

Mailed
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WATER/ICRJ/RHG

Decision 05-01-015 January 13, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application for Authority to Transfer Control or Ownership of SLEEPY HOLLOW ACRES, INC. doing business as WEIMAR WATER COMPANY U-100-W to GERRY LaBUDDE pursuant to Public Utilities Code Sections 851-854.

Application 03-12-018
(Filed December 12, 2003)

O P I N I O N

1. Summary

Pursuant to Pub. Util. Code §§ 851 through 854¹, this decision authorizes Frederic J. Fahlen, owner of Weimar Water Company (WWC), to sell and transfer ownership of the water system to Gerry O. LaBudde, as described in Application (A.) 03-12-018 and exhibits attached (Application). LaBudde is an experienced water system operator who has been solely operating the WWC water system since 2000.

While the parties previously endeavored to transfer ownership in 2000, such transaction was void, lacking prior Commission approval. Today's authorization required cancellation of the prior agreement and issuance of a new agreement that is prospective in its effectiveness.

Notice of the filing appeared on the Commission's Daily Calendar of December 15, 2003. No protests have been received.

¹ All statutory references are to the Public Utilities Code unless otherwise indicated.

2. Background

WWC, a California corporation, is a Class D water utility subject to the jurisdiction of this Commission. WWC was originally granted a Certificate of Public Convenience and Necessity (CPCN) by Decision (D.) 62890², dated December 5, 1961 in A.43501. D.62890 also authorized WWC's request to issue not to exceed \$200,000³ aggregate par value of its capital stock at par.

D.92663, dated February 4, 1981 in A.59742, authorized the transfer of all the issued and outstanding shares of WWC's common stock from the original owners, who were past retirement age and lack the financial and managerial ability to operate the system, to Fahlen, Boyd Sears, III, and Charles F. Gierau.

WWC provides water to about 400 active services in approximately three-square miles of mountainous terrain, in and near the town of Weimar, ten miles northeast of Auburn, Placer County. WWC obtains raw water from the Placer County Water Agency through a series of seven pumping stations ranging from 5 to 20 HP, capable of pumping between 200 and 1,400 gallons per minute. The system has five water storage tanks with a total capacity of 260,000 gallons, 85,000 feet of water main, 60 fire hydrants and three buildings.

WWC's Balance Sheet as of December 31, 2003 shows Common Stock at \$100,000 or 1,000 shares issued with a stated par value of \$100 per share. As of August 26, 1987, Fahlen owns 1,000 shares as evidenced by WWC's Stock Certificate No. 15.

² In this decision, the incorporators were identified as Leo Meneley, Louis R. Sacchetto, Joseph Contarini, and Samuel J. Contarino.

³ WWC is authorized by its Articles of Incorporation to issue not to exceed 5,000 shares of common capital stock with a stated par value of \$100 per share.

On October 8, 2000, by a Stock Purchase Agreement, shown as part of Exhibit A to the Application, Fahlen sold 521 shares of WWC's stock owned by him at a price of \$311.322 per share to LaBudde. This transaction was done without Commission authorization.

Also, on October 8, 2000, by a Redemption Agreement, shown as part of Exhibit A to the Application, WWC redeemed 479 shares of WWC stock owned by Fahlen at a price of \$311.322 per share.

3. Sales Agreement

By this Application, Fahlen requests authorization to sell the WWC water system to LaBudde. The selling price is based on the original cost of the utility assets of \$751,238 less accumulated depreciation of \$439,916--as of January 1, 2000. The Sales Agreement provides for a total selling price of \$311,322. WWC will assume part of the obligation and LaBudde will assume the remaining obligation as discussed below.

A. Stock Redemption

The Stock Redemption Agreement provides that WWC will reacquire 479 shares at \$311.322 per share or a total obligation of \$149,123 from Fahlen. WWC has paid Fahlen \$55,000 and the remaining \$94,123 is represented by a promissory note. The promissory note calls for equal principal payments of \$784.36 monthly over a ten-year period, and monthly interest payments based upon the average of the Federal Reserve rate for Bank prime loan rate, and the Federal Reserve rate for six-month Certificates of Deposit, with no penalty for pre-payment.

B. Stock Purchase

The Stock Purchase Agreement provides that LaBudde will buy 521 shares from Fahlen at \$311.322 per share or a total obligation of \$162,198. LaBudde has paid Fahlen \$28,000 and the remaining \$134,198 is

represented by a promissory note. The promissory note calls for equal principal payments of \$745.55 monthly over a fifteen-year period, and monthly interest payments based upon the average of the Federal Reserve rate for Bank prime loan rate, and the Federal Reserve rate for six-month Certificates of Deposit, with no penalty for pre-payment.

Pursuant to Section 816, a public utility is required to obtain the Commission's authorization for the issuance of stock, and after authorization has been issued, later sales by stockholders do not come within the jurisdiction of the Commission. A utility may amend its articles of incorporation to provide for an increase of its capital stock without the authorization of the Commission, but no stock may be issued under the amended articles without an order.

However, Section 854(a) states, in relevant part, as follows:

No person or corporation...shall merge, acquire, or control...any public utility organized and doing business in this state without first securing authorization to do so from the commission...Any merger, acquisition, or control without the prior authorization shall be void and of no effect.

4. Discussion of Stock Transactions

Both parties desire the transfer of the WWC water system from Fahlen to LaBudde. Fahlen of WWC wants to exit the water utility business because he desires to retire and wishes to ensure an orderly transition. La Budde is an experienced water system operator, and he would like to purchase the WWC water system from Fahlen.

At the time of this Application, Fahlen and LaBudde have in fact already executed the Stock Purchase Agreement that theoretically transferred control of WWC to LaBudde and for which they are seeking approval in this Application. The parties have thereby violated the Pub.

Util. Code, and the offending transaction is void under Section 854(a), which forbids any person or corporation from acquiring control of a public utility without first securing authorization to do so from the Commission.

The Commission has no power to validate a transaction which, under the Pub. Util. Code, is *void ab initio*. The Commission has no power to make valid an act that is void. However, the Commission may direct the cancellation of the Stock Purchase Agreement executed without authority and authorize the execution of a new agreement in lieu thereof. We will, with the authority vested in the Commission by Section 854(a), require Fahlen and LaBudde to execute a replacement Stock Purchase Agreement to be effective prospectively, on substantially the same terms and conditions as those set forth in Exhibit A to the Application.

WWC is put on notice by this decision that the Commission does not permit a utility, either through carelessness or design, to disobey the provisions of the Pub. Util. Code either in letter or in spirit. If in the future, the Commission becomes convinced that any of its orders are being knowingly violated, WWC will find us less accommodating.

We remind WWC of the provision of Section 856:

Every officer, agent, or employee of a public utility, or of a subsidiary or affiliate of, or a corporation holding a controlling interest in, a public utility, and every other person subject to the requirements of this article, who violates or fails to comply with, or procures, aids, or abets any violation of, this article is guilty of a misdemeanor.

The Commission has broad discretion to determine if it is in the public interest to authorize a transaction pursuant to Section 854(a). The primary standard used by the Commission to determine if a transaction should be authorized under Section 854(a) is whether the transaction will

adversely affect the public interest. The Commission may also consider if the transaction will serve the public interest. Where necessary and appropriate, the Commission may attach conditions to a transaction in order to protect and promote the public interest.

First, WWC will continue to operate as it has in the past, using the same name and operating authority. Second, the public may benefit from the transfer of control to the extent the transaction enhances WWC's ability to maintain and expand its services and operations in California. Third, there is no opposition to this Application. Thus, we see no reason to withhold authority for the transfer of control before us here.

While the prior stock transfers were not authorized by the Commission, we have voided that transaction and now require the principals to execute a new Stock Purchase Agreement, to be effective prospectively. Although it is within our discretion to assess a penalty to be paid, we will not do so, given the specific facts in this particular case. However, as previously noted, we will not tolerate such behavior in the future.

We find that a penalty is not appropriate in this case. The company's failure to seek Section 852 approvals for the prior stock transactions caused neither physical nor economic harm to customers or competitors⁴. In fact, in this case, the customers would be negatively impacted if we did not approve this transfer.

⁴ In the *Final Opinion Adopting Enforcement Rules* (1998) D.98-12-075, the Commission established factors it would use in determining the level of penalty for violation of the Commission's rules. A key factor is "severity of the offense," including actual physical harm, economic harm, competitive harm, and harm to the regulatory processes, as well as the number of violations and number of persons affected. A second key factor is "conduct of the utility," including conduct in preventing, detecting, disclosing and rectifying the violation. (*Id.*, pp. 36-39.) The severity of the offense here is not substantial, and we have now taken steps to prevent violations in the future.

To evaluate whether LaBudde and WWC will be able to handle this long-term obligation, the Water Division examined available records of the water system and LaBudde, including recent balance sheets, income statements, the sales agreement, existing debt, and other pertinent records. We have determined that LaBudde is financially capable, and that WWC can redeem Fahlen's stock without incurring financial trouble, or raising the rates of its customers beyond what the rates ordinarily would be.

WWC's Balance Sheet as of December 31, 2003 shows current assets of \$90,030 and zero current liabilities. This indicates WWC's solvency. For the same period, WWC reported total operating revenues of \$247,972 and net income of \$34,016.

LaBudde shows total assets of \$1,050,870 and total liabilities of \$337,560 in his November 20, 2003 Net Worth Report shown as Exhibit D to the Application. The same report shows current assets of \$5,248 and current liabilities of \$3,852.

5. Ratepayer Indifference

The Commission requires a test of ratepayer indifference when evaluating the sale of a public utility. The ratepayer indifference concept is one that states that any sale of a public utility should not have any net consequences that cause the ratepayer to prefer the seller to the buyer. For example, the ratepayer should not be subject to increased rates or reduced service as the result of a change of ownership. In more recent years, the Commission has further approved transfers where the buyer demonstrated that his acquisition of the public utility would yield a tangible benefit to the ratepayer.

Using the ratepayer indifference test to assess the proposed sale of the water system, the Water Division evaluated several key metrics including (1) the impact of purchase price on ratebase, (2) service quality,

and (3) continuity of service. LaBudde proposes to adopt the presently filed tariffs of WWC, and upon approval of the transfer of control, to continue offering its current services and using the same name and operating authority. As discussed at greater length below, the key matrices are all satisfied. The buyer has been the *de facto* operator of WWC for several years, during which time service quality appears good. Based on the desire of the current owner to retire, it is appropriate and in the public interest to ensure an orderly transition in the ownership of WWC. Accordingly, it is reasonable from the ratepayer standpoint to approve the transfer.

6. Selling Price

The Water Division reviewed the Applicant's calculations of utility assets and depreciation and confirmed them with Commission adopted resolutions and annual reports filed with the Commission.

Section 2720 requires the Commission to use the fair market standard in establishing the rate base for an acquired water system:

(a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting.

(1) For purposes of this section, "public water system" shall have the same meaning as set forth in Section 116275 of the Health and Safety Code.

(2) For purposes of this section, "fair market value" shall have the same meaning as set forth in Section 1263.320 of the Code of Civil Procedure.

(b) If the fair market value exceeds reproduction cost, as

determined in accordance with Section 820 of the Evidence Code, the commission may include the difference in the rate base for ratesetting purposes if it finds that the additional amounts are fair and reasonable. In determining whether the additional amounts are fair and reasonable the commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable.

(c) The provisions of subdivisions (a) and (b) shall also be applicable to the acquisition of a sewer system by any sewer system corporation or water corporation.

(d) Consistent with the provisions of this section, the commission shall retain all powers and responsibilities granted pursuant to Sections 851 and 852.

The Water Division believes that the selling price of \$311,322 meets the fair value doctrine as it represents the amount paid by a willing buyer to a willing seller. It is also the value of the depreciated assets of the water system.

7. Service Quality

The buyer has been operating the water system since October 2000 and is an experienced water system operator holding a Grade 4 Treatment Operator license, a Grade 2 Distribution Operator license, General Contractor's license and Civil Engineering license. LaBudde previously worked for Fahlen in the operation of WWC and is intimately familiar with the WWC water system.

8. Service Continuity

Fahlen is the sole owner of Weimar. He wishes to exit the water utility business. LaBudde is an experienced water utility plant operator with a long history with the WWC water system.

The Sales Agreement ensures an orderly water system ownership transition and thereby offers continued water service by a responsible and experienced new owner, and greatly reduces the chance of these water systems being abandoned and turned over to their respective county health departments.

