

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

CASE NO. WF-82-159

In the matter of the application of
TERRE DU LAC UTILITIES CORPORATION
for retroactive authority to issue
stock and create evidence of
indebtedness pursuant to Section
393.220, RSMo 1981.

CASE NO. WF-82-193

In the matter fo the application of
TERRE DU LAC UTILITIES CORPORATION,
a corporation, for authortiy to create
evidence of indebtedness pursuant to
Section 393.200, RSMo 1981.

APPEARANCES: Richard S. Brownlee, III, Attorney at Law, 235 East High
Street, Jefferson City, Missouri, for Terre Du Lac Utilities
Corporation.

Michael C. Pendergast, Assistant Public Counsel, 1014 Northeast
Drive, Jefferson City, Missouri 65101, for the Office of the
Public Counsel.

Mary Ann Garr, and Martin C. Rothfelder, Assistant General
Counsels, P. O. Box 360, Jefferson City, Missouri 65102, for
the Staff of the Missouri Public Service Commission.

REPORT AND ORDER

On December 22, 1981, Terre Du Lac Utilities Corporation (Company) filed an
application seeking retroactive approval of the following actions:

1. The issuance of the stock in the corporation;
2. The issuance of a promissory note in favor of Terre Du Lac, Inc.
in the principal sum of \$400,000 at an interest rate of 13-3/4
percent per annum with the principal to be due January 1, 1985;
3. The issuance of a security agreement pledging all of the assets
of the Company as collateral for a loan from CIT Corporation to
Terre Du Lac, Inc.

The application was assigned Case No. WF-82-159.

On February 8, 1982, Company filed its application seeking approval of the execution of a promissory note in favor of Terre Du Lac, Inc. (Developer) to reflect the purchase of water and sewer property used in rendering utility service at a subdivision known as Terre Du Lac. The latter application was assigned Case No. WF-82-193.

By a letter dated April 6, 1982, the Company's attorney requested a consolidation of these two cases with the Company's pending water and sewer rate cases. By order issued on April 29, 1982, the Commission consolidated only these two finance cases and set the matters for hearing on a joint record on June 30, 1982.

Following the hearing the briefing schedule in these two finance cases was extended on several occasions. On December 3, 1982, the parties to the financing cases, and the parties to the rate cases (Case Nos. SR-83-69 and WR-83-70) filed a joint motion seeking the filing of simultaneous briefs in all of the four related matters. The request for the briefing schedules to coincide was granted, and the record was complete by the filing of the Company's reply brief on April 15, 1983.

The Company's initial brief was a consolidated brief filed for Case Nos. SR-83-69, WR-83-70, WF-82-159 and WF-82-193. The Company's brief also seeks a consolidation of the four cases for all purposes. The Commission Staff has filed separate briefs in the financing cases and in the rate cases, and opposes the consolidation. The Public Counsel and Intervenor, Terre Du Lac Property Owners Association, Inc., (Property Owners) also oppose the consolidation. Property Owners was not a party to the finance cases and the Public Counsel participated to a very limited extent in this matter.

In the Commission's opinion the request for consolidation should not be granted and this Report and Order addresses only the record made in Case Nos. WF-82-159 and WF-82-193.

Findings of Fact

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact:

The predecessor to the Developer was incorporated in 1966 as Big River Lakes Development Corporation. Terre Du Lac Utilities was organized as a separate corporation in 1967 for the purpose of operating the water and sewer utilities in an area known as Terre Du Lac, being developed by the Developer west of Bonne Terre, Missouri. In 1973, the Developer's name was changed to Terre Du Lac, Inc. Also in 1973, the Company applied to this Commission for a certificate of public convenience and necessity to operate water and sewer utilities at Terre Du Lac. Certificates were granted by the Commission's Report and Orders issued on January 14, 1974, in Case Nos. 17,887 (sewer) and 17,888 (water).

At the time the certificates were granted in 1974, a substantial amount of water and sewer plant had been constructed, but the number of water and sewer customers being served is unknown by the Company. The original construction was performed through the use of the engineering department of the Developer and the use of subcontractors such as a company owned by one of the principals of the Developer.

As the result of financial difficulties, both the Company and the Developer were involved in a Chapter 11 bankruptcy proceeding in 1975. In the bankruptcy proceedings, Sensibar Enterprises, Inc., and James O. Kwon acquired the capital stock of both the Developer and the Company. Those purchasers had not previously been involved in the ownership or operation of either the Developer or the Company. James O. Kwon is now the president of the Company.

In late 1978 or early 1979 the Public Service Commission Staff undertook a plant record review to determine the extent and cost of the Company's utility properties. The Staff reviewed the Company's "as-built" maps, performed field inspections, reviewed Company check stubs and examined vendor invoices to price the plant in service.

The Staff formed the opinion that most of the Company's properties were contributed either by the Developer or received in connection fees from the customers. The Company tariffs provide for a connection fee of \$200 for each connection to the central water or sewer system.

The Staff's opinion was formed partly because the contents of the financial statements of Big River Lake Development Corporation prepared by its certified public accountants for the three years ending August 31, 1974. The following statements appear in each of the three reports:

Real estate held for sale is stated at original cost of acquisition and cost of improvements allocated to inventory. Improvements include streets, dams, selective clearing, recreational facilities, unrecoverable water and sewer systems costs, and other amenities and development costs. As homesites are sold, an allocated unit cost, including the estimated cost to complete improvements, is charged to cost of sales.

The allocated unit cost is computed by prorating the total estimated costs in the proportion that the sales price of each homesite bears to the total estimated sales price of all homesites.

The cost of water and sewer and all recreational facilities, such as the golf course, swimming pool, recreation pavilion, club house and tennis courts, has been allocated as part of the unit cost of the homesites.

The Commission Staff's opinion is also developed partly by the contents of the feasibility study filed in the Company's certificate cases. The feasibility study was performed by the engineering department of the Developer and recites in part as follows:

C. Budgeting for Capital Improvements:

In conjunction with financing arrangements now being negotiated, an "Improvement Escrow Fund" will be established. This escrow fund will represent 22-1/2% of all receipts from lot purchasers and is to be maintained until all improvements have been fully paid for in all recorded plats of land comprising the development.

All moneys in the "Escrow" account will be used by the developer for payment of the cost of construction of roads, sewers, sewage treatment facilities, utility lines, recreational facilities and other amenities and improvements to be provided for the

development according to a schedule of improvements and plans to be prepared and certified by a registered, professional engineer.

A final document developing the Staff's opinion was a letter dated January 16, 1979, to the Company's president from its CPA firm. The letter was sent to the Company's president to confirm the results of conversations between Commission Staff members and the representatives of the CPA firm. The letter stated that repayment by the Company of advances from the Developer is uncertain and may not be possible unless the Company is able to eventually sell its assets for a price large enough to discharge all of its obligations. The letter further stated that the balance in the advance account on the Company's books at the close of each fiscal year is considered an additional cost of land and is used in the determination of cost of land sales.

The Commission Staff requested the Company to make changes on its annual report for 1978 to reflect the large amount of contributed property. The annual report filed for 1978 showed contributed property to be increased from \$400,630, to \$2,179,760, a net increase of \$1,779,130.

There is a substantial difference of opinion as to whether or not the Company understood the meaning of this action. The Commission Staff witnesses contend that the Company representatives appeared to understand and accept the change. The Company witnesses now contend that the president and accountant were not sophisticated in utility matters and did not understand the significance of the entry, but performed the action merely to acquiesce in the Staff's request. At any rate, the Company continued to show the large amount of contributions-in-aid-of-construction on its annual reports for 1979 and 1980. For its 1981 annual report the Company removed the large amount of contributions-in-aid-of-construction. The Company's president testified that the change was made in ignorance of the consequences, in an effort to cooperate with the Commission Staff. No similar changes were made on the books and records of either the Developer or the Company.

It is the controversy concerning the existence or nonexistence of a Company-supplied rate base that has prompted the instant applications. The belated application in Case No. WF-82-159 was also filed because of the Company president's ignorance that such approval is required.

Two of the residents of Terre Du Lac testified at the hearing and reinforced the contention that the utility plant is primarily Developer contributed from funds originally supplied as part of the lot purchase prices. It was contended that salesmen working for the Developer represented that no charge would ever be made for water and sewer service other than the initial connection fees. Copies of the property reports required by the Department of Housing and Urban Development (HUD) refute that contention. The HUD reports are required to be furnished to purchasers of lots from sellers engaged in interstate land sales. The cover of the report bears a conspicuous warning that the report should be read before signing. The applicable reports clearly indicate that charges for water and sewer service will be rendered. The sellers are required to furnish acknowledgement that the report has been read by the prospective purchaser.

The issue of the amount of contributed plant was properly tried in the Company's rate cases and has been extensively discussed in the Report and Order in Case Nos. SR-83-69 and WR-83-70 being decided and issued concurrently with the instant cases.

As a result of the bankruptcy proceedings, Kwon and Sensibar acquired the stock of both the Developer and the Company but no evidence was offered concerning the purchase price or any allocation as between the corporate entities. An existing loan from CIT Corporation to the Developer was assumed by the new shareholders. At that time, there was an outstanding balance of \$4.5 million on the original note in the amount of \$15.3 million. The purchasers borrowed an additional \$1.5 million and negotiated an interest ceiling of 13-3/4 percent.

One of the requirements of CIT was that the Company execute a security agreement encumbering its entire system to guarantee payment of the obligation of the Developer. The Company's president was unaware that such action required Commission approval and now seeks approval in Case No. WF-82-159. The Commission Staff opposes the approval.

On June 8, 1976, 40 shares of the Company stock were issued to James Kwon and 360 shares were issued to Sensibar Enterprises. On December 30, 1980, the Sensibar shares were reissued as follows to reflect the current ownership:

James Kwon	112 shares
Steven Davis	216 shares
Jack Goldfarb	72 shares

Staff has not contested this segment of the application and there is no contention by any person that the approval of the reissuance of the shares of the stock should not be approved.

The third part of the authority sought in Case No. WF-82-159 is approval of the promissory note dated January 1, 1981, in the principal sum of \$400,000 payable to the Developer, borrowed for purposes authorized by Section 393.200, RSMo 1978, including but not limited to purposes of acquiring property, construction, completion, extension and improvement of service and the establishment of working capital for the Company.

Although the Company's application does not mention that the proceeds of the note are to apply to operating expenses, the evidence offered establishes that the proceeds were actually used to cover operating deficits and for new construction. \$205,000 had been spent with approximately \$150,000 being spent for new plant in 1981.

The application in Case No. WF-82-193 seeks approval of a promissory note and a purchase agreement under which the Company would purchase the water and sewer related properties from the Developer. The Company's purpose in executing the note

in the amount of \$601,400 was to create a bona fide evidence of indebtedness and to acquire a rate base in the event there is no determination that a present rate base exists. In short, the issue is directly related to that of the existence of a rate base in the Company's current rate cases.

Conclusions

The Missouri Public Service Commission has arrived at the following conclusions:

Section 393.200, RSMo 1978 requires any water or sewer corporation to secure this Commission's approval before issuing any stocks, bonds, notes or other evidence of indebtedness payable at periods of more than 12 months after the date thereof, when necessary for the acquisition of property, the construction, completion, extension or improvement of its plant or system, or for the improvement or maintenance of its service or for the discharge or lawful refunding of its obligations or for the reimbursement of monies actually expended from income, or from any other monies in the treasury of the corporation not secured or obtained from the issue of stocks, bonds, notes or other evidence of indebtedness.

Section 393.220.7 authorizes the Commission to approve issues of stocks, bonds, notes or other evidence of indebtedness which were issued without prior approval when it can be shown that the issuance was for purposes authorized by Section 393.200, and were issued in good faith without knowledge of the requirements of obtaining prior approval.

Section 393.190 requires a water corporation or sewer corporation to secure prior approval to mortgage or encumber a whole or part of its sewer system.

The Staff has not opposed the stock reissuance. When no valid objection has been raised, and when there is no showing that the reissuance is improper or detrimental to the Company's ratepayers, the transaction should be approved.

The evidence adduced at the hearing revealed that a portion of the proceeds of the promissory note in the amount of \$400,000 was to apply to operating expenses.

The Company's application to issue the promissory note does not divulge that purpose. As such the Company's application is deficient.

Since a portion of the proceeds of the \$400,000 note are intended to be used for the payment of past operating deficits, any recovery of the cost of that borrowing in future rates would be prohibited retroactive ratemaking. The Missouri Supreme Court has disallowed this Commission's attempt to allow a utility to recover past losses collected under a rate which did not perfectly match expenses with the rate actually established. State ex rel. Utilities Consumers Council vs. Missouri Public Service Commission, 585 S.W.2d 41 (Mo. banc). This result is consistent with our decisions in Re: Martigney Creek Sewer Company, Case No. SR-83-166 (March 4, 1983) and Re: Missouri Cities Water Company Case No. WR-83-14 et al (May 2, 1983).

The proposed issuance of the security agreement to CIT Corporation constitutes the encumbrance of the Company's entire system for the purpose of guaranteeing the obligation of an affiliated corporation. The affiliated corporation is not a utility subject to the jurisdiction of this Commission. The guaranteeing of that obligation is not the proper purpose of utility assets and serves no beneficial purposes as far as the utility's ratepayers are concerned.

The authority sought in Case No. WF-82-193 is a collateral effort to resolve an issue properly raised in the Company's rate case. The purchase agreement is conceded to be a substitute or replacement in the event there is a finding that the Company has no rate base. The application seems to miss one significant point. If it is determined that the Company has no rate base on which it can earn, it is on the basis of the property being contributed, not because the Company does not own it. The Commission has for some time not allowed a rate of return on property not supplied by the investors. This is not to say that contributed property does not belong to the Company.

The instant case cannot be determined as an abstract proposition. If it is determined that the customers have provided the plant initially in the lot purchase price, it is improper to assess them a second time in the form of higher rates to pay for a purchase of that same property. The rate base question is properly determined in the Company's rate case and the instant application should be denied.

It is, therefore,

ORDERED: 1. That the reissuance of capital stock of Terre Du Lac Utilities Corporation to the following individuals, and in the number indicated, which represents the current ownership of the utility stock is hereby approved:

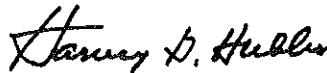
James Kwon	112 shares
Steven Davis	216 shares
Jack Goldfarb	72 shares
	<u>400 shares</u>

ORDERED: 2. With the exception of the authority granted in Ordered: 1 above, all other authority sought by Terre Du Lac Utilities Corporation for retroactive authority to create evidence of indebtedness pending in Case No. WF-82-159, is hereby denied.

ORDERED: 3. That the application of Terre Du Lac Utilities Corporation to create evidence of indebtedness by the issuance of a promissory note in the amount of \$601,400 in favor of Terre Du Lac Incorporated, pending in Case No. WF-82-193, is hereby denied.

ORDERED: 4. That this Report and Order shall become effective on the 1st day of August, 1983.

BY THE COMMISSION



Harvey G. Hubbs
Secretary

(S E A L)

Shapleigh, Chm., Fraas, and
Musgrave, CC., Concur and
certify compliance with the provisions
of Section 536.080, RSMo. 1978.
Dority, C., Not Participating.

Dated at Jefferson City, Missouri,
this 3th day of July, 1983)