

ORIGINALDecision 93838 DEC 15 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of)
 JOSEPH GLENN SELLARS and ALICE SELLARS,)
 doing business as SELLARS WATER SERVICE,)
 for an order authorizing the sale and)
 transfer of the public utility water)
 properties and related assets to)
 ALLEN C. DAILEY and OPAL M. DAILEY and)
 authorizing said transferees to issue)
 a note and trust deed, to record, in)
 favor of JOSEPH GLENN and ALICE SELLARS,)
 husband and wife, as joint tenants, in)
 the amount of \$142,000.00.)

Application 60275
 (Filed February 17, 1981)

Alice Sellars and Joseph Glenn Sellars,
 for themselves; Allen C. Dailey, for
 himself; and Anna M. Thompson, for
 Allen C. Dailey and Opal Dailey; applicants.
Alvin S. Pak, Attorney at Law, Mary Jean
Purcell, and Robert M. Mann, for the
 Commission staff.

O P I N I O N

Joseph Glenn Sellars and Alice Sellars (sellers), doing business as Sellars Water Service, and Allen C. Dailey and Opal M. Dailey (buyers) request an order from the Commission authorizing sellers to transfer their public utility water system located in Kern County to buyers, and for buyers to issue a note and trust deed to sellers in the amount of \$142,000.

Sellers provide water service to approximately 285 flat-rate customers located in and around the communities of South Shafter and North Shafter. Sellers were granted authority to acquire the system

by Decision 72193, dated March 31, 1967 in Application 49191.

The system consists of:

- Four parcels of land.
- Four pumps - One 50 HP; two 30 HP; one 25 HP.
- Four pressure tanks.
- 18,136 feet of distribution system.
- Assorted office equipment.
- One 1958 pickup truck; one 1964 automobile.

It is stated in the application that the original cost of the utility property being transferred was \$59,997 and the depreciation reserve as of December 31, 1979 was \$29,154, resulting in a net book value of \$30,843. However, the plant acquisition account is \$22,620. The selling price is \$200,000, of which \$58,000 is in cash and the remainder in the form of a note and trust deed, in favor of sellers, in the amount of \$142,000. The note is payable at \$2,000 or more per month, including interest at the rate of 10 percent per annum.

The Commission staff expressed concern about the large difference between the net book value and the agreed purchase price for the system and four parcels of land upon which the wells and pressure tanks servicing the system are located. Additionally, a preliminary investigation performed by the staff developed that water in part of the system had been found by local health officials to contain excessive amounts of nitrates. Because of these potentially overburdening considerations, it was determined by the assigned hearing officer that the interests of the public and the Commission would best be served through development of an evidentiary record at a public hearing. Accordingly, a duly noticed public hearing was held in Shafter on June 12, 1981 before Administrative Law Judge (ALJ) John Lemke, and the matter was submitted subject to receipt of late-filed Exhibit 2. Late-filed Exhibit 2 was received July 2, 1981.

Summary of Evidence

I. The Application

Sellers state in their application that due to age and poor health it is necessary for them to withdraw from the business of providing water service. Joseph Sellars has become permanently disabled and it has become necessary to hire a caretaker for the system. It is alleged that Allen Dailey is well-qualified to operate and maintain the system, having 20 years of general plumbing experience acquired through ownership of rental property. He also possesses a great deal of experience in remodeling homes for resale. It is stated that the parcels of land on which the wells and pumps are located are large enough to be used for other income purposes, and that one parcel has a machine shop which will be operated. Much of the selling price is based on the value of lots, machine shop, and equipment. Opal Dailey is a licensed real estate broker now doing business in Shafter.

Sellers warrant that:

1. There are no customer deposits to establish credit;
2. There are no main extension advances;
3. The system is in good condition;
4. Pump efficiency tests conducted in August, 1980 show that no corrective work is required;
5. Water tests are made regularly by the Kern County Health Department, and the water is classified satisfactory for drinking purposes.

The income statements in sellers' 1979 and 1980 annual reports contain the following information:

	<u>1979</u>	<u>1980</u>
Operating income	\$30,495	\$31,120
Operating expenses	20,296	26,604
Net operating income, after taxes	10,098	4,465

Exhibit D, attached to the application, is a statement showing the financial condition of buyers as of January 1981. The statement indicates total assets of \$1,078,890. \$955,000 of this amount is represented by real property located in Santa Barbara. There is an outstanding debt of \$527,000 in connection with this real property which is being paid in monthly installments of \$4,968. Monthly rental income from this real property totals \$6,140. Income from other business activity amounts to \$3,800 per month.

Two escrows have been opened in connection with this transaction. One escrow concerns four separate lots with one well located on each lot. The price for this land is \$185,000 (\$43,000 cash and \$142,000 in a note with trust deed). The second escrow relates to the utility's pumps and tanks, distribution main, office, maintenance garage housing the machine shop, welding equipment, and tools. The price for this latter material is \$15,000.

The notice of sale and transfer was published on January 14, 1981 in the Daily Report of Bakersfield. The buyers are now residing in Shafter and are in fact operating the water system.

Buyers state they are fully aware that they are paying far more than the net book value of the system, and that rates may be based upon no more than that net book amount. They estimate their personal income for the year 1981 to be in excess of \$200,000. They do not expect income from the water system to support the purchase. They are looking to the real property and water service as a combined investment, and to outside personal income to satisfy the loan.

II. Testimony

Buyers and sellers, in addition to information contained in their application, testified for the record as follows:

A. Sellers

Alice Sellars stated that the machine shop included in the sale is used only in connection with the water service system. She testified that although there are two escrow agreements, she considers the transfer of system and land a package deal. When asked how sellers were able to convince buyers to pay \$200,000 for the package, she replied that sellers had initially offered the agreed price. She testified that the four wells are set in approximately the middle of each of the four lots; that the location of wells and tanks might inhibit the development of the lots for other purposes.

Joseph Sellars testified that he has had two operations. The poor state of his health does not permit him to take care of the water system any longer.

B. Buyers

Allen C. Dailey testified that he is buying the water system because it is a new venture for him. He has spent much of his life working with automobiles and has tired of that activity. Buyers find the warmer weather in Shafter more to their liking. Dailey stated that the price of \$200,000 might be a little high, and the county might have assessed the land a little low, but that he is happy with the price. He is aware that the 1980 net income from the water system was about \$4,500 and that the annual debt service on the promissory note will be approximately \$24,000. He stated that his wife has a very good income from her real estate business, and that they have a very solid financial background to ensure payment of the debt. Dailey stated they are definitely pledging nonutility income for the benefit of the utility. He said that if county health officials order improvements in the North

Shafter portion of the system in order to correct a nitrate problem, sufficient income would be available to pay for such an expense, even though the cost of drilling a new well could exceed \$30,000.

He stated that he would be willing to place a performance bond with the Commission to ensure that a new well could be added to the system, if necessary. When asked by staff counsel whether it would be possible to rewrite the promissory note and secure the note against nonutility property owned by buyers, Dailey stated it would be difficult because the deal is already set up, and that he views the combined transaction as a package deal consisting of the water system plus the land upon which the system, in part, is situated. He testified that he has surveyed the system to determine what improvements might be necessary. Only a minor upgrading of the land appears necessary in his opinion, involving some fence repairs and general beautification. No main replacements are necessary.

Anna Thompson is a real estate agent who works with buyers. She testified that buyers' estimated income for 1981 shown in Exhibit E (approximately \$200,000) has already been surpassed. She stated that two escrows were opened in connection with the purchase because escrow laws require separate transactions for real and personal property.

C. Staff Presentation

The staff offered evidence through a Kern County Health Department official and two Commission staff witnesses.

Chris Burger, a Senior Sanitarian with the Kern County Health Department, testified that one well in the North Shafter portion of the Sellar's Water Service has been found to have nitrates in excess of the maximum contaminant level of 45 milligrams per liter established under the California Administrative Code, (CAC) Title 22. Results of three tests taken over about 18 months are shown in Table I.

TABLE I

Sellars Water Service - Nitrate Levels

<u>Test Date</u>	<u>Millicgrams per Liter</u>
9-17-79	45
1-8-80	58
3-26-81	49

Burger stated that excess nitrates may cause infant methemoglobinemia, or "blue babies," a disease characterized by certain blood changes. His department recommends that contaminated water not be used by infants or pregnant women. Exhibit 1 was offered in evidence by the staff through this witness. It is a letter dated October 9, 1980 from the Kern County Health Department to Sellars Water Service regarding the excess nitrates. The letter informed sellers that they must notify their customers of the problem. It also advised sellers of three possible remedies. These are:

1. Drilling a deeper well;
2. Intertie with another system with acceptable water;
3. Installation of an ion exchange or reverse osmosis facility.

Burger testified that there is a fourth method which sellers may consider for removing the excess nitrates from their water. This is to set up a procedure where one of the two wells in North Shafter would be used as a blender for the North Shafter system, thereby lowering the level in the contaminated part and increasing the level in the second part of the system, but rendering both wells

safe. This witness had no specific information pertaining to the cost of any of the four possible remedies. The ion exchange method, Burger stated, is still largely experimental.

Mary Jean Purcell is a research analyst in the Commission's Policy and Program Development Division. She recommended that the application be either denied or dismissed without prejudice at this time. Her recommendation is not based entirely upon the inflated agreed price for the system and land. Rather, it is due to a considerable number of instances, similar to the one here involved, where the purchaser of a water company has agreed to make certain needed improvements but defaulted. She is concerned that the costly debt service associated with this purchase would inhibit buyers' ability to finance necessary improvements which may be associated with the nitrate problem. Alternatively, she recommended that if the sale and transfer is approved, it be conditioned upon the securing of a performance bond by either the buyers or sellers. The bond would be payable to the Commission in accordance with new Public Utilities (PU) Code Section 1006.5. (Chapter 1078, Statutes 1980). Under this code provision the Commission may require the placing with it of a bond in an amount not exceeding \$50,000, payable to the Commission and conditioned on the water corporation's furnishing adequate service within its service area. The witness recommended that the bond be for an amount equal to the cost of a new well, plus six months operating expenses. She also recommended that buyers be ordered to investigate the feasibility of securing a loan under the Safe Drinking Water Bond Act.

Exhibit 2 consists of two letters. The first, dated June 26, is an inquiry from Ms. Purcell to the California Department of Water Resources (DWR) concerning the availability of Safe Drinking Water Bond Act funds for private water companies. The second letter

is the answer to the June 26 inquiry. It states that under the program the DWR may provide loans up to \$1.5 million to eligible water utilities. Further, that currently over half of the \$175 million fund is uncommitted and available for loans subject to the sale of state bonds.

The last witness for the staff was Clark Fong, an associate engineer employed in the Commission's Hydraulic Branch. He sponsored Exhibit 3, a report concerning his investigation of the Sellars Water Service. He recommends that since sellers are unable to personally operate the system, the application be granted. He states in his report that no authority is required to encumber the water system, since the system is the subject of one escrow and the land the subject of a separate escrow. Fong also recommended that the sought authority, if granted, be conditioned upon buyers' clearly identifying all wells and easements associated with the system on maps filed with the Commission.

Subsequent to the submission of the proceeding, information was furnished to the staff alleging that the financial position of the Daileys had changed significantly since the application was filed. Based upon the allegation, the ALJ contacted the Daileys by telephone. They admitted that their situation has changed adversely, but nevertheless requested that the application be favorably considered.

By letter dated November 5 the ALJ advised the Daileys that inasmuch as their statement of financial assets presented at the hearing was no longer current, it would be necessary to obtain independent verification of their current financial status. They were instructed to furnish records to a certified public accountant (CPA) indicating monthly income from any source, such as balance sheets from their real estate and plumbing businesses, letters of credit from their bank, tax statements, deeds to property, etc. The CPA was to prepare and submit to the ALJ a financial statement which would be received

as a late-filed exhibit. The information was to be provided by November 23 so that the Commission could act on the application at its December 1 Conference. The Daileys were further advised that without the requested information, it was doubtful whether the Commission would approve the transfer.

On November 20 Mrs. Dailey contacted the ALJ by telephone and advised him that she had only received the November 5 letter on November 12, had been ill for several days, and was unable to secure the services of a local CPA. She requested, and the ALJ granted by letter dated November 23, additional time until December 4 within which the Daileys could furnish the requested financial information. Mrs. Dailey was informed that the Commission would definitely consider the application at its December 15 Conference and base its decision on the information before it at that time.

As of December 7 the updated financial information requested from the Daileys had not been received.

Discussion

The principal issue we are faced with in this proceeding is whether the buyers will be able to furnish adequate, safe water to the customers located within the sellers' service area. There appears to be little question about sellers' need for authority to be excused from the duties and commitments which are incumbent upon a public utility water system. They have performed their obligation to their customers diligently. Joseph Sellars is unable to devote his own energy to maintaining the system any longer and it has been necessary to hire a caretaker.

Sellers have found ready buyers in Mr. and Mrs. Dailey. Buyers are anxious to get away from the coastal climes of Santa Barbara and to relocate in sunnier regions. Sellers need a cooler environment for Joseph Sellars. Allen Dailey informs us that buyers are willing to pledge their personal assets in maintaining a safe, dependable system.

He is willing to place a bond with the Commission to ensure buyers' making necessary improvements in the system in order to overcome the nitrate problem. The fact that buyers are paying an amount considerably in excess of the net book value for the system is essentially a matter between the parties. The evidence concerning the land use and value upon which part of the system is located is conflicting, but buyers are content with the total package price.

However, we need to concern ourselves in this case with buyers' ability to service the debt they are incurring on the note because of the strong likelihood of a large capital expenditure in connection with the excess nitrates. The payments for purchase of system and land, in addition to the cost of remedying the nitrate problem, could prove to be excessive for buyers, especially in light of their changed financial picture. Our duty in this matter is not merely to ensure the continued delivery of water to the customers; it is to attempt to guarantee that water will be furnished in an adequate, healthful state, free from excess contaminants.

In review of the fact that buyers have not supplied us with the information requested by the ALJ in his letter of November 5, we have no real choice but to deny the requested transfer at this time. If the buyers' financial condition improves at some later time, the parties may file a new application.

Findings of Fact

1. Sellers operate a public utility water system serving approximately 285 flat rate customers located in and around the communities of North Shafter and South Shafter, in Kern County.

2. Joseph Glenn Sellars has become permanently disabled and is no longer able personally to care for the system.

3. Sellers and Allen C. Dailey and Opal M. Dailey (buyers) request authority to transfer the system to buyers, and for buyers to issue a note and trust deed to sellers in the amount of \$142,000. The total price for the system and four parcels of land upon which the system is partly located is \$200,000.

4. Much of the selling price is based upon the land underlying part of the system.

5. Buyers have been residents of Santa Barbara. They are in the process of relocating to Shafter and Allen Dailey is, in fact, presently operating the water system.

6. Net income from the system for 1980 was \$4,465. Buyers do not expect this income to support the purchase. They estimate their personal income for 1981 to be over \$200,000.

7. Buyers are pledging nonutility income for the benefit of the water system.

8. The Kern County Health Department has determined that water from one of the four wells in the system contains nitrates in excess of the maximum contaminant level established under the CAC, Title 22.

9. Sellers have been advised by the Kern County Health Department of four possible remedies for their excess nitrates problem. No specific costs for any of the remedies were provided for the record in this proceeding.

10. The Commission, under the provisions of PU Code Section 1006.5, may require the placing with it of a bond payable to the Commission, and conditioned on the water corporation's furnishing adequate service within its service area.

11. Buyers are willing to post a performance bond as a condition of the transfer, in order to guarantee the delivery of adequate and safe water to customers.

12. The DWR has informed the Commission by letter that funds are available under the Safe Drinking Water Bond Act for buyers to borrow in order to remedy the excess nitrates problem presently found in part of the system.

13. Cost of the bond and/or loan incurred by buyers in connection with this transfer is an expense which may be recovered by buyers through assessment of a tariff surcharge.

14. Subsequent to the submission of this proceeding, information was furnished to the staff alleging that buyers' financial status had changed since the application was filed. These changed circumstances were admitted by buyers in a telephone discussion with the ALJ.

15.. Buyers were directed by the ALJ in letters dated November 5 and 23, 1981 to furnish information verified by a CPA, pertaining to their current financial status. This information has not been provided for our analysis.

16. Buyers have not demonstrated a present and continuing ability to supply adequate, safe water to the customers located within the sellers' service area.

Conclusion of Law

The application should be denied.

O R D E R

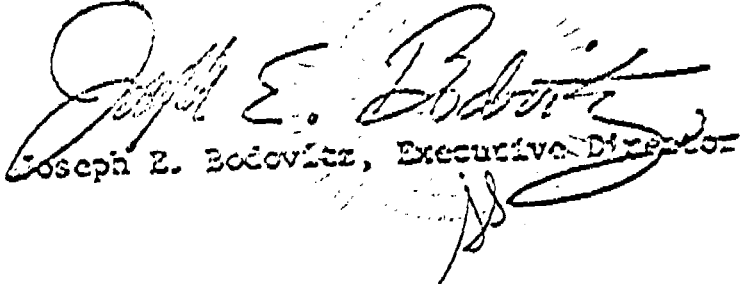
IT IS ORDERED that Application 60275 is denied.

This order becomes effective 30 days from today.

Dated DEC 15 1981, at San Francisco, California.

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

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


Joseph E. Bodovitz, Executive Director