9. Public Notification

LaBudde has been managing the WWC water system since October 2000 and has worked with WWC since 1997. Upon transfer of the water system to LaBudde, WWC's phone number and mailing address stayed the same. WWC's office was relocated from Fahlen's home to LaBudde's home. WWC's new office address is listed in the local telephone directory. In the monthly water bill, WWC's phone number and mailing address are listed. While no formal notification was provided to WWC's customers, the steps taken by WWC (1) ensured that customers had no lapse in their ability to contact WWC, and (2) allowed for an orderly continuity of service. Furthermore, a public meeting was held on January 20, 2004 with regard to a general rate increase application, which afforded customers an opportunity to meet LaBudde.

10. Conclusions and Recommendations

The Water Division recommends:

1. That the Application be accepted and approved with no further hearings, pleadings or filings necessary.

2. That Fahlen be granted authorization to withdraw from providing water utility service to customers of Weimar Water Company.

3. That LaBudde be authorized to assume the water utility service to the customers of the Weimar Water Company.

4. That LaBudde comply with the provisions of California Health and Safety Code (CH&S) § 116525(a), which states: “No person shall operate a public water system unless he or she firsts submits an application to the department and receives a permit as provided in this chapter. A change in ownership of a public water system shall require the submission of a new application.” Accordingly, apart from authorization from the Commission for LaBudde’s acquisition of WWC, LaBudde also must file an application with the Department of Health Services.

The Commission has considered the Water Division’s recommendations and, finding them reasonable, will adopt them as stated above.

11. Categorization and Need for Hearings

In Resolution (Res.) ALJ 176-3125 dated December 18, 2003, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3125.

12. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

13. Assignment of Proceeding

Izetta Jackson is the assigned Examiner in this proceeding.

Findings of Fact

1. Fahlen seeks authority to transfer ownership of the Weimar Water Company, which serves about 400 customers.
2. The prospective new owner, LaBudde, is an experienced water system operator and has operated the Weimar Water Company since October 2000.
3. Fahlen and LaBudde have violated Section 854(a) and the October 8, 2000 Stock Purchase Agreement is void.
4. The execution of a new Stock Purchase Agreement to replace and cancel the unauthorized transaction is in the public interest.
5. Ratepayers will benefit from the transfer because the prospective new owner is experienced in operating the water system and has been doing so successfully since October 2000.
6. The Commission's Water Division has determined that the purchase price of the three systems, \$311,322, is the fair market value, as required by Section 2720.
7. There is no known opposition and there is no reason to delay granting the authority requested.

Conclusions of Law

1. Transfer of ownership of WWC meets the test of ratepayer indifference, in that customers will be unaffected or better off in terms of service, water quality, and continuity of service.
2. Pursuant to California Health and Safety Code, a change in ownership of a public water system shall, and a change in regulatory

jurisdiction may, require application for a new operating permit from DHS.

3. Section 854(a) requires prior Commission authorization for the acquisition or control of public utility.

4. This is an uncontested matter in which the decision grants the relief requested.

5. Today's order should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. Frederic J. Fahlen is authorized pursuant to Public Utilities Code §§ 851-854 to sell and convey Sleepy Hollow Acres, Inc. doing business as Weimar Water Company (WWC) to Gerry O. LaBudde, as more fully described in Application 03-12-018 and exhibits attached to the Application.

2. Fahlen and LaBudde may execute a Stock Purchase Agreement in substantially the same form as set forth in the Application.

3. The Stock Purchase Agreement shall be effective prospectively and shall replace the document that was issued and executed without authorization from the Commission.

4. Applicants within 10 days of the transfer of ownership shall notify the Director of the Water Division in writing that the transfer has taken place, attaching copies of the transfer document.

5. Upon consummation of the transfer of ownership, Fahlen shall be relieved of public utility responsibility for the operation of the WWC water system.

6. WWC shall continue offering its current services and using the same name and authority after the transfer of ownership.

7. LaBudde is directed to comply with § 116525(a) of the Health and Safety Code, which states: “No person shall operate a public water system unless he or she first submits an application to the department and receives a permit as provided in this chapter. A change in ownership of a public water system shall require the submission of a new application.”

8. Application 03-12-018 is closed.

This order is effective today.

Dated January 13, 2005, at San Francisco, California.

MICHAEL R. PEEVEY

President

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners