have executed a main extension contract with Mathis under Rule 15 without obtaining special Commission authorization. However, in May 1978, the balances on outstanding advance contracts exceeded 50% of LHWC's total capital. Consequently, LHWC could not thereafter enter into new MECs without the specific authorization of the Commission.

A letter from LHWC to Mathis dated September 7, 1978 confirmed LHWC's inability to execute MECs without obtaining special authorization from the Commission and noted LHWC's severe working capital shortage. While confirming that repayment for the advances made by Mathis was to have been made under the main extension rule, this letter also served to advance a proposal that the contract for the special facilities, which would now require Commission approval, provide for refunds on the "22% of revenue" basis instead of the "per-unit" basis. In August 1979 Warmington, Mathis, and LHWC entered into a written agreement under which Warmington advanced $113,083 to LHWC in exchange for LHWC's agreement to complete construction of the pump station to serve Mathis Ranch.

As developed, the 169-acre Mathis Ranch property consists of 2 separate commercial areas, an apartment complex, and 3 residential tracts. On the per-unit basis for refunds, in excess of $300,000 of the entire $386,586.90 advanced for the special facilities by Mathis-Warmington would be due for repayment in 1979/80 and the remainder by 1982. Following 2 years of negotiations, LHWC, Mathis, and Warmington have arrived at the agreement set forth in A.60149.

Under the application, the entire advanced amount will be converted to 2 promissory notes due October 1, 1984. One note will be executed in favor of Mathis and the other in favor of Warmington. Each note will provide for an annual payment of interest only. The notes are to be secured by the facilities that Mathis-Warmington have completed and transferred to LHWC. More specifically, by A.60149 LHWC seeks authority to:

1. Execute a note to Mathis for $273,503.90. The Mathis note will accrue simple interest at the rate of (1) 7% per annum on $50,000 of the refund for the period April 1, 1979 to March 31, 1980, and (2) 10% per annum on $273,503.90 of the refund for the period from April 1, 1980 to October 1, 1984; and

2. Execute a note to Warmington for $113,083. The Warmington note will accrue simple interest at the rate of 10% per annum on one ninety-second (1/92) of $113,083 of the refund ($1,229.16) from April 1 of that calendar year following the calendar year during which occupancy of each of the last 92 residential units located in the Mathis residential development area to October 1, 1984 occurs.

PCM opposes the application, taking the position that there was not a legal agreement between LHWC and Mathis-Warmington effective under Rule 15 "prior to the time LHWC became disabled from using Rule 15 because of the 50% limitation." PCM believes that the entire amount advanced by Mathis-Warmington should be treated as a contribution. PCM is also critical of securing the promissory notes by trust deeds on facilities Mathis-Warmington have completed and transferred to LHWC.

In evaluating the facts on this record it becomes clear that:

1. Rossmoor and Mathis agreed in 1976 that Mathis would advance the sums for the special facilities under Rule 15.

2. At the time of the 1976 agreement, Rossmoor could have entered into an MEC without special authorization from the Commission. However, an MEC was not to be executed until the specific costs of the facilities were determined.

3. In May 1978 the advance balances on outstanding MECs first exceeded 50% of LHWC's total capital.

4. Mathis advanced $263,000 prior to LHWC's becoming prohibited from using Rule 15, because of the 50% limitation, without special authorization from the Commission.

5. The pump station element of the special facilities project was in the design stage before May 1978.

6. In August 1979, Mathis-Warmington and LHWC entered into a written agreement to fund the $113,000 balance for the facilities contemplated in the 1976 agreement in order to have the pump station completed. At that time, LHWC was subject to the 50% limitation of Rule 15.

7. A written main extension contract was not executed for the special facilities project prior to the advance balances of LHWC's MECs outstanding exceeding 50% of its total capital.

8. By filing A.60149, LHWC has acknowledged its legal obligation to refund the $386,000 advanced for the special facilities.

9. The rate impact of A.60149 is minimal. If the application is denied and the sums repaid under Rule 15, making them due and payable almost immediately, those sums will enter rate base very shortly. If the application is granted, the amounts will be placed in rate base upon execution of a note.

It is also evident that the advances made by Mathis to LHWC prior to May 1978 were required to be included in the calculation which determined that the outstanding advance contract balances exceeded 50% of LHWC's total capital. Although by then most of the funds for the pump station had not been advanced, this facility was a part of the original commitment. It was in the design stage before May 1978.

Although a written MEC-Special Facilities between Rossmoor and Mathis was not drawn up, the arrangements for the special facilities project substantively followed Rule 15. Indeed, if the project had not qualified under Rule 15 because properties other than Mathis Ranch served by the project were to exceed 50% of the project's capacity, its financing could have been exclusively the utility's responsibility, since that is where the responsibility normally rests for financing backbone plant including pump stations. The per-unit basis of refunds and the resultant rapid payback of the advance, once the development is no longer an uneconomic one, bear out the utility's primary role in the financing of such plant.

In that regard Rule 15, as presently constituted, envisions refunds, not contributions, once a development is no longer potentially uneconomic or speculative:

> "The essential function of a water main extension rule in the field of large-scale land developments, such as residential subdivisions and industrial tracts, is to provide a method by which construction of the necessary distribution facilities may be accomplished with minimum financial risk to the utility and its consumers from potentially uneconomic or speculative developments. Once the development begins to 'pay its way', by producing revenues to cover at least the operating and maintenance costs, depreciation expense and some return on the investment in water facilities, the uneconomic or speculative aspects of the installation are

> diminished to a point at which it may be said that the rule has served its primary purpose. In the context of this discussion, an 'uneconomic' extension is one where the plant investment, including backup plant, required to provide service to a prospective customer might impose an undue burden on the utility's other consumers. A 'speculative' extension is one where there is no reasonable assurance that enough customers will be added to justify the capital expenditure." (Water Main Extension Rule - 60 CPUC 318, 320.)

In our considered judgment, A.60149 provides a reasonable resolution of this situation and should be granted. Before going on to other matters, however, we should point out that the concern expressed by PCM over the securing the 2 promissory notes by trust deeds is unwarranted. This was made clear by LHWC in its reply brief:

> "While PCM is also critical of the security provided Mathis-Warmington, Applicant finds no basis for such criticism. The Mathis-Warmington Agreement falls due in 1984. In the event that Pacific Mutual does <u>not</u> re-finance either the Mathis note or the existing First Mortgage Bonds, a new lendor would be sought. If the new lendor will refinance both debts (Mathis-Warmington and the First Mortgage Bonds) then the Mathis lien becomes extinguished. If the new lendor will only finance the First Mortgage Bonds, then that lendor will still be provided with ample security in the form of the senior lien on all of Applicant's facilities <u>except</u> those located in the Mathis development. <u>The Mathis-Warmington trust deeds only provide for a lien on the facilities in the Mathis Ranch development</u>. The remainder of Applicant's approximately $15,000,000 in facilities would be available to secure the refinancing of the $923,700 balance which will be due to

> Pacific Mutual in 1984 (as well as secure the approximately $1,200,000 which will represent the balance, in 1984, on Applicant's Series B Bonds)."

X. A.59051

In January 1978 LHWC and LPD executed a $650,000 special facilities contract for the installation of a reservoir, pipelines, and booster pump stations. Subsequently, it became apparent that the amount required to be advanced by LPD for construction of the facilities would greatly exceed $650,000. After lengthy negotiations, LPD and LHWC executed the $1.5 million agreement which is before the Commission in A.59051 for approval. The agreement was entered into on August 29, 1979. All facilities are in place and the reservoir, known as the R-5 Reservoir, is in operation.

Even though the original sum to be repaid was $650,000 and the amount to be repaid under the new agreement is $1.5 million, the substantial deferral of repayment provided for under this application represents a reduction in net present value. For example, employing a 10% interest rate for purposes of determining net present value, the net present value of $650,000 repaid under provisions of the original contract is $522,533. Employing that same interest rate, the net present value of $1.5 million paid over the 20-year life of the proposed agreement is $502,153. When higher interest rates are employed for purposes of net present value, the difference becomes more pronounced. Employing a 20% interest rate, the net present value of $650,000 repaid under the provisions of the original agreement is $475,434. Under the provisions of the proposed agreement, the net present value of a refund of $1.5 million is $240,218 at the 20% interest rate,

a reduction of almost 50%. More importantly, the new agreement spreads LHWC's substantial obligations, which would otherwise arise during the early 1980s, to a 20-year period.

This application was essentially unopposed and will be granted.

XI. THE FINANCING APPLICATIONS

In A.60490 LHWC proposes to borrow $500,000 from UCB for 3½ years at a variable interest rate which will be set at about 1% over the prime rate. The loan will be refinanced in 1984 when LHWC will refinance its existing Series A bonds. The proceeds of the loan will be used to repurchase MECs of LHWC from present holders.

In A.60491 LHWC proposes to issue 5,000 shares of its $100 par value common stock. The proceeds from the stock will be used to pay amounts overdue to holders of LHWC MECs. Clearly, approval of A.60491 is essential because of the purpose to which the proceeds will be put. In addition, however, the stock issue should lead to a resolution of the pending formal complaints and reduce LHWC's working capital deficiency by $500,000.

Although viewing approval of both financing applications as essential, the Commission staff and LHWC maintain that in the event of sufficient financing for only one of the two objectives, the repurchase of the MECs should prevail.3/ Presumably, this is based on:

3/ This could prove unwieldy in that an MEC holder interested in selling the contract would presumably be, at least, equally interested in collecting the overdue refund.

1. The repurchase price to be placed on the MECs will approximate only 40% of the repayment obligation that would otherwise eventuate;

2. The buyback of MECs will have a generally favorable effect on rates since rather than 100% of a contract balance eventually becoming part of rate base, only a portion of that contract balance will enter rate base upon a purchase by the utility; and

3. The MEC holders could, through the setting of an adequate interest rate, be well compensated for a delayed repayment, as embraced in the 5-year repayment plan proposed by the staff (Exhibit 63, Table IIIB), of the overdue refunds.

PCM disagrees:

"...we see no need for Applicant to 'buy up' existing MECS. This present addition to rate base in lieu of slower year-by-year additions is (i) not in the interests of current ratepayers and those for some years to come, and (ii) not needed to solve Applicant's problems."

From LHWC's A.60635 filed June 8, 1981 seeking rate relief, we note that the proposed buyback of MECs would modify the test year 1980 operating results adopted for LHWC in D.91915, supra, by increasing rate base by $500,000 from $5,596,000 to $6,096,000 and gross revenues by $83,200 from $3,687,800 to $3,771,000, a 2.26% increase. In about 7 years,[4/] the crossover point would be reached.

4/ $17.4 \text{ years} \times \frac{\$1,215}{\$2,999} = 7.04 \text{ years}$
where 17.4 years is the average payout period under staff proposal to base refunds on January 1, 1981 rates, $2,999,000 is LHWC's presently outstanding MEC contract balance, and $1,215,000 is their repurchase cost at an 18% interest rate.

Thereafter, rate base and thus revenue requirements would become progressively less with the buyback than otherwise for the remaining life of the plant involved. This is borne out by comparing rate base projections in Exhibits 64 and 65, which show that the crossover occurs in 1987 when without the buyback, rate base is $7,369,300 (Exhibit 64) and with the buyback rate base is $7,325,700 (Exhibit 65). By 1990, these comparative projections show the rate base without the buyback exceeding the rate base with the buyback by $206,300.

The buyback, of course, would reduce materially LHWC's advances for construction, a primary source of its financial difficulties. Relatedly, it would improve LHWC's balance sheet, especially the capital structure, as defined in the main extension rule ["...total capital (defined...as...capital stock and surplus, plus debt and advances for construction)"], by substantially reducing the ratio of advances for construction to debt and equity capital. A comparison of the recorded capital structure at December 31, 1980, with the pro forma capital structure at December 31, 1980 developed below, illustrates this improvement.

	12/31/80 Recorded	Transaction	12/31/80 Pro Forma
Advances for Construction	$ 5,413,758[a]	$ (500,000)[c] 500,000[d] (1,215,000)[e]	$ 4,198,758
Long-Term Debt	2,752,767	500,000[b]	3,252,767
Common Stock	1,794,000	500,000[f]	2,294,000
Retained Earnings	2,050,388		2,050,388
Total Capitalization	$12,010,913	$ (215,000)	$11,795,913
Contributions	3,195,201	715,000[e]	3,910,201
Advances as % of Capitalization	45.1%		35.6%

a/ Exceeds LHWC's balance sheet (Exhibit 43) entries by $1,458,084 representing facilities constructed by developers which were recorded as advances for construction after December 31, 1980.

b/ Proposed $500,000 loan (A.60490).

c/ Payment of overdue MECs.

d/ New Laguna Village MECs (A.59748).

e/ Repurchase of MECs.

f/ Proposed $500,000 stock issue (A.60491).

If A.60490 is granted, LHWC will have to refinance the bank loan along with its Series A bonds in 1984. In the cash-flow studies made on LHWC in this proceeding (Exhibits 63, 64, and 65), it was assumed that a 12% interest rate would apply to the refinancing. If the assumed interest rate for the refinancing is actually obtained, the repurchase of MECs at a discount rate of not less than 18% (i.e., a present-worth valuation with 18% or higher interest) would turn out to be markedly advantageous to LHWC and its ratepayers.

While we share PCM's concern over the immediate effect on rate base and rate of return of the buyback of MECs, we must nevertheless recognize that at the peak the rate effect on gross revenues is less than 3%, that it occurs in the first year, and that after about 7 years the effect of the buyback will be to progressively reduce the revenue requirement over that which would otherwise be required. With the early years' rate increase viewed in this perspective and in light of the greater than 2 for 1 reduction in future liabilities, as represented by advances for construction, we are persuaded that the buyback will not only strengthen this utility but is in the ratepayers' interest.

We will grant A.60490 and A.60491 by separate decision to be issued concurrently with this decision.

XII. INTEREST PAYMENTS

Overdue MEC payments are included in LHWC's Account 230.1, Amount Due/MEC Refund Agreements, which is a subaccount to Account 230, Other Current and Accrued Liabilities. Interest accrues on the overdue payments at a rate of 7 percent.

In D.91915, supra, overdue refunds were not included in advances for construction to be deducted from utility plant in determining rate base. Accordingly, plant in the amount of the overdue refunds can be viewed as generating an authorized rate of return of 11.28% on a 1980 test year basis, since mid-1980 when the rates established under that decision became effective.

In its opening brief The Simmons Group took the position that "interest should be made payable on all overdue or past-due installments on MECs since 1978 at the minimum rate of 12% per annum", arguing that: The Commission should require LHWC to do equity if it seeks equitable relief under A.59023; the cost of money to LHWC exceeds the prime rate; and the Commission may take judicial notice that over the preceding years the prime rate has been in excess of 12%.

The Commission has traditionally applied the interest rate set forth in the California Constitution in connection with refunds or the award of reparation. That rate continues to be 7% per annum. However, D.91269 dated January 29, 1980 in Order Instituting Investigation (OII) 56 signaled a departure from this practice. In that decision the Commission found no longer reasonable a 7% interest rate on the Energy Cost Adjustment Clause (ECAC) balance of electric utilities, the 7% interest level having been established by the generic ECAC decision (D.85731 dated April 27, 1976).

In our considered judgment in light of all the circumstances, a 7% rate of interest should apply to overdue refunds prior to 1980 consistent with the then Commission practice, and an 11% rate of interest should apply to overdue refunds post-1979 consistent with the ratemaking determinations made in D.91915, supra.

XIII. REQUEST FOR ATTORNEYS' FEES

The Simmons Group asserts that its request for an award of reasonable attorneys' fees for its efforts in this proceeding can and should be granted. In support of this assertion The Simmons Group made the following short statement in its opening brief:

> "One of the established exceptions to the familiar American and California rule prohibiting an award of attorneys' fees in the absence of a statute or contract occurs when, by bringing the action, a party confers a substantial benefit on others. This 'common benefit' rule has been expanded to cover cases where, although suit was not formally brought on behalf of a class, the party establishes the rights of others, including non-monetary rights. See, e.g., Reiser v. Del Monte Properties Co., 605, F.2d 1135 (9th Cir. 1979). The record demonstrates but for actions of these complainants and opponents and protestants, Laguna Hills Water Company would have suffered the full consequences of its insolvency arising from its undercapitalization."

The Simmons Group neither presented an analysis to validate the implication that it conferred a substantial benefit on others nor explained how, had it in fact conferred such a benefit, that would relate to the Commission's jurisdiction to award attorneys' fees.

We find that the Simmons Group did not prevail in its major contention that no deviation from the MECs could be authorized. We also find that the Commission staff and LHWC, not the Simmons Group, is responsible for the solution found herein to LHWC's undercapitalization and cash flow problems. We further find that the Simmons Group has not conferred a substantial benefit on others in this case. Accordingly, the claim for attorney fees, assuming we even have jurisdiction to award such, is denied.

XIV. STAFF RECOMMENDATIONS

The recommendations set forth below were presented by the staff in Exhibit 42 at the January 1981 hearings, which was before the possibility of LHWC's obtaining $1 million in debt and equity financing was raised. No mention of these recommendations was made in the staff brief.

"9. Applicant be prohibited from paying dividends or making up stream loans to parent company until all obligations are on a current basis and refinancing of all obligations due in 1984 has been arranged.

"10. All future main extensions not considered in this report are to be contributed to the utility.

"11. Applicant be directed to file quarterly financial statements together with a summary of earnings showing rate base and return on rate base.

"12. Applicant be granted continuing, prompt rate relief that will enable the utility to actually earn its allowed rate of return.

"Recommendation No. 12 should be implemented by authorizing applicant to file for an offset rate increase:

"(a) At the time that the R-4 reservoir is placed in service the previous disallowance in D-91915 should be removed.

"(b) Semi annually, until June 30, 1984 LHWC should be permitted to file for offset increases to reflect additional plant placed in service, or refunds paid on existing main extension contracts. The offsets should be limited to an amount computed by multiplying the additional plant by an 11.28% return, plus additional depreciation related thereto. No consideration should be given to property taxes, income taxes or any claimed increase in expenses."

It is LHWC's position that, while it does not intend to issue dividends until all overdue amounts are brought current, the dividend restriction proposed by the staff is neither appropriate nor within the Commission's jurisdiction to adopt. This position is not sufficiently compatible with LHWC's financial plight warranting our granting A.59023 to the extent of basing future MEC refunds on present rate levels, the stringent requirements being imposed by UCB for LHWC's obtaining a $500,000 loan, and the importance of the 1984 refinancing. In this light the dividend restriction recommended by the staff appears prudent and warranted. Accordingly, LHWC will be required to accept this dividend restriction as a condition precedent to its exercising any of the authority granted by our order on the submitted applications.

The next staff recommendation, whether all future LHWC main extensions should be treated as contributions, is the subject of pending A.60551 which LHWC filed May 14, 1981. Our eventual decision determinative of this issue will be issued in that application. At present, under D.90006, supra, LHWC is not authorized to accept developer advances subject to refunds until all of its present MEC payment obligations are current.

Another LHWC pending application, A.60635 filed June 8, 1981, seeks an increase in rates to alleviate the effect of financial attrition resulting from an infusion of $1 million in debt and equity capital, under the financing applications (A.60490 and A.60491, supra), if consummated. Upon a proper showing, which would include establishing that the new funds have been obtained and expended as well as demonstrating that the earnings level at present rates would be below the new overall rate of return required, rate relief to alleviate the financial attrition would be justified. Notably, in connection with A.60635 as well as with the above staff recommendation on continuing, prompt rate relief, the result of LHWC's recorded 1980 operations was a rate of return of 12.8%. This compares with a presently authorized rate of return of 11.28%.

It seems likely to us at this juncture, in light of LHWC's 1980 earnings and its pending A.60635, that a combination of existing available procedures should prove adequate to LHWC's being provided the necessary opportunity to earn its allowed rate of return. Those procedures are rate relief for offsettable expenses by advice letter and general rate relief, employing several future test years, under the regulatory lag plan. If additional measures are shown to be needed in either the A.60635 proceeding or LHWC's next general rate proceeding, appropriate action can then be taken.

Of the above-quoted staff recommendations, only placing a restriction on dividends is adopted.

XV. FINDINGS AND CONCLUSIONS

<u>Findings of Fact</u>

1. As of December 31, 1980:

   a. LHWC was in default on $512,000 of MEC obligations.

   b. LHWC's advances for construction, including overdue refunds, were $3,955,674, or 30.2% of net utility plant.

   c. LHWC's contributions in aid of construction were $3,195,201, or 24.4% of net utility plant.

   d. LHWC's equity capital was $3,844,388.

   e. LHWC's long-term debt was $2,688,867.

2. LHWC's MECs are projected to be repaid under Section C.2.b. (the 22% of revenue provision) of the main extension rule over an average period of 14.2 years rather than the 20 years nominally contemplated by the rule, largely as the result of the following factors:

   a. LHWC's service area has undergone rapid development.

   b. LHWC has neither wells nor water rights; it purchases its entire water supply.

   c. Since 1977 there have been numerous increases in LHWC's cost of purchased water and in certain other offsettable expenses; these offsettable costs have been passed through into rates on a dollar-for-dollar basis.

3. In the years 1981 through 1984 LHWC's refunds under Section C.2.b. of the main extension rule are projected to run from $300,000 to $340,000 per year, or roughly 40% of net operating revenues.

4. The rapid occupancy of developments in LHWC's service area has placed another severe, but more immediate, burden on LHWC through Section C.2.c. of the main extension rule. Section C.2.c. provides for refunds of advances for special facilities and requires the refunds to be determined on a per-unit-served basis.

5. In 1984 LHWC will have to refinance:

a. Its Series A first mortgage bonds. These bonds have a balance of $999,300 and are due October 1, 1984.

b. $452,367 in notes payable, if A.59748 and A.60149 are granted.

c. A $500,000 loan from UCB, if obtained.

6. It is essential for LHWC to achieve a degree of financial stability that will enable it (1) to pay past-due MEC refunds, (2) to meet current and future obligations as they fall due, and (3) to have adequate earnings, cash flow, and interest coverage to put it in a position to refinance long-term debt and other obligations that will fall due in 1984.

7. A cumulative cash-flow deficiency of $1,168,400 was reached at December 31, 1980. If A.59051, A.59748, and A.60149 are approved, this deficiency would be reduced by $595,300. If $350,000 to $500,000 of the overdue refunds are repaid from the proceeds of a contemplated bank loan, the deficiency would be further reduced to $223,100 and $73,100, respectively.

8. LHWC's cumulative cash flow, by the end of 1984, is projected to increase by $709,800 if A.59023 is approved as filed, or by $281,700 if prospective MEC refunds are based on rate levels in effect January 1, 1981.

9. The main extension rule is made an integral part of, and attached to, each MEC, and each MEC contains the Commission jurisdictional clause:

> "This contract shall at all times be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may from time to time direct in the exercise of its jurisdiction."

10. Section A.8. of the main extension rule, among other things, provides:

> "...in circumstances where the application of this rule appears unreasonable to either party, the utility, applicant or applicants may refer the matter to the Commission for determination."

11. A.59023 cited Section A.8. as the authority under which relief is sought.

12. This proceeding has provided The Simmons Group with notice and opportunity to be heard sufficient to overcome any lack of due process which might exist if Section A.8. of the main extension rule were not to apply to existing MECs. To hold that Section A.8. applies only to prospective MECs, however, appears too restrictive to be tenable in light of Finding 9.

13. The impact of granting A.59023 to the extent of basing MEC refunds on rates for water service in effect January 1, 1981, as advocated by the staff, would be to extend the average payout time on LHWC's MECs from the present average of 14.2 years to 17.4 years and to improve LHWC's cumulative cash flow by a projected $281,700 by the end of 1984.

14. The factors listed in Findings 1 through 6 and in Finding 13 demonstrate that (1) serious cash-flow problems exist which could threaten the existence of LHWC; (2) the terms of LHWC's existing MECs combined with increased rates have contributed to the problems; and (3) modifying the terms of the MECs will alleviate those problems.

15. Basing future MEC refunds on rates in effect January 1, 1981 as advocated by the staff, rather than on rates in effect at the time the MEC was entered into as requested in A.59023 is, in conjunction with the new financing applications (A.60490 and A.60491), an adequate and more appropriate level of relief. A prerequisite to LHWC's obtaining that new financing is approval of the staff position in A.59023.

16. The termination factors listed in Section C.2.d. of the main extension rule are uniform series present-worth factors at an interest rate of 12% per annum covering the years remaining of the 20-year contract period, which establish a ceiling price of the termination or buyback of the contract.

17. Because the ceiling price is established on present value based on a 12% interest rate, sufficient latitude presently exists for LHWC in price negotiations to accommodate the effect of the 5-year extension period provided for under Section C.3.a. of the main extension rule without having additional termination factors.

18. By Interim D.91236 dated January 15, 1980 in A.58861, LHWC was authorized to issue 3,440 shares of its capital stock to its parent corporation, LHUC, in order to repurchase and terminate MECs held by LHUC as well as repay overdue amounts on those MECs. There is no justification for the issuance of more shares to LHUC for this purpose.

19. Laguna Village presently holds 5 MECs (R-210, R-247, R-253, R-258, and R-268), together with the special facilities contract (S-211). Under the terms of the contracts $113,000 was due and unpaid as of January 1, 1981 and the total amount subject to refund is $408,500.

20. Deferment of the past-due and future amounts beyond the time of payment contemplated by the contracts presently held by Laguna Village is sought under A.59748:

a. The special facilities contract (S-211) would be paid in full plus accrued interest in 1985 and the payment on the MECs would commence on the earlier of (1) July 1, 1986 or (2) July 1 of that calendar year immediately following the calendar year in which LHWC's outstanding MEC balance does not exceed 30% of LHWC's capitalization; and

b. LHWC's total obligation to refund sums during the years 1980, 1981, 1982, and 1983 will be reduced by approximately $63,800, $39,100, $42,900, and $29,200, respectively.

21. At interest rates above 11%, the present value of refund obligations under A.59748 is less, and at current borrowing rates substantially less, than that of the original contracts either on the main extension rule basis or with A.59023 implemented on the staff basis.

22. The $65,780.20 promissory note, as partial consideration for modification of the special facilities contract (S-211), is for lawful purposes which are not, in whole or in part, chargeable to operating expenses or income.

23. Projections of LHWC's gross revenues over the 11-year period 1980 through 1990 indicate a $200,000 reduction in cumulative revenue requirements if A.59748 is granted.

24. To better assure a deferral of LHWC's refund obligations to Laguna Village under A.59748 from the early 1980s to later periods, the payment of refunds on MECs should not commence until July 1, 1986.

25. The development of the 169-acre Mathis Ranch property, now consisting of 2 separate commercial areas, an apartment complex, and 3 residential tracts, began in 1976.

26. Rossmoor, LHUC's predecessor, and Mathis agreed in 1976 that Mathis would advance the sums for the special facilities to serve the ranch property under Rule 15.

27. At the time of the 1976 oral agreement, Rossmoor could have entered into an MEC without special authorization from the Commission. However, an MEC was not to be executed until the costs of the facilities were determined.

28. Mathis advanced $268,000 prior to LHWC's becoming prohibited from using Rule 15, because of the 50% limitation, without special authorization from the Commission.

29. In May 1978 the advance balances on outstanding MECs first exceeded 50% of LHWC's total capital.

30. The pump station element of the special facilities project was in the design stage before May 1978.

31. In August 1979, Mathis-Warmington and LHWC entered into a written agreement to fund the $113,000 balance for the facilities contemplated in the 1976 agreement in order to have the pump station completed. At that time, LHWC was subject to the 50% limitation of Rule 15.

32. Although a written MEC has not been executed for the special facilities project either prior to the advance balances of LHWC's MECs outstanding exceeding 50% of its total capital or since, the arrangements for the project substantively followed Rule 15.

33. By filing A.60149, LHWC has acknowledged its obligation to refund the $386,587 advanced for the special facilities.

34. The rate impact of A.60149 is minimal. If the application is denied and the sums repaid under Rule 15, making them due and payable almost immediately, those sums will enter rate base very shortly. If the application is granted, the amounts will be placed in rate base upon execution of 2 promissory notes.

35. The 2 promissory notes covering the entire advanced amount of $386,586.90 become due October 1, 1984. Each note will provide for an annual payment of interest only.

36. The 2 promissory notes, replacing obligations to refund advances for special facilities, are for lawful purposes which are not, in whole or in part, chargeable to operating expenses or income.

37. A.60149 represents a reasonable resolution of LHWC's obligations to Mathis, while achieving a necessary deferral in the refund payments.

38. In January 1978 LHWC and LPD executed a $650,000 special facilities contract for the installation of a reservoir, pipelines, and booster pump stations.

39. After it became apparent that the amount required to be advanced by LPD for construction of the facilities would greatly exceed $650,000, LHWC and LPD executed the $1.5 million agreement which is the subject of A.59051.

40. Even though the original sum to be repaid was $650,000 and the amount to be repaid under the new agreement is $1.5 million, the substantial deferral of repayment provided for under A.59051 represents a reduction in net present value.

41. A.59051, which was unopposed, will alleviate LHWC's working capital deficiency.

42. In A.60490 LHWC proposes to borrow $500,000 from UCB for 3½ years at a variable interest rate which will be set at about 1% over the prime rate. The loan will be used to repurchase LHWC's MECs from present holders.

43. The repurchase price of the MECs on an average will approximate 40% of the contract balance, if an interest rate of 18% is used to determine the price.

44. The repurchase of the MECs will materially reduce LHWC's advances for construction, a primary source of its financial difficulties. Relatedly, it will improve LHWC's balance sheet by substantially reducing the ratio of advances for construction to debt and equity capital.

45. The rate effect of the repurchase of the MECs on gross revenues is less than 3% at its peak. It is at that level only in the first year, and after about 7 years the rate effect will be to progressively reduce the revenue requirement over that which would otherwise be required.

46. The buyback of the MECs will not only strengthen this utility but, on balance, is in the ratepayers' interest.

47. In A.60491 LHWC proposes to issue 5,000 shares of its $100 par value common stock. The proceeds from the stock will be used to pay amounts overdue to holders of LHWC's MECs.

48. Approval of this proposed stock issue is essential to a prompt repayment of LHWC's overdue MEC refunds, a resolution of pending formal complaints, and a reduction in LHWC's working capital deficiency by $500,000.

49. Upon becoming in default on its MEC refund obligations, LHWC made provision for interest to accrue on the overdue payments at a rate of 7% per annum.

50. Until early 1980 the Commission had traditionally applied the interest rate set forth in the California Constitution to refunds or an award of reparation. That rate continues to be 7% per annum.

51. In D.91269 dated January 29, 1980 in OII 56 the Commission found no longer reasonable a 7% interest rate, signaling a new policy on interest rates applicable to refunds or an award of reparation.

52. Since mid-1980 when LHWC's rates were established under D.91915, supra, overdue refunds, as a rate base component, can be viewed as generating an authorized rate of return of 11.28% on a 1980 test year basis.

53. An interest rate of 7% per annum should apply to overdue refunds prior to 1980 consistent with the then Commission practice, and an interest rate of 11% per annum should apply to overdue refunds post-1979 consistent with the ratemaking determinations made in D.91915, supra.

54. The Simmons Group neither presented an analysis to validate an implication that it conferred a substantial benefit on others nor explained how, had it in fact conferred such a benefit, that would relate to the Commission's jurisdiction to award attorneys' fees.

55. We find that the Simmons Group did not prevail in its major contention that no deviation from the MECs could be authorized We also find that the Commission staff and LHWC, not the Simmons Group, is responsible for the solution found herein to LHWC's undercapitalization and cash flow problems. We further find that the Simmons Group has not conferred a substantial benefit on others in this case.

56. In light of LHWC's financial plight warranting our granting A. 59023 to the extent of basing future MEC refunds on present rate levels, the stringent requirements being imposed by UCB for LHWC's obtaining a $500,000 loan, and the importance of the 1984 refinancing, LHWC should refrain from paying dividends until all obligations are on a current basis and refinancing of all obligations due in 1984 has been arranged.

Conclusions of Law

1. This proceeding has provided The Simmons Group with notice and opportunity to be heard sufficient to overcome any lack of due process which might exist if Section A.8. of the main extension rule were not to apply to existing MECs.

2. The Commission has the authority and the continuing jurisdiction to regulate the relationship between parties to a main extension agreement.

3. A.59023 should be granted to the extent that future MEC refunds should be based on rates in effect January 1, 1981. In all other respects, A.59023 should be denied.

4. LHWC should not be authorized to issue shares additional to those authorized by Interim D.91236, supra, for the purpose set forth in A.58861.

5. A.59748 should be granted subject to the condition that the refund payments to Laguna Village on MECs are not to commence until July 1, 1986.

6. A.60149 should be granted.

7. A.59051 should be granted.

8. A.60490 and A.60491 will be granted by separate decision to be issued concurrently with this decision.

9. LHWC should be directed to increase the rate at which interest accrues on its MEC refunds, which are overdue on or after January 1, 1980, from 7% per annum to 11% per annum.

10. The Simmons Group's request for reasonable attorneys' fees for its participation in the instant proceedings should be denied.

11. As a condition precedent to its exercising any authority granted by our order which follows, LHWC must secure the $1 million in debt and equity financing authorized by a decision being issued today in A.60490 and A.60491.

11.a. The following order should be effective today so the solution reached in these proceedings can expeditiously go forward.

12. As a further condition precedent to its exercising any authority granted by our order which follows, LHWC should be required to accept the restriction on the payment of dividends prescribed in the order.

ORDER

IT IS ORDERED that:

1.a. Laguna Hills Water Company (LHWC) is authorized to determine refunds under main extension contracts (MECs), in a manner different than that prescribed in Section C.2.b. of the main extension rule, as follows:

> Rather than making refunds to an MEC holder based upon 22% of the prior year's revenue from the extension for which construction sums were advanced, LHWC shall base each year's repayment, starting with the one becoming due in 1982, upon the revenues derived from that extension as though LHWC's January 1, 1981 rates for water service were still in effect.

b. In all other respects Application (A.) 59023 is denied.

2.a. LHWC's petition for modification of Interim Decision (D.) 91236 in A.58861 is denied.

b. The authority sought in A.58861, beyond that granted by Interim D.91236, is denied.

3. LHWC is authorized to:

a. Modify existing MECs (R-210, R-247, R-253, R-258, and R-268) in the manner set forth in Appendix D to A.59748, inclusive of an exemption to Ordering Paragraph 1.a. above, except that regardless of LHWC's capital ratios, payment of the adjusted contract refund shall not commence until July 1, 1986;

b. Issue new MECs to Laguna Village, Inc. in accordance with the provisions set forth in Appendix F to A.59748, inclusive of an exemption to Ordering Paragraph 1.a. above, except that regardless of LHWC's capital ratios, payments of contract refunds shall not commence until July 1, 1986;

c. Modify the special facilities contract (S-211) and provide a $65,780.20 promissory note, in accordance with Appendix E to A.59748; and

d. The authority in 3.c. above to provide the promissory note will become effective when LHWC pays $131.56, set by PU Code Section 1904(b).

4.a. LHWC is authorized to incur a long-term indebtedness of $386,586.90, to execute promissory notes for that indebtedness, to encumber its property, and to deviate from the provisions of the main extension rule, all substantively in the manner and for the purposes set forth in A.60149.

b. The authority in 4.a. above to execute promissory notes and to execute and deliver encumbering documents will become effective when LHWC pays $773.16, set by PU Code Section 1904(b).

5. LHWC is authorized to deviate from the main extension rule, as requested in A.59051, by amending its special facilities contract with LPD Associates (LPD) as follows:

a. LPD will increase its advance to a total of $1.5 million;

b. LHWC will repay to LPD the amounts due under the modified special facilities contract at the rate of 22% of the revenue received from the dwelling units located in the general area to be served by the special facilities, the first such payment occurring no sooner than 30 days after the effective date of this order; and

c. The payment as set forth in 5.b. above, however, will be limited by not permitting the cumulative payments to exceed the product of the number of payments already made plus the payment being determined times 5% of $1.5 million to ensure that the period during which the repayment to LPD is to occur will be a minimum of 20 years.

6. LHWC shall increase the post-1979 rate at which interest accrues on its overdue MEC refunds from 7% per annum to 11% per annum.

7. The Simmons Group's request for attorneys' fees is denied.

8. As conditions precedent to its exercising any authority granted by this order, LHWC must:

a. Secure the $1 million in debt and equity financing authorized by a decision being issued today in A.60490 and A.60491; and

b. Accept the following restriction on the payment of dividends: LHWC will not declare or pay dividends until all obligations are on a current basis and refinancing of all long-term debt due in 1984 has been arranged.

9. LHWC shall file the reports required by General Order Series 24.

10. By this decision, A.58861, A.59023, A.59051, A.59748, and A.60149 are closed. The remaining matters remain open.

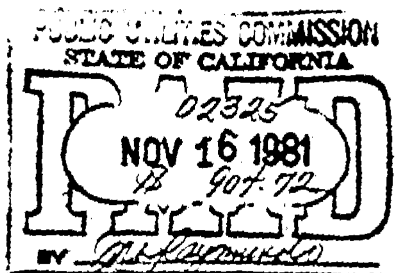
This order is effective today.

Dated October 6, 1981, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

I certify that this decision was approved by the above Commissioners today.

Joseph E. Bodovitz



APPENDIX A

List of Appearances

Applicant: Graham & James, by Thomas J. MacBride, Jr., Attorney at Law, for applicant and defendant.

Complainants: Arthur H. Burnett, for himself; Simmons, Ritchie, Segal and Stark, by Frederick L. Simmons, Attorney at Law, for Lawrence T. Solomon, A. L. Leyva Trust, Lawrence Solomon and Stanley Solomon, Greenville Development Company, Syd Carnine, Stanley Solomon, and Holstein Industries, complainants and protestants in Application 59023; and Simon Miller, Incorporated, by Simon Miller, Attorney at Law, for Lloyd E. Rigler and Lloyd E. Rigler, as executor of the will of Lawrence E. Deutsch, deceased, complainant in Case 10757.

Protestants: Martin E. Whelan, Jr., Inc., by Martin E. Whelan, Jr., Attorney at Law, for Professional Community Management, Inc., Golden Rain Foundation, and Mutual Housing Corporations Inside Leisure World.

Interested Parties: Virtue & Scheck, Inc., by Paul B. George, Attorney at Law, for Laguna Village, Inc., Mathis Ranch Land Company, and Warmington Development, Inc.; Ronald Steelman, Attorney at Law, for South Coast Community Development Corp. Timberline Partnership; Parker & Covert, by Clayton H. Parker, Attorney at Law, for LPD Associates; Raymond J. Lee, for Pacific Mutual Life Insurance Company, Bondholders of Laguna Hills Water Company; and Roderick A. Carter, for Pacific Mutual Life Insurance Company.

Commission Staff: William Jennings, Attorney at Law, and John Gibbons.

(END OF APPENDIX A)