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Decision 97-06-105 June 25, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of Hillcrest Water Company, for a 23.3% general rate increase in TY 1993 for service provided to 3,000 flat-rate customers in and around Yuba City, and an additional increase of 1.7% for 1994 and 1995.	Application 92-11-016 (Filed November 13, 1992)
Ordering Instituting Investigation into the Rates, Charges, and Practices of Hillcrest Water Company.	I.93-03-056 (Filed March 24, 1993)

Stefel, Levitt & Weiss, by Lenard G. Weiss, Attorney at Law, Martin Abramson, and Daryl Morrison, for Hillcrest Water Company, applicant.
Peter G. Fairchild, Attorney at Law, for the Water Division.

O P I N I O N

Summary

Hillcrest Water Company (Hillcrest) is found to be in continuing violation of a Commission decision and penalized by a reduction in rate of return for a period equal to the period that it remains in violation.

Background

This proceeding began with an application for rate increase filed by Hillcrest in November, 1992. Among other matters, Hillcrest sought to be compensated for expenses involved in the repayment of a Safe Drinking Water Bond Act (SDWBA) loan. Customer rates were increased for repayment of this loan, plus interest.

In 1993, an Order Instituting Investigation was issued to inquire into the usage of the funds obtained for the purpose of repayment of the SDWBA loan. Increase in the number of customers, and thus the amount of surcharge money collected by Hillcrest, was sufficient to complete customer responsibility for the SDWBA loan.

A settlement was reached between Hillcrest and the Division of Ratepayer Advocates (DRA) and was adopted by the Commission in Decision (D.) 95-01-038. The precise terms of the settlement are contained in that decision, but may be summarized as follows in so far as this decision is concerned:

1. The surcharge previously imposed on customers to fund the SDWBA loan would cease, since customer funds had already satisfied that loan.

2. The utility would repay the loan in total by January 1, 1996.

3. Three properties owned by the President of Hillcrest (Morrison) were conveyed to Hillcrest by a deed of trust. The properties were to be sold to pay off the loan. Once the loan had been repaid, any of the properties not sold would be returned to Morrison.

By letter of July 18, 1996, DRA notified the Chief Administrative Law Judge (ALJ) that the loan had not been discharged and requested that a prehearing conference (PHC) be held. A PHC was held on September 5, 1996 before Commissioner Duque and ALJ Rosenthal. A subsequent PHC was held on October 17, 1996. At both conferences, the parties were urged to settle this dispute, and mediation services were offered. Settlement proved unsuccessful, and an evidentiary hearing (EH) took place before Commissioner Duque and ALJ Rosenthal on January 22, 1997. Opening briefs were filed on February 28, 1997. On March 11, 1997, a further conference occurred at which the parties outlined a sketch of a possible settlement. The ALJ expressed concern about the

direction this settlement was taking so that the parties might take his thoughts into consideration. The parties waived closing briefs.

Discussion

Undisputed at the EH was the fact that the SDWBA loan was not discharged by January 1, 1996, as required by the settlement entered by the parties and approved by the Commission in D.95-01-038. (Tr. 385.) Also undisputed was the fact that one of the properties placed in the deed of trust for Hillcrest was allowed to be repossessed by the holder of a prior loan on that property. (Tr. 401.) There was no effort made by Hillcrest to seek permission of the Commission to remove this property from the reliance placed on it in D.95-01-038. (Tr. 402.) Furthermore, Hillcrest introduced no evidence of any effort made by Morrison to replace that property with other assets he may have owned so as to provide the security that had been unilaterally removed by Morrison.

In his explanation of the above facts, Morrison testified that he tried in good faith to sell the properties, but received no offers to purchase the properties. (Tr. 387-8.) He further testified that the property allowed to be obtained by default by its lenders was one in which he held a minority interest, repairs were required which exceeded his interest, and the majority owners were not interested in contributing to the repairs. Thus it was not worthwhile for him to make the repairs on his own. (Tr. 401.)

Morrison testified, and it was not disputed, that the loan payments have been timely made, that there is a security deposit to cover one year's worth of payments on deposit, and that he is willing to increase this deposit by an additional year, making a security for two years of payments on the SDWBA loan. (Tr. 388-92.) He also testified that money to repay the loan, approximately $10,000 per month, is coming from utility operations. (Tr. 389.) Under questioning by DRA and the ALJ, it appears that

approximately $4,000 of this sum is generated by the use of depreciation (Tr. 446.), as well as deferred replacement of equipment such as trucks and computers (Tr. 425.) and work performed by Morrison and his son without compensation. (Tr. 425.) In response to a question by the ALJ, Morrison testified that Hillcrest was in a deficit position of approximately $4,000 per month with regards to cash flow. (Tr. 446.)

Discussion

In its opening brief, Hillcrest states:

> "The critical question is whether the utility's ratepayers are at any risk by reason of Mr. Morrison's continuing inability to liquidate in full the $658,761 balance now owed to DWR." (Emphasis in original: page 2.)

While this is a consideration, we do not agree that it is the "critical question." We believe that the critical question is compliance with Commission orders.

To begin, we emphasize that D.95-01-038 was an acceptance of a settlement between Hillcrest and DRA. We adopted the settlement expecting that its terms would be followed. That did not occur.

Hillcrest, on its own, decided that it would remove one of the properties contemplated in Paragraph 5 of the settlement agreement from the settlement. It did this by allowing the holder of a deed of trust to assume title of the property. No request was made to the Commission to change D.95-01-038 to account for this deletion. In fact, there was no notification, so far as the record discloses, that the event even occurred. This action could be considered an attempt by Hillcrest to unilaterally alter a Commission decision, reducing the properties mentioned in the settlement agreement to two, rather than three. If Hillcrest wished to change the obligations imposed upon it by D.95-01-038, it could have petitioned for modification of the decision, a process affording notice and opportunity to be heard to all impacted

parties via the Commission's formal procedures, and complying with PU Code § 1708.[1] Instead, Hillcrest circumvented this legal requirement and resorted to impermissible "self help" measures to change the obligations this Commission had imposed upon it.

Next, Hillcrest allowed the date for repayment in full of the SDWBA loan to pass without requesting an extension of the time set by the Commission when it adopted the settlement. Once again we see Hillcrest arrogating unto itself the power to ignore Commission mandates by unilaterally extending its own compliance date.

We believe both of these acts are inexcusable. If circumstances were as stated by Hillcrest with regard to the property allowed to revert to the holder of a prior deed of trust, the proper course of action would have been to request a modification of D.95-01-038. We would have expected Hillcrest to substitute some other securities for the property that was being withdrawn. Cross-examination by DRA disclosed the existence of other real property and securities. (Tr. 435.) No application for modification was made. (Tr. 402.)

Similarly, the proper course of action by Hillcrest on finding that it was unable to timely retire the SDWBA loan as agreed in D.95-01-038 would have been to bring that circumstance to the attention of the Commission. The good faith effort of Hillcrest to dispose of the properties at a reasonable price could have been explained. Instead, Hillcrest blithely carried on as if that portion of the settlement, which was part of D.95-01-038, really didn't matter.

Can it be said, as Hillcrest contends, that the ratepayers are not put at risk because of the conduct of Hillcrest?

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1 All statutory references are to the Public Utilities Code.

We think not. The promise to retire the entire loan by January 1, 1996 was an important part of the settlement. We assume it was part of a bargaining process between Hillcrest and DRA. We know it was part of the basis for our acceptance of the settlement. We anticipated that the loan would be off the books by January 1, 1996. Instead, over a year later the utility is incurring a negative cash flow of approximately $4,000 per month to continue payments on what we thought would be a terminated loan. In addition, purchase of capital items necessary for the efficient operation of the utility are being deferred. These are certainly risks that are being borne by the ratepayers.

Another risk, which the utility fortunately escaped, is the risk of natural calamity. Flooding occurred in the vicinity of Hillcrest shortly before the EH. In response to the ALJ's question, Morrison testified that Hillcrest had not been affected. (Tr. 445-6.) Had it not been so fortunate the ability of Hillcrest to obtain loans to repair or rebuild its system would likely have been adversely affected by the outstanding SDWBA loan that should have been repaid by January 1, 1996.

But even if Hillcrest were right about lack of risk, that misses the point. Hillcrest was under Commission order to do certain things. Morrison determined that those things would not be done because they were to his economic disadvantage. Morrison did not ask the Commission to amend its order. Morrison saved the Commission that trouble by simply not complying. That is the crux of the present situation.

Another matter deserves comment. All parties agree that sufficient funds were obtained from the ratepayers to pay off the SDWBA loan. That was the reason for the investigation that gave rise to the settlement adopted in D.95-01-038. Hillcrest was under a Commission order to segregate these funds.

> "To assure repayment of the loan, Hillcrest shall deposit all rate surcharge revenue collected, in an interest-bearing account,

> with the fiscal agent approved by DWR. Such deposits shall be made within five working days after the surcharge monies are collected from customers." (Hillcrest Water Co., D.83-07-004, 12 CPUC 1, 7, Ordering Paragraph 5.)

Morrison admitted that he did not comply with this directive. (Tr. 397.) It is another example of his decision to do what he considered convenient, not what the Commission ordered him to do. While he testified that he invested the money for the utility (Tr. 397.), he admitted that he did not ask the Commission for permission to deviate from the order quoted above. (Tr. 398.) Indeed, had he complied with that order, the money to pay the loan would have been intact; available for payment on the loan; and we would not be going through the present expenditure of Commission time, energy, and taxpayer money that could have been devoted to other matters.

One further factual matter deserves attention. In its prepared testimony staff witness Paige characterized the present status, wherein the ratepayers have already contributed sufficient money through the surcharge to completely pay off the SDWBA loan as "...a personal loan from DWR guaranteed by the ratepayers of HWC." (Exhibit 33, pg 3). At the hearing, Morrison was asked if he had sought a personal loan with which he could have paid off the SDWBA loan. His response:

> "A. I casually discussed it with the Feather River [Bank]. That was when we were setting up this letter of credit. Their first statement was they don't understand why we would pay off the lower interest rate loan than they would loan. And that is about as far as we went." (Tr. 433.)

We certainly do not believe that this exhibits a sincere effort on the part of Morrison to extricate either the ratepayers or the utility from a situation that is to his individual advantage.

What now should be done? Hillcrest suggests that we accept an additional letter of credit from Morrison that would provide another year of protection against default by Hillcrest. That would bring the protection to a total of two years. (Opening brief, page 3.) Hillcrest says that ratepayers would be protected because the Commission could condition any transfer of the utility, other than by condemnation, on the customers being insulated from repayment of the loan. (Opening brief, page 2.)

DRA suggests that Hillcrest be given 90 days to repay the loan in total. (Brief, pages 4-5.) If that is not accomplished, DRA suggests a fine of $20,000 be imposed on Morrison, pursuant to PU Code § 2107. (Brief, page 5.) In the alternative, it suggests a fine sufficient to cause repayment, pursuant to PU Code § 701. (Brief, page 5.) It finally suggests the possibility of a contempt action against Morrison pursuant to PU Code § 2113. (Brief, page 5.)

We find the suggested solution of Hillcrest to be unacceptable. It amounts to a total whitewash of the repeated violations of Commission orders by Hillcrest. It actually rewards Morrison for these violations by allowing him to continue enjoyment of a state-backed, ratepayer-guaranteed, low-interest loan.

In anticipation of DRA's suggestion of a penalty, Hillcrest argues that a fine can only be imposed on Hillcrest, not on Morrison. It argues that Morrison signed the stipulation on behalf of Hillcrest, not personally. It further points to the settlement wherein the "Company" agreed to repay the outstanding loan. It then asserts that any fine against Hillcrest might impair Hillcrest's ability to continue timely repayments of the loan, concluding that no fines should be imposed. (Opening brief, pages 4-5.)

Hillcrest's arguments against fines on itself or Morrison are not convincing. We have no doubt that Hillcrest and Morrison are one and the same. Morrison did not consider the interest of

Hillcrest when, as owner, he decided to ignore the Commission order to place surcharge money collected from ratepayers in a special account. He did not consider the interests of Hillcrest when he had a "casual" conversation with Feather River Bank concerning substitution of a loan to himself to pay off the loan to Department of Water Resources (DWR). He did not consider the interest of Hillcrest when he allowed one of the properties held to secure repayment of the loan to be repossessed. He did not consider the interest of Hillcrest when he declined the offers of Citizen Utilities Company of California and California Water Service Company to purchase Hillcrest, because of a possible offer from the City of Yuba City (Yuba City). (Tr. 426.) As testified by Morrison:

> "It doesn't seem like a very good business decision to do that as long as I have got the City of Yuba City sitting there that may be interested in paying a little bit more." (Tr. 437.)

As part of the bargain with DRA resulting in the settlement, he placed his own personal property as security for total repayment of the DWR loan. He may not now be heard to claim that he and the utility are distinct entities for the purpose of this proceeding.

As to the claim that a fine would inhibit the ability of the utility to repay the loan, we find that this proves too much. Under this approach we would never be able to impose a fine on a recalcitrant utility, since any fine, by its very nature takes away from some ability to comply with Commission orders.

We note that PU Code § 2107, cited by staff, permits a penalty of not less than $500 and not more than $20,000 for each offense. We further note that PU Code § 2108 makes each day of a continuing violation a separate offense. At the minimum penalty of $500 per day this would total a penalty of $183,000 for only the year 1996. Were we to pursue penalties at this minimum statutory

rate the total would easily exceed $250,000 by the time this decision becomes final.

We further call attention to PU Code § 2110, which makes it a misdemeanor for a utility or an officer of a utility to fail to comply with a decision of the Commission. This misdemeanor is punishable by a fine of $1,000 and/or imprisonment for up to one year.

Another approach is available to us. We note that D.93-12-013, Hillcrest's last rate application, granted Hillcrest a rate of return of 10.75%. (52 CPUC2d 296, 305.) This raised Hillcrest's net revenue from ($4,308) to $75,972 and its rate of return from -0.61% to 10.75%. We further note that this is a continuation of that application as well as an investigation into the rates, charges, and practices of Hillcrest. That being the case, we believe it appropriate to reconsider the authorized rate of return last accorded to Hillcrest in light of the violations committed by Hillcrest.

Rate of return is not an exclusively financial determination. The Commission also employs it as a means of penalizing a utility for poor service (General Telephone Company of California, 4 CPUC2d 428, 511 (1980)) or ineffective management (Gibbs Ranch Water Company, 56 CPUC2d 468, 480 (1994)). In the present instance we have a utility that has directly violated a Commission order and placed its ratepayers at risk. Rather than imposing a monetary penalty on Hillcrest in the form of a fine, we believe it more appropriate to reduce the rate of return of Hillcrest by one-half to 5.375%, with corresponding reductions in the rates charged to its customers. This reduction in rate of return should begin immediately and continue for a period equal to the time that Hillcrest is in violation of D.95-01-038. Thus, if the SDWBA loan which was promised and ordered to be repaid on January 1, 1996 is not repaid until January 1, 1998, then the reduced rate of return will be in force for two years from the date

of its inception. Since there was testimony in the record of this proceeding that other utilities and Yuba City are interested in purchasing Hillcrest (Tr. 426.), we think it only fair to caution any purchaser that the rate of return penalty in this decision will not be rescinded merely because there is a change in ownership of the utility.

On June 6, 1997, Hillcrest filed a petition to set aside submission and reopen the proceeding. The petition contained a proposed settlement drafted by Hillcrest by which it hoped to settle this matter. DRA filed a statement indicating it did not support the petition. By an ALJ Ruling dated June 11, 1997, Hillcrest's petition was denied. That ruling stated that Hillcrest's proposed settlement did not admit any wrongdoing on the part of Hillcrest and did not contain any penalty for Hillcrest's noncompliance with Commission orders.

Hillcrest filed comments to the Proposed Decision (PD) dated June 12, 1997. These comments assert that the penalty in the PD are too harsh, that the Commission staff was aware of Hillcrest's efforts to liquidate the SDWBA loan, and that delay was caused because its bank did not act quickly enough to satisfy the ALJ. We are not persuaded by the arguments. The record and this decision amply paint Hillcrest's misconduct justifying the penalty imposed. Conversations with the Commission staff cannot be substituted for compliance with Commission orders. The ALJ can hardly be accused of impatience for rejecting a proposed banking arrangement submitted after distribution of the PD and not supported by the Commission staff.

Findings of Fact

1. In Order Instituting Investigation 93-03-056 the Commission opened an investigation into the rates, charges, and practices of Hillcrest.

2. This investigation produced a settlement between staff and Hillcrest which was adopted by the Commission.

3. The settlement required Morrison to place three properties in trust for Hillcrest. These properties were to be sold and the proceeds used to repay the SDWBA loan obtained by Hillcrest.

4. The loan was to be repaid no later than January 1, 1996.

5. Prior to January 1, 1996, Morrison allowed one of the properties placed in trust pursuant to the settlement to be repossessed by the holder of a prior deed of trust on the property.

6. The Commission was not notified of the repossession and the record does not disclose any effort on the part of Morrison to substitute another property into the trust.

7. Hillcrest did not repay the SDWBA loan by January 1, 1996, as agreed in the settlement adopted by the Commission in D.95-01-038.

8. Hillcrest did not seek an extension of the time set in D.95-01-038 for repayment of the SDWBA loan.

9. Hillcrest has continued to make timely repayment on the SDWBA loan.

10. Hillcrest admitted that it did not take surcharge rates and deposit them in a bank, as required by D.83-07-004.

11. The full amount of the SDWBA loan was paid to Hillcrest by its customers earlier than expected because of the increase in customers not contemplated at the time of the surcharge on rates.

12. Service to customers of Hillcrest has been placed at risk because of deferred purchase of necessary equipment while cash from the utility is used to pay the SDWBA loan.

13. The customers of the utility are at risk of natural catastrophes such as last year's floods, since the debt burden of the utility, which should have been retired by January 1, 1996, will diminish its opportunity to gain favorable loans for repair and replacement.

14. Hillcrest and Morrison have been and are in direct violation of D.95-01-038.

15. PU Code § 2107 provides that failure to comply with any part or provision of a Commission decision is subject to a penalty of not less than $500 and not more than $20,000.

16. PU Code § 2108 provides that each day of continuing violation of a Commission decision is a separate offense.

17. PU Code § 2110 makes it a misdemeanor to violate a Commission decision and provides for a fine of up to $1,000 and/or imprisonment for up to one year.

18. Hillcrest's last authorized rate of return was 10.75%.

19. The Commission has used rate of return as a means of improving service and encouraging compliance with its orders.

Conclusions of Law

1. Hillcrest and Morrison failed to comply with D.95-01-038.

2. Hillcrest and Morrison have continued this failure of compliance with D.95-01-038 since January 1, 1996, and are out of compliance at this time.

3. The Commission has a variety of approaches it may take to punish noncompliance and encourage compliance. Among these approaches are fines, criminal penalties, and rate of return reductions.

4. We conclude that the most equitable punishment to be accorded Hillcrest is a reduction in its rate of return for a period of time equal to the length of its violation of D.95-01-038.

5. We conclude that the appropriate rate of return for Hillcrest, in view of its flagrant and continuing violations of Commission decisions, is 5.375%, which is a 50% reduction in its last authorized rate of return.

6. This reduced rate of return shall continue even if ownership of the utility changes.

O R D E R

1. The rate of return of Hillcrest Water Company (Hillcrest) is reduced from 10.75% to 5.375% beginning the effective date of this order.

2. This reduced rate of return shall continue for the same period as Hillcrest is out of compliance with Decision (D.) 95-01-038. Noncompliance began on January 1, 1996.

3. The Commission's Water Division is directed to fashion sample tariffs for Hillcrest that conform to the reduced rate of return found appropriate by this decision. These tariffs shall be furnished to Hillcrest within 20 days of the date of this order. Hillcrest shall file new tariffs reflecting the reduced rate of return on the effective date of this order.

4. Hillcrest shall notify the Executive Director of the date it has fully repaid the Safe Drinking Water Bond Act loan. Documents supporting this repayment shall be included. A copy of this notification shall be directed to Water Division.

5. When Hillcrest has completed the penalty contained in this order and wishes to obtain a normal rate of return it shall file for its requested rates. That filing shall show the dates it was out of compliance with D.95-01-038 and the dates of reduced rate of return.

6. This matter is closed.

This order becomes effective 30 days from today.

Dated June 25, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners