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Decision 88-04-068 April 27, 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's
own motion into the practices of
Citizens Utilities Company of
California, its operating divisions
and its subsidiaries, with regard
to the transfer of real property
rights and the management of its
watershed resources.

OII 83-11-09
(Filed November 30, 1983)

Kathy Wyrick, Intervenor,

Complainant,

v.

Citizens Utilities Company of
California, and subsidiary
companies and corporations,
Sacramento Water Works, Jackson
Water Works, Larkfield Water
Company, Felton Water District,
Montara Water District, Guerneville
Water District, Washington Water
and Light Co.,

Case 83-12-07
(Filed December 19, 1983)

Defendants.

In the Matter of the Application
of Citizens Utilities Company of
California for authority to increase
rates and charges for water service
in its Guerneville Water District.

Application 60220
(Filed January 27, 1981)

E. Garth Black and John H. Engel, Attorneys at Law, for respondents.
James Squeri, Attorney at Law, for Kathy Wyrick, complainant and interested party, and for PATRIOTS, interested party.
Kathy Wyrick, for herself, complainant, and for PATRIOTS, interested party.
Jack Crlenjak, Attorney at Law, Carlos E. Beneman, and Harry Smith, for Ferndale Intervention Team and Ratepayers of Montara-Moss Beach Water District;
Phyllis J. Betz and Nicholas R. Tibbetts, for Congressman Douglas H. Bosco; Richard Massa, Attorney at Law, for City of Jackson; Edgar L. Shiffrin, for himself; Rosemary H. Morgan, Attorney at Law, for the County of Sonoma; Ron Sonenshine and Neil Sinclair, for PATRIOTS; and David J. Byers, Attorney at Law, for Half Moon Bay Properties and Farralon Vista Associates; interested parties.
Freda Abbott, Attorney at Law, and Douglas Long, for the Division of Ratepayers Advocates.

SECOND INTERIM OPINION

1. Introduction

This proceeding involves three consolidated proceedings. Order Instituting Investigation (OII) 83-11-09 is an investigation into the practices of Citizens Utilities Company of California (CUCC) and its operating districts and subsidiaries. Consolidated with the investigation is Application (A.) 60220, the most recent general rate proceeding involving CUCC's Guerneville Water District. In its OII the Commission reopened A.60220 to consider ratemaking treatment of revenues generated by timber harvesting in the Guerneville Water District watershed. The third proceeding is the complaint of Kathy Wyrick against CUCC and its subsidiaries. The Commission ordered in D.84-02-066 that C.83-12-007 be consolidated with the other two proceedings.

This decision deals principally with the issues in this proceeding that are specific to the Guerneville Water District. A later decision will address all issues remaining in this proceeding and close the file. Issues that are specific to the Montara-Moss Beach District that arise out of these proceedings have been transferred by ruling of the Administrative Law Judge (ALJ) to A.85-06-010, an application of CUCC for an order restricting the addition of consumers in the Montara-Moss Beach District. A final order in that proceeding will close out all issues pertaining to Montara-Moss Beach.

2. Procedural Background

On February 16, 1984, the Commission issued D.84-02-066 which, among other things, set forth the issues to be addressed in this proceeding. They are as follows:

- a. Whether CUCC has transferred any real property interests, including mineral and timber rights, (assets) without Commission approval in violation of Public Utilities Code (PU) § 851;
- b. What, if any, ratemaking adjustments are appropriate with respect to each CUCC entity subject to our jurisdiction;
- c. Whether CUCC has prudently managed water sources in the best interests of its ratepayers; and
- d. Whether common expenses among CUCC entities are being properly allocated for ratemaking and what, if any, orders should we make to ensure a reasonable allocation procedure is adopted and followed.

A prehearing conference was held March 26, 1984, in which a schedule for the submission of prepared testimony and exhibits was established by the ALJ and hearings were scheduled to begin October 30, 1984. Requests to postpone the initial hearing date were received from various parties, principally consumers or their representatives, which resulted in taking the matter off calendar.

On January 28, 1985, a second prehearing conference was held. Thereafter, hearings before ALJ Baer began on May 28, 1985 and continued on May 29, 30, and 31, July 1, October 7, 8, 9, 10, and 11. Hearings concluded on November 18, 1985. The matter was submitted subject to the filing of concurrent opening and closing briefs. CUCC, the Public Staff Division (PSD), PATRIOTS, and Congressman Douglas H. Bosco filed concurrent opening briefs on or about December 26, 1985; opening briefs were also filed by the Department of Health Services (DHS) on January 15, 1986 and by the Ferndale Intervention Team and Ferndale Chamber of Commerce (FIT) on March 28, 1986. The PSD, FIT, and CUCC filed concurrent briefs on or about March 31, 1986 while PATRIOTS filed its closing brief on April 8, 1986.

3. Timber Harvest Revenues

a. Evidence

On February 28, 1981, Citizens Utilities Company of California (CUCC), a California corporation, filed Application (A.) 60285 seeking authority to increase rates in its Felton Water District (Felton) in Santa Cruz County. The record in A.60285 revealed certain intercompany transactions involving Felton and Citizens Resources Company (CRC), a Delaware corporation.¹ By deed recorded August 19, 1974, CUCC transferred timber rights to 7 of 9 parcels of public utility watershed property in its Felton District to CRC. Also, in 1974 CRC signed a timber management contract with an expert forester. Pursuant thereto, CRC harvested 2,303,000 board feet of lumber in 1976, 1978, and 1979.

The Commission found in Decision (D.) 82-05-038 that timber harvest revenues from Felton's watershed lands were \$266,549

¹ CRC and CUCC are subsidiaries of Citizens Utilities Company (CUC), a Delaware corporation. However, CRC does not operate public utilities in this state and is not subject to Commission regulation.

for the years 1978 and 1979. It also found that watershed lands from which timber was harvested are included in Felton's rate base, and are necessary and useful² to Felton's utility functions; Commission authority to transfer timber and mineral rights to CRC was never obtained. (9 CPUC 2d at 209.)

The Commission concluded that the transfer of timber and mineral rights from Felton to CRC was void.³ It ordered CUCC to arrange for transfer of those rights back to Felton; and it amortized the timber harvesting revenues of \$266,549 over 12 years, thus reducing Felton's revenue requirement by \$22,213 each year.

In D.82-05-038 the Commission also ordered CUCC to file, on a district-by-district basis:

- "a. A list of all property and assets transferred between the particular district and [CRC] going back to the date [CUCC] acquired the...district....

2 Significantly, in its brief CUCC did not contend that the pertinent watershed lands or the part consisting of timber rights were neither necessary nor useful in Felton's performance of its duty to the public so as to obviate application of Public Utilities (PU) Code § 851; and CUCC did not seek rehearing on the § 851 issue or on the Commission's disposition of the timber harvesting revenues.

3 "No public utility...shall sell, ..., or otherwise dispose of...the whole or any part of its..., plant, system, or other property necessary or useful in the performance of its duties to the public, ..., without first having secured from the commission an order authorizing it so to do. Every such sale...[or] disposition...made other than in accordance with the order of the commission authorizing it is void.

"Nothing in this section shall prevent the sale...or other disposition by any public utility of property which is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value; ..." (PU Code § 851.)

- "b. A list of all property and assets transferred to CRC which [were] thereafter sold, transferred, harvested, or leased by CRC; ..." (9 CPUC 2d at 211.)

CUCC filed the required data on July 6, 1982. Based upon that filing and the record and decision in A.60285, the Commission on November 30, 1983 issued OII 83-11-09. The Commission stated therein that:

"...it appears that CUCC may have violated [§] 851 by unilaterally transferring assets to CRC from its other operating districts listed in its compliance filing."

It then ordered an investigation "into the practices of CUCC, its operating districts, and its subsidiaries with regard to the transfer of real property rights and the management of its watershed resources." In particular the Commission ordered:

"4. This investigation will consider:

- "a. Whether for each district or subsidiary CUCC has violated [PU] Code [§] 851. To this end it will be necessary to consider whether the transferred parcels and assets were necessary or useful in the performance of the utility's duties to the public. Each respondent shall carry the burden of proof that its properties transferred were not useful or necessary."

On February 16, 1984, the Commission issued D.84-02-066 to clarify the scope of the investigation and to establish procedures and schedules to be observed before hearings began. D.84-02-066 summarized the § 851 issue as follows: "whether CUCC has transferred any real property interests, including mineral and timber rights, (assets) without Commission approval in violation of [PU] Code § 851." This restatement of the § 851 issue defined the term "asset" in Ordering Paragraph 4.a. of the OII to include the timber and mineral rights transfers that were to be one of the main

objects of the investigation. D.84-02-066 also required CUCC to submit a report with detailed information on each transfer.

CUCC described the timber rights transferred to CRC in its Asset Report (Exh. 7), submitted in compliance with D.84-02-066. The individual transactions involving the Guerneville Water District are summarized, as follows:

<u>Asset Report Parcel No.</u>	<u>Parcel Size In Acres</u>	<u>Date of Transfer</u>
I-15	80	November 16, 1971
I-16	80	November 16, 1971
I-17	23.9	November 16, 1971
I-19	278	July 5, 1971
I-22	240	November 16, 1971
I-28	<u>175</u>	September 11, 1973
Total	876.9	

In each of these cases the transfer involved only timber rights on unimproved real estate. The underlying fee to each parcel remained in CUCC.

The Asset Report contained additional information as to each of the parcels identified above, as follows:

- "B. The rights were not included in rate base and had no value to be recorded in plant-in-service.
 - "(a) The cumulative amount of return calculated was zero.
 - "(b) Commission authorization to transfer the [timber] rights was not required and was not obtained because the rights were not used and useful when transferred.
 - "(c) The book value at acquisition was zero.

- "(d) The market value when transferred was zero.
- "(e) The consideration received upon transfer was zero.
- "(f) The expenses of transfer were zero.
- "(g) The amount reflected as a reduction to the plant account upon transfer is zero.

"C. The [timber] rights were transferred to [CRC].

"D. The proceeds received by CRC by year are:

<u>Year</u>	<u>Gross Income*</u>	<u>Costs/Expenses</u>	<u>Net Income (Loss)</u>
1971	\$ 17,016	\$ -	\$ 17,016
1972	1,055	-	1,055
1973	51,337	-	51,337
1974	43,807	-	43,805
1975	43,524	-	43,524
1976	13,892	-	13,892
1977	33,145	1,481	31,664
1978	57,638	2,951	54,687
1979	30,608	855	29,753
1980	37,916	1,052	36,864
1981	-	605	(605)
1982	-	-	-
1983	-	1,016	(1,016)
Total	\$329,938	\$7,960	\$321,978

*Gross income from timber harvesting on all parcels, Items I-15, I-16, I-17, I-19, I-22, and I-28.

"E. The rights are still held by CRC." (Exh. 7, pp. 18-19.)

CUCC's witness O'Brien explained in his prepared testimony what he meant when he designated an item of real property or an interest in real property as "not used and useful." He first noted that the statutory language in § 851 is "necessary or useful." However, interim D.84-02-066 used the language "used and useful." In his testimony and in the Asset Report, which he sponsored, he adopted the "used and useful" phraseology of D.84-02-066. When he says that a piece of property or plant is not used and useful in

providing utility service, he means that such property is not performing any utility function and the removal of the property does not affect the providing of utility service. (Exh. 47, p. 11.)

The initial determination that an item of property was not used and useful was made by CUCC's operating people who know the system and how it is operated. Then, for purposes of his testimony and the Asset Report, O'Brien went over each transfer with CUCC's operating people and satisfied himself that their initial determinations were correct.

CUCC's position as to the Guerneville timber rights is that no action by the Commission is required. Since, in CUCC's view, the timber rights were not necessary or useful, Commission approval of the transfers was not required. Therefore, it would be inappropriate for the Commission to void the transfers of timber rights or to take any ratemaking action with respect to them.

CUCC takes the same position vis-a-vis the timber rights in Felton transferred to CRC and reconveyed by CRC to CUCC in compliance with D.82-05-038 in A.60285. CUCC asks the Commission to reconsider that disposition and to vacate its orders: (1) requiring the reconveyance of timber rights from CRC to CUCC, and (2) attributing the timber harvesting proceeds to Felton's operating income over a 12-year period. In CUCC's view this is an appropriate result because: (1) the timber harvesting rights had no asset value assigned to them, (2) were never included in rate base, and (3) were not necessary in providing utility services.

On cross-examination O'Brien distinguished between the land parcels themselves and the timber harvesting rights on those parcels. O'Brien testified that the land parcels, i.e. the watershed areas, continue to be used and useful to the utility because they capture water for providing utility services. This is so even though the spring or surface diversion sources on those

parcels may not be used. In his opinion⁴ the water captured in the watershed areas would still be applicable to the utility's other water supply sources, such as those wells down by the Russian River.

In contrast to the land parcels, however, the timber rights, according to O'Brien, do not provide the utility service as does the land by virtue of the water flowing under or over it. O'Brien denied that the timber or timber rights needed to be retained to protect the watershed lands, stating that the evidence in the proceeding showed that any forestry work that was done was done to enhance the watershed lands and was in no way detrimental to them.

PATRIOTS subpoenaed Loren Montgomery Berry to testify in support of its recommendations. Berry is a forester, land manager, and owner of Berry's Sawmill. He has been CUCC's forester and land manager since 1968, but is not now under contract. He has been a forester for over 40 years and has been registered in the State of California as a forester for many years. Berry harvested timber for CUCC from 1968 to 1980, during which time he was never cited for a violation of the regulations of any state agency.

According to Berry, timber harvesting is heavily regulated by various state agencies. The Department of Forestry and the Water Quality Control Board require specific and stringent measures to be taken before timber may be harvested. Berry gave one example. After working for 6 weeks to evaluate a piece of property in Cazadero and after coming up with the functional equivalent of an environmental impact report with erosion control built in, a preharvest meeting was held on the property. In

4 He admitted that he was not a geologist and suggested that the questions about the usefulness of the land parcels should have been put to the geologist.

attendance were two forestry men, one geologist, one water quality man, one Fish & Game man, a representative of the Sonoma County Planning Department, three of the landowners, the logger, Berry, and Berry's son, Jim (also a forester). The purpose of the meeting was to evaluate what the proposed harvesting would do to the water source. Berry opined that California has the toughest environmental guidelines in the nation as far as protecting water and natural resources.

Timber harvesting is very strictly regulated under the Z'berg-Nejedly Forest Practice Act of 1973 (California Public Resources Code section 4511 et. seq.), which specifically includes safeguards for the maintenance of water resources (also, statutory protection measures for watersheds predated the comprehensive regulations adopted in the Forest Practice Act). Before harvesting can occur a timber harvesting plan must be submitted, held open for public comment, and approved by the appropriate state agencies. The plan must provide the names and addresses of the timber owners and operators, as well as detailed descriptions of the area to be harvested, the methods and equipment to be used, and any special procedures to be followed to reduce erosion. The plan must also include expected commencement and completion dates of the harvesting. The statutes provide for very strict penalties for anyone making material misstatements in a filed plan, and require inspections to ensure that an approved plan is followed.

These plans, and the underlying laws and regulations, distinguish between watershed property that is being used as a water source for commercial uses and a watershed that is, for instance, in the middle of a national forest that has no commercial use associated with it. Different guidelines, distances, and practices apply to watershed used as a water source for people. In the timber harvesting plans identified in this proceeding, Berry applied the more stringent guidelines when working around water

source points. The services he provided to CUCC as a forester and land manager consisted of:

1. Surveying CUCC's property with the best management practices in mind, keeping in mind the priority of the springs, which in turn relied on a good watershed.
2. Putting in fire trails and access roads.
3. Removing fire fuel, i.e., dead wood.
4. Cutting mature trees on a selection basis only.
5. Patrolling the roads in the wintertime to keep trespassers off and to maintain the integrity of the watershed.

Berry was particular to correct any reference by counsel to "logging" operations. He was not involved in logging, but rather in the harvesting of selected mature trees only. When asked whether his harvesting methods include clear cutting any parcel, he replied "never" and stated that his methods only involved selective thinning.

Berry described several steps taken to ensure the integrity and purity of the CUCC watershed, as follows:

1. Working no closer than 150 feet to a known water source. However, this distance can be extended to 1/4 mile if the work is above a stream;
2. Felling trees away from the water source;
3. Culvertizing crossings;
4. Building access roads to minimize erosion by proper sloping and sizing; and
5. Inspecting by state agencies, both during harvesting by surprise inspections, and after harvesting.

Berry stated that it was possible that selective timber harvesting can enhance waterflow of surface sources of domestic

water supply on timberland. However, he had no way of telling whether his harvesting actually had that effect. He did understand that it was part of his contract with Citizens to maintain the purity and integrity of its domestic water supplies. His function was to observe the guidelines established by the Department of Forestry regarding harvesting and working within certain distances from springs, which he did. Water Quality, Fish & Game, and Department of Forestry then inspected his work, for which he never received a single citation.

Berry stated that he never discussed his forest management practices with any representative of Citizens. Instead, Berry testified: "We've just fulfilled our obligations at all times." Those obligations are established by the forest practice laws. Berry volunteered that it was a strange thing that he had never discussed his practices with Citizens but explained that:

1. California has by far the toughest environmental laws in the nation, and almost everything is run by the state;
2. CUCC was relying on Berry to ensure that the requirements of state law were observed; and
3. Forest practice laws are very complicated and extensive, and unless a person has spent many years in the field, he would just be a novice at it.

In other words, Berry was the expert and CUCC personnel were the novices. They relied upon him to understand and comply with the law. He testified that the agencies give the guidelines; he complied rigidly with them; and he was never cited for a violation of those guidelines.

PATRIOTS subpoenaed another witness, Gerald A. Griffith, whose testimony corroborated Berry's in part. Griffith is a water company manager by profession. During the past year he worked for Millview County Water District. From May 15, 1973, until June 15,

1984, he worked for CUCC, first as manager of Guerneville (1974-1981) and then as superintendent over four systems: Guerneville, Larkfield, Felton, and Montara (1981-1984). He left CUCC to take the job at Millview. He is not now employed by CUCC. He has a degree in biology. His work experience before coming to CUCC included about 20 years in laboratory work (industrial chemistry) in various industries, (rockets, missiles, and food), three years running an anodizing plant, and cancer research. He was also an efficiency expert for Macheshim Chemical Company in Beer-Sheva, Israel. He is a class 4 water operator and teaches the certification course for water operators at Santa Rosa Junior College.

When Griffith first became manager of Guerneville in 1974, he was told to keep an eye on Berry's harvesting operations and to make sure he stayed well away from CUCC's springs and generally followed good practice. Griffith admitted that he was no logger and had no authority on logging, but from his perspective Berry had a model operation. He testified that Berry has a reputation of probably being the best logger in California.

Griffith had occasional contact with Berry regarding trespassers on CUCC watershed lands. Berry would come in or call Griffith to let him know about trespassers Berry had encountered and run off. These trespassers were frequently wood poachers, cutting timber for themselves without permission. Griffith recounted:

"I had one [wood poacher] tell me it was perfectly all right to cut the timber because he got permission from Jerry Griffith."

One of the things that Griffith's superiors warned him about was letting anybody cut undersized timber. Sixteen inches was the minimum. He went out with a tape measure one day to check up on Berry's operation, and the smallest stump he found was 18 inches. Griffith believes that Berry did an outstanding job.

He could only remember two instances when Berry's operations had any effect on the water company. In one case at Villa Grande Spring he found that early rains had washed some mud from a road embankment into the spring. That was the only case he cited where he thought that logging had directly contributed to the amount of mud in the water supply.

He also thought that there was a case where a road crossing caused a line to crack. However, he considered this "no big deal," as it merely involved fixing the line with a clamp. He did not believe that any complaints resulted from this incident.

Griffith testified that mud in the water was a fairly standard thing every winter. Every time it rained the springs turned muddy. When that would occur he would turn off the springs and pump well water up to the higher tanks that are normally filled by springs. The springs were unusable for four months each year during the rainy season because of the high annual rainfall averaging 46-1/2 inches per year and twice in his memory reaching 100 inches per year.

In 1976 on his own initiative Griffith took all the spring sources off of the system. He did this because of the high cost of doing DHS mandated daily turbidity tests on each spring source. He began the daily testing procedures on July 1, 1976, and continued them for 48 days until he determined that he did not have the manpower to continue. The testing required 12 man-hours per day and the cost of that effort exceeded the value of the water supply by five times. When the springs were usable (other than in the four months of the rainy season) they only provided at best 3% of the total water supplies. In the dry months of August and September that percentage fell to 1%.

The testing procedure involved obtaining a sample of water and returning to the office to perform the test. If the sample passed the test the employee could go to the next spring. However, if the sample failed, he would return to the same spring

for a second sample. Many of the springs are inaccessible by vehicle and require long walks to and from a road.

On the issue of timber rights the staff witness in prepared testimony stated only that:

"The transfer of...timber...rights of watershed properties to other parties jeopardizes CUCC's control over water resources. These rights are necessary for the safe and reliable operation of the water systems. In view of this, all these property rights should be retained by CUCC." (Exh. 16, p. 4.)

The staff appended to its report (Exh. 15) a December 1975 report by the Water Sanitation Section of the California Department of Health. The report contains information pertinent to the issue of timber harvest revenues.

In 1975 the system derived its water from 11 wells and 13 surface stream diversions. Water is diverted from these 13 points by dams across stream beds. The water from the surface sources flows by gravity to the distribution system. All surface water sources are disinfected by means of chlorinators before the water enters the distribution system. Water from the surface stream diversions is not filtered to reduce turbidity, however. The watersheds of the surface sources are not patrolled and are accessible to the general public.

The DHS concluded, inter alia, that the system does not meet the requirements of California's laws and regulations as to water quality. Turbidity was specifically mentioned. DHS also concluded that: "The use of surface stream water from unprotected watersheds without treatment other than disinfection does not provide adequate treatment."

The DHS recommended that CUCC:

- "1. Complete the chemical, trace elements, and general physical analyses required for all water sources. On completion of these analyses, the Company should sample each source monthly and complete analyses made for those constituents found to be present

in excess of allowable concentrations; such as iron, manganese, turbidity, and color."

* * *

- "3b. Installation of a duplicate chlorinator, an audible or visual alarm, a turbidity recorder, and a water supply turn-out for each of the [13] surface water sources."

* * *

- "4. Install water treatment facilities for surface water sources including the processes of turbidity removal, iron and manganese removal, and disinfection; or abandon the sources." (Emphasis added.) (Exhibit 15, Appendix C, p. 5.)

David Clark, District Engineer for the DHS, sponsored prepared testimony on behalf of DHS. He did not mention the surface water sources in his Exhibit 22. He recommended that "if the PUC determines that [CUCC] must return revenues from the sale of timber to the ratepayers, it is strongly recommended that the return[ed revenues] be directed to financing improvements necessary to meet [the requirements of] the Health and Safety Code." (Exh. 22, p. 4.) However, he sponsored no direct evidence in support of this recommendation.

Clark was principally concerned with actions to correct deficiencies in the system. He stated that on November 1, 1983, DHS requested that CUCC conduct a complete engineering study of its system to address certain deficiencies he listed. CUCC completed the engineering study (Exhibit 23) and sent it to DHS on May 17, 1985. In Clark's opinion the study adequately addresses each of the deficiencies in the system (except for fire flow questions which were not requested) and proposes an improvement program to resolve them. DHS now intends to negotiate in cooperation with the Commission the priority and time schedule for implementing the corrective actions proposed in the study.

During cross-examination, Clark testified that the improvements proposed by CUCC's consulting engineers in Exhibit 23 were acceptable to him and that his office requested that CUCC implement them immediately. Exhibit 23 does not call for further development of the upland spring or stream sources, but rather for new wells to be developed in the alluvium near the Russian River. In terms of quantity of water, vertical river wells would be expected, in Clark's opinion, to deliver larger quantities of water than horizontal wells drilled in the uplands near existing streams. In Clark's view horizontal wells in the uplands would not alone supply the Guerneville system during the summertime and heavy demand periods. If the existing surface water collection system were developed and expanded, the surface water would require full treatment in order to meet state requirements; but the cost of that treatment would render the source uneconomical.

The conclusion of this report, with which Clark agrees, is that Guerneville cannot afford alternative water supplies. The report, therefore, opts to develop the wells in the river alluvium, where prospects for finding large quantities of potable water are good, rather than to develop existing surface water sources in the upland areas.

b. Discussion of Timber Rights

Some may believe that the timber rights issue cannot be disposed of until it is first determined whether CUCC should develop new water supplies in the river alluvium or in the hills around the spring sources. However, it is clear from the evidence summarized above that timber harvesting and water development in the watershed areas are compatible. The testimony of CUCC's former forester and former Guerneville District manager, sponsored by PATRIOTS, showed that timber harvesting is highly regulated with a primary goal of preserving water resources. It also showed that CUCC's harvesting had only negligible effects upon the spring sources or the water system as a whole. Rain caused some mud to

wash into one spring from a road cut and one pipeline was cracked where a road crossed over it. The cracked pipeline required only a simple repair and did not result in any complaints. In fact, irrespective of the single instance cited where mud from a road cut washed into a spring, all of the springs were shut down for four months of each year during the rainy season because of debris washed into them by natural runoff. The rainfall is excessive in the winter and the slopes are steep. No one has even suggested that this condition is other than a natural phenomenon.

Responsible timber harvesting, as the record indisputably shows was performed on the Guerneville District watershed lands, is compatible with the use of those lands for water production. The harvesting in this instance was limited to selective thinning of mature trees only. The harvesting was performed with particular care to prevent any degradation of water sources or supplies in the Guerneville District watershed area. All harvesting is heavily regulated and is done pursuant to license in each case. On-site inspections, before, during, and after harvesting, are conducted by state agencies to ensure that water resources are protected and that harvesting is conducted in accordance with the regulations applicable thereto and the terms of the license. No clear cutting of any area of the watershed lands was involved here. Berry was careful in his testimony to state that he was involved in selective harvesting only, not "logging". To the extent that that term may tend to suggest clearcutting, this record does not show any clearcutting was performed on CUCC's Guerneville District watershed lands. Irrespective of the regulation of other state agencies, were the evidence to show that watershed lands were being denuded of all commercially exploitable trees in a manner that would destroy or impair water sources or supplies used by or necessary for a public utility water company we would not hesitate to take action to protect those sources. However, the evidence in this case does not show that logging or clearcutting has taken place or

that the harvesting that has been accomplished has impaired the spring sources in the Guerneville District watershed lands.⁵ The management of watershed lands by a skilled forester, including selective harvesting, may actually enhance the watershed by cutting dead and diseased trees and removing fire fuel, preventing wood poaching, and enhancing growth of young trees by cutting mature trees.

Since the harvesting of timber is compatible with water production in the Guerneville District watershed lands, why are the timber rights in those lands so "necessary or useful in the performance of its duties to the public" that CRC should be forced to reconvey them and to disgorge the timber harvest receipts for the benefit of the ratepayers? Moreover, if we ultimately determine that CUCC acted in a reasonable and prudent manner in abandoning the spring sources in favor of wells in the river alluvium and in choosing to develop more wells there, then it is immaterial whether harvesting affects the spring sources, since the springs would no longer be a factor in providing water for the system.

The testimony by CUCC that the timber rights are not in rate base and the testimony by the staff and others that they are in rate base does not bear on this point. The language of Section 851 is not couched in such terms. The key issue is not how the property is accounted for but how it is used. It is clear from the evidence that the timber rights are neither "useful" nor are they "necessary in the performance of [CUCC's] duties to the public." That is, if tree A is cut down, hauled away, and sold, will that disposition affect the water service rendered to the public in the

5 In recent years, before the springs were discontinued as water sources in 1976, they only produced at most 3% of the water supply for the Guerneville District.

spring sources in the Guerneville District watershed lands.⁵ The management of watershed lands by a skilled forester, including selective harvesting, may actually enhance the watershed by cutting dead and diseased trees and removing fire fuel, preventing wood poaching, and enhancing growth of young trees by cutting mature trees.

Since the harvesting of timber is compatible with water production in the Guerneville District watershed lands, why are the timber rights in those lands so "necessary or useful in the performance of its duties to the public" that CRC should be forced to reconvey them and to disgorge the timber harvest receipts for the benefit of the ratepayers? Moreover, if we ultimately determine that CUCC acted in a reasonable and prudent manner in abandoning the spring sources in favor of wells in the river alluvium and in choosing to develop more wells there, then it is immaterial whether harvesting affects the spring sources, since the springs would no longer be a factor in providing water for the system.

The testimony by CUCC that the timber rights are not in rate base and the testimony by the staff and others that they are in rate base does not bear on this point. The language of Section 851 is not couched in such terms. The key issue is not how the property is accounted for but how it is used. It is clear from the evidence that the timber rights are neither "useful" nor are they "necessary in the performance of [CUCC's] duties to the public." That is, if tree A is cut down, hauled away, and sold, will that disposition affect the water service rendered to the public in the Guerneville District? We have determined that it will not affect

5 In recent years, before the springs were discontinued as water sources in 1976, they only produced at most 3% of the water supply for the Guerneville District.

such service, whether we assume the springs become again a source of water for the system or whether they remain abandoned.

Accordingly, we conclude that the transfer by CUCC of timber rights in its watershed lands to CRC was of property neither useful nor necessary in the performance of CUCC's duties to the public in the Guerneville District and that such transfers were not void ab initio.

It is interesting to note that the second paragraph of Section 851 states that:

"Nothing in this section shall prevent the sale ...or other disposition by any public utility of property which is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value; ..."

The initial determination whether the item of property is necessary or useful is for the utility to make. Where the disposition is to a purchaser in good faith and for value it is conclusively presumed to be property that is not useful or necessary. Where, as here, the disposition is to neither a purchaser, lessee, nor encumbrancer and is not for value there is at most a rebuttable presumption that the disposition is of property that is neither necessary nor useful. In any event the issue is a factual one that the Commission may review. In this case the evidence, as opposed to the conclusions of witnesses and the arguments of counsel, overwhelmingly favors the initial determination of CUCC that the timber rights were neither necessary nor useful.

Disposing of the Section 851 issue does not, however, end the matter. We must next determine whether the transactions in which timber rights were transferred from CUCC to CRC were properly

accounted for. The staff testimony regarding the appropriate accounting treatment of such transactions is cogent and we rely for the most part on it. Summarizing his accounting testimony, the staff accounting witness stated:

"Thus, if the land is in Plant Held For Future Use when sold, the gain is above-the-line (to the ratepayers' benefit) but if it is sold from Plant in Service or from non-utility plant the gain is below-the-line (to the shareholders' benefit)." (Exhibit 9, p. 17, paragraph 42, as amended.)

If this statement of the requirements of the Uniform System of Accounts (USOA) is not clear enough, the same witness reiterated the same matter in more detail under cross-examination by CUCC. (Tr. 1:93-98.) Actually, there is no dispute among the parties as to the requirements of the USOA. They do differ, however, on whether the timber rights were in rate base or not. CUCC, as we indicated above, asserted that the timber rights were not included in rate base and had no value to be recorded in plant-in-service. We do not accept this naked assertion as fact, for it is contrary to the fundamental principles of real property law. When CUCC acquired the watershed lands from which timber rights were later severed, it acquired them in fee simple absolute. Its title to those lands included all rights associated with such titles, e.g. water, timber, mineral and development rights. The original cost of such lands was not allocated among the various rights associated with land ownership when that cost was entered upon the books of account of the Guerneville District of CUCC. The USOA does not call for such an allocation. Thus, the timber rights were in rate base as part of the watershed lands.

Since the timber rights were in rate base when transferred, the value of those rights should have been reflected in the plant accounts of the Guerneville District when the transfers occurred. They were not so reflected because, as CUCC's witness testified, the utility did not consider them to be part of

the rate base and, in any event, did not ascribe to them any value. Neither of these conclusions was reasonable. CUCC knew or should have known that if the timber rights had not been severed from the watershed lands and transferred to CRC, an unregulated affiliate, the revenues from the timber harvesting would have accrued to the benefit of the ratepayers, thus reducing CUCC revenue requirement. We infer that CUCC transferred the rights to avoid this result and that the transfers were made in anticipation of timber harvesting revenues being received. One of the transfers occurred on July 5, 1971, and four more on November 16, 1971. In 1971 CRC received \$17,016 of net proceeds from timber harvesting. The dates of transfer and receipt of revenue are contemporaneous, making it improbable that CUCC and CRC did not expect to receive income as a consequence of the transfers and almost simultaneous harvesting.

Since revenues were expected from the harvesting, it follows that the timber rights had market value. Beyond the mere assertion that the timber rights had no market value when transferred, CUCC offered no other evidence on the issue of their value when transferred. There is evidence in the record from which a value can be derived, however. Exhibit 7 shows the net revenues from harvesting received by CRC each year between 1971 and 1980. They total \$323,600, or an average of \$32,360 per year for the 10 year period. By capitalizing those revenues at CUCC's most recently authorized rate of return (12.04%) we derive a market value of \$269,771.⁶ We do not, however, adopt this figure as the fair market value of the timber rights when transferred. It is nevertheless one measure of the value of those rights and is useful to show what order of magnitude their value might attain.

⁶ The formula for deriving market value from annual revenues is: Market value = annual revenue/rate of return.

How then should the value of the timber rights be reflected on the books of the Guerneville District? Had the timber rights been sold for fair market value with the knowledge of the Commission, sale revenues would have gone to shareholders in keeping with our policy that the proceeds of non-utility plant sales do not belong to ratepayers. Since no sale has occurred here, there is no gain to disburse. There is, however, a presumptive value for the timber rights included in the rate base associated with the land parcels in question. In the absence of a valuation of this amount, we will attribute the timber harvesting revenues to the original cost of the 6 parcels involved, and reduce the balances associated with these parcels to zero. The 1973 annual report for the Guerneville District shows that the balance in Account 306 (Land and Land Rights) at year end was \$76,060. Some part of that balance represents the original costs of the 6 watershed parcels. CUCC will be ordered to report to the staff the original costs of the 6 watershed parcels, to reduce Account 306 by those amounts, and to reflect those reductions of ratebase in an advice letter rate decrease.

Furthermore, since CUCC unreasonably failed to reduce Account 306 when the transactions occurred, rates have reflected a balance in Account 306 in the \$76,000 range since 1971. CUCC will be ordered to report to the staff the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar effect of those adjustments in each year since 1971. In addition, CUCC will be ordered to compute an interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and to propose a method whereby the total of overcollections and interest components may be amortized through rates to the benefit of the ratepayers. If CUCC and the staff can agree upon the

appropriate dollar figure and the method of amortizing it, then an advice letter filing can accomplish the required rate reduction. If no agreement can be reached, then we will set further hearings to take evidence before issuing a decision on this issue.

We have not required CUCC or CRC to disgorge timber harvesting revenues, having concluded that CUCC did not err under Section 851 by transferring the timber rights in certain watershed lands to CRC. CUCC's mistake was in concealing the transactions from the Commission by failing to reflect the effects in Account 306. CUCC attempted to, and did, earn a return on the value of those rights in rate base while at the same time diverting the harvesting revenues to the benefit of the shareholders of its parent company. CUCC cannot have it both ways. Had title to the timber rights remained in CUCC, the timber harvesting revenues would have accrued to the benefit of the ratepayers, according to the requirements of the uniform system of accounts. Having transferred those rights lawfully, CUCC has diverted those revenues to the shareholders.

We are concerned that our ability to monitor CUCC's transactions with its affiliates has been inadequate in the past to prevent surprises like those that have come to light in these proceedings. We will take no punitive action against CUCC (although we believe that a case could be made for such action), but we will ensure that we are able in the future to track closely CUCC's affiliate transactions. In order to allow for this monitoring, we will require CUCC to report quarterly to the Commission Advisory and Compliance Division according to the following requirements:

1. CUCC shall give full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.

2. CUCC shall report any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

Before leaving the issue of timber rights, we should consider and dispose of CUCC's request that D.82-05-038 in A.60285 be vacated insofar as it requires CRC to reconvey timber rights to the Felton District and imputes timber harvesting revenues to Felton's operating revenues over a 12 year period. As we noted above (mimeo. p. 5, fu. 2) in the Felton case (9 CPUC 2d 197, 204 (1982)) CUCC "... does not contend that the pertinent watershed lands or the part consisting of timber rights are not necessary or useful in Felton's performance of its public utility duty to the public so as to obviate application of PU Code § 851." Accordingly, CUCC did not brief the Section 851 issue nor did it seek rehearing on that issue or on the disposition of the timber harvesting revenues. This is not the case with the instant proceeding. CUCC made the argument that it did not make in Felton and the evidence supports CUCC's position and the result we have reached.

But returning to CUCC's request re Felton, D.82-05-038 is now final. If the orders in D.82-05-038 were erroneous, those errors have been waived.⁷ Accordingly, we will not review, revise, or rescind D.82-05-038.

4. Management of Water Resources

a. Plant Improvements Required in Guerneville District

CUCC proposes and PSD and DHS agree that River Meadows System should be interconnected with the Monte Rio System. In addition, chlorination at Monte Rio should be improved and the El

⁷ Section 1709 provides: "In all collateral actions or proceedings, the orders and decisions of the commission which have become final shall be conclusive.")

Bonita wells should be replaced. In addition to these improvements PSD and DHS recommend that test wells should be drilled to explore the possibility of redeveloping the springs as water sources.

CUCC does not favor the PSD's recommendation to redevelop the upland spring sources. Rather, to the extent that the development of future water resources is even an issue in this proceeding, CUCC contends that its plans to develop new wells and other plant facilities near the Russian River should be approved and that other proposals to develop supplemental water resources in the spring areas would be duplicative and unnecessary.

PATRIOTS requests that the Commission order Citizens to restore the valuable alternative supplies existing in the watershed areas, using the timber harvest revenues plus interest to pay for the development.

The position of the DHS changed between the hearings and the filing of opening briefs. At hearing DHS recommended that CUCC should investigate new well sites along the Russian River that had potential for better water quality or provide treatment for the El Bonita wells. It was the understanding of DHS that it was technically and economically infeasible to develop well sites off-river. After reviewing the testimony DHS changed its position.⁸ It now believes that the prospect of developing an alternate source of supply away from the Russian River is much greater than was reported in the Brown and Caldwell study and should be explored. DHS now recommends that in order to provide the maximum public health protection to the consumers in the Guerneville area, the Commission should direct CUCC to fully explore the feasibility of

⁸ This was done through the DHS brief, which procedure is improper for two reasons: (1) DHS did not file an appearance form, is not a party to these proceedings, and may not file a brief, and (2) no person, whether or not a party, may change its testimony after the record has closed, thus depriving the other parties of their right to confront and cross-examine that person.

developing an off-river source of horizontal and/or vertical wells. Furthermore, in this exploration DHS recommends that CUCC should hire a competent hydrogeologist with experience in this area to direct the construction of horizontal and/or vertical test wells and then evaluate their performance as to quality and quantity over a 12-month period.

The County of Sonoma in its opening brief concurred with the arguments and conclusions in the opening brief filed by PATRIOTS and joins with PATRIOTS in requesting the Commission to grant the relief requested in PATRIOTS' brief.

Congressman Douglas H. Bosco did not address the issue of development of off-river water sources in his opening brief. The FIT did not address any Guerneville-specific issues in its opening brief.

b. Discussion

It is undisputed that the Guerneville District requires about 1,000 gallons per minute to supply its needs on a maximum demand day. Relying on its consulting engineers, CUCC proposes to drill three wells in the Russian River alluvium which would be expected to yield 500 gallons per minute per well. Thus, two wells would supply enough water to meet maximum demand while the third well would be used as standby. CUCC's expert hydrogeologist testified that there were no large aquifers in the upland areas above the Russian River in the Guerneville District. She was unwilling to risk her client's funds on drilling for large quantities of water in the upland areas when there was a high probability of finding large quantities of water in the Russian River alluvium near areas where CUCC's present wells are now in service.

PATRIOTS' expert witness Boudreau testified from his personal experience with roughly 1,000 well drilling projects in Franciscan rock that highly-fractured Franciscan sandstone, chert, and greenstone can yield as much as 500 to 600 gallons per minute,

and that much of the upland area along the Russian River consists of these potentially permeable rocks. He noted further that problems of turbidity and high iron and manganese in upland spring water could be greatly reduced by producing the water from properly drilled and constructed wells, cased with PVC instead of iron pipe. Boudreau acknowledged, however, that wells yielding in the 500 gallon per minute range were the exception rather than the rule in the Franciscan formation. Thus, the probability of finding wells yielding hundreds of gallons per minute in the upland areas is fairly low.

PATRIOTS' would prefer that Russian River water not be used to supply CUCC's Guerneville District. One of PATRIOTS' primary reasons for this preference is the undeniable fact that the Russian River is subject to various kinds of contamination by virtue of sewage spills and other kinds of accidents. A second reason for PATRIOTS' preference is its belief that it may well be possible to procure water that is free from such potential contamination from upland sources at less cost than water from the large Russian River wells proposed by CUCC. PATRIOTS' believes it is at least worth exploring this possibility through a relatively inexpensive exploration effort before making the large financial commitment involved in the Russian River wells.

The staff and DHS do not unconditionally oppose the company's plan, supported by its engineering consultant, to drill three high production wells in the Russian River alluvium. What is at stake is merely the proposal of staff, supported by DHS in its brief only, to first require CUCC to explore for water in the upland regions and other off-river areas.

There is a high probability that commercially exploitable quantities of water in the range of 500 gallons per minute per well can be obtained by drilling wells in the Russian River alluvium. Unfortunately, the Russian River is subject to periodic flooding and contamination. While modern well design, construction, and

treatment could most probably overcome whatever potential hazards that untreated Russian River water may pose, we can certainly understand the reluctance of PATRIOTS, DRA, and DHS to rely on such water for 100% of the Guerneville District's needs without first exploring off-river water sources further.

New vertical or horizontal wells drilled in the upland areas could supply an unknown quantity of water that could be used to meet a portion of the Guerneville system requirements and/or to supply emergency water in the event of flooding or other contamination of the Russian River area. While individual wells in these areas are unlikely to be able to supply more than a fraction of the overall system needs, the aggregate potential contribution of wells of these types cannot be determined without further exploration and test drilling. Unfortunately, it appears likely that a fairly large number of upland wells would be needed to produce as much water as the three Russian River wells proposed by CUCC.

Fortunately, the record in this proceeding suggests that there may be sources of water in the Guerneville District that meet the essential needs of both sides of the upland versus Russian River wells controversy. PATRIOTS' witness Boudreau noted in Exhibit 61 that wells capable of yielding over 100 gallons per minute of good quality water have been drilled in the alluvium along tributary creeks feeding into the Russian River. He states that wells of this magnitude have been drilled in the alluvium along Fife Creek; and might similarly be drilled along the Hurlbut, Dutch Bill, and other alluvium filled valleys whose ground water is not derived from the Russian River. Wells in these tributary valleys are fed from local rainfall within their own watersheds, and thus seem likely to be free of the contamination potential associated with Russian River wells. On the other hand, the potential yields of wells closely associated with a tributary stream seem likely to be an improvement over those which would

result from the majority of upland wells. Off-river wells in tributary valleys thus appear to have a number of potential advantages over both the Russian River wells proposed by CUCC and the redeveloped upland water sources desired by PATRIOTS.

While we recognize that CUCC's proposed Russian River wells would almost certainly supply adequate water for its Guerneville District system, we also recognize the possibility that CUCC's optimism regarding the ability of the Russian River sources to produce clean water in the event of river flooding or contamination may turn out to be unfounded. Since it is possible that upland or other off-river sources in tributary valleys could supply a portion of CUCC's system needs and/or provide a useful source of water should any authorized Russian River wells become contaminated, we find it necessary to order CUCC to hire an independent geohydrologist to explore potential off-river sources in the manner suggested by staff, PATRIOTS, and DHS. We would like the geohydrologist to pay particular attention to potential water sources associated with tributary streams flowing into the Russian River. If this exploration reveals the absence of economic off-river sources of water, CUCC will be authorized to proceed with the proposed Russian River wells.

We will also order CUCC to maintain the upland watershed in good condition so that upland sources can be redeveloped and expanded should the need arise.

5. Common Expenses

In OII 83-11-09, dated November 30, 1983, the Commission stated that: "This investigation will consider... Whether adjustments should be made in the allocation of common expenses among CUCC's districts and subsidiaries." (Paragraph 4.f.)

The Commission next addressed the issue of common expenses in an interim order, D.84-02-066, dated February 16, 1984. It stated that the investigation was started to address four topics, the fourth of which was whether common expenses among CUCC

entities are being properly allocated for ratemaking and what, if any, order should be made to ensure a reasonable allocation procedure is adopted and followed. The Commission ordered its staff to submit the results of its analysis of common expense allocation, and any recommendations within 180 days of the date of the order.

In response to the direction of the Commission contained in OII 83-11-09 and in D.84-02-066, the Public Staff Division (PSD) sent Douglas Long, Financial Examiner IV, to Stamford, Connecticut to audit Citizens Utilities Company, the holding company, and its various regulated and unregulated subsidiaries. Long was the same staff member who had supervised the previous audit of the holding company and its subsidiaries in connection with a general rate increase proceeding involving CUCC's telephone division. That audit, involving four person-weeks of staff time, occurred less than two years before Long's most recent audit.

Long's Exhibits 9, 10, and 11 summarize the findings of his audit as they relate to this proceeding. They show that he conducted a much more comprehensive audit than the Commission's decisions and orders required. He not only audited the allocation of common expenses but examined the entire allocation process involving CUCC's California operations. He stated that the costs incurred at Stamford, the office of Citizens Utilities Corporation, are allocated to its operating divisions and subsidiaries using four different allocations. These included direct charges, accounting charges, administrative and general expenses charged to construction, and general charges.

Direct charges are billed directly to the operating divisions and subsidiaries which receive direct benefit from the work performed. Examples of direct charges are toll study costs, rate case costs, and internal audit costs.

Accounting charges are billed directly to the operating divisions and subsidiaries which receive direct benefit from the

work performed at Stamford. Accounting for all California utilities owned by Stamford is performed in Redding, California. No accounting charges were billed by Stamford to its California utilities in 1981 or 1983, the last two years reviewed in A.82-09-052 (CUCC's telephone division) and for this OII.

Administrative and general expenses charged to construction are billed to operating divisions and subsidiaries on their percentage of total construction costs. The function of the construction overhead is to charge the properties for construction-related services performed by Stamford. Examples of administrative and general expenses charged to construction are direct charges related to construction, supervision, and general overhead. In 1983 the A&G charges to construction were 8.57% of budgeted construction expenditures.

General charges to the operating divisions and subsidiaries are allocated on a four-factor method. General charges are amounts which are not charged directly to operating divisions and subsidiaries and which are not generated by construction. The four-factor method produces a numerical average of each operating division's and subsidiary's percentage to total plant, total payroll, total operating and maintenance expenses, and total customers.

Long's current review at Stamford showed no material changes in expenses or procedures that need to be addressed in this proceeding. Stamford has improved the data processing direct allocations since the last audit. Any subsequent rate cases are the correct venue for staff versus company expense estimation differences, according to Long.

Long had only one recommendation with respect to the allocation of expenses in Stamford. He stated that the officers of CRC are also officers or employees of Stamford. Their time and expenses are recorded in Stamford expenses and then allocated to the districts and subsidiaries. CRC is not charged with expenses

from Stamford. The utility rightly points out that CRC would have a miniscule allocation if it were included in the four-factor general allocation process because it has no payroll of significance, no customers, minimal plant and little operating and maintenance expenses. However, according to Long, there is a real cost of doing business for CRC and that is the pieces of time used on CRC transactions, reporting requirements, and miscellaneous activity. In his opinion the correct way to capture this cost is through direct charges by CRC employees at Stamford, which would reduce the balance remaining to be allocated through the four-factor method. This is so because all utility operations personnel at Stamford directly charge their time whenever possible.

Long stated that, since Stamford does not record the time spent on CRC he proposed that a minimum charge should be assigned to CRC amounting to one week per year. One week per year is only 40 hours out of about 2,000 work hours each year. In his opinion 40 hours seems to be the reasonable minimum that CRC officers must require to fulfill their duties to CRC. Long used 1983 recorded data to develop a minimum adjustment. He recommended in subsequent rate cases that CUCC and/or Stamford should have the option of justifying detailed direct charges or accepting a minimum charge for CRC to reduce Stamford costs to be allocated by the four-factor formula. His suggested adjustment to reduce Stamford costs is \$18,400. This adjustment would have, for example, an impact on the Guerneville District of \$125 per year, on the Montara-Moss Beach District of \$68 per year, on the telephone district of \$4,180 per year, and on the Sacramento Water District of \$879 per year.

We believe it would be appropriate to implement the CRC adjustment in any future rate proceedings involving CUCC's California operations. We will direct our staff to propose such an adjustment in those proceedings. We note that in its opening brief CUCC stated that current allocation procedures do provide for direct charges to CRC. Apparently CUCC already agrees with the

staff's proposal. However, the actual adjustments can be quantified and adopted in future proceedings.

Congressman Douglas H. Bosco, PATRIOTS, and FIT believe that the staff audit was inadequate. We are convinced, however, that the staff audit, considered in conjunction with the previous audit involving four person-weeks in the telephone general rate case, was sufficient for our purposes. We believe that Citizens is following previously adopted recommendations and orders of the Commission and its staff respecting the allocation of its costs to its California operations.

PSD's other recommendations involving later Stamford audits conducted or performed jointly with other states and its recommendation that a regulatory review of CUCC's water operations in California should be combined into one proceeding should be refined at the staff level and presented to the Commission at some later time. It seems clear to us that any joint audits must be with the consent and cooperation of other states. The staff should correspond and meet with state regulatory staff members in other jurisdictions to determine if there is any interest in this proposal. The PSD and the Water Utilities Branch of the Evaluation and Compliance Division should consult with one another with regard to the combining of CUCC water rate proceedings into a single proceeding. If it is the staff view in general that the proposal should be adopted, then the staff should propose such a measure to the Commission by memo and we may order the utility to file its water rate proceedings in a series of applications filed concurrently. This order may issue by resolution.

6. Step Rate Increase for 1984

OII 83-11-09 reopened A.60220 (general rate proceeding for the Guerneville District) to:

- a. Investigate the appropriate ratemaking treatment for the timber revenues described in CUCC's compliance filing;

- b. Consider the appropriate ratemaking treatment for any other illegal or imprudent actions of the types described in the OII; and,
- c. Consider the appropriateness of granting the January 1, 1984, step increase authorized by D.82-03-023, dated March 2, 1982, in A.60220.

We address item c. in this section.

This OII was issued on November 30, 1983, one month before the 1984 step rate increase might become effective according to the terms of D.82-03-023. CUCC had not yet filed an advice letter seeking to implement the 1984 step increase authorized by D.82-03-023.

By D.82-03-023 in A.60220 (filed January 27, 1981) the Guerneville District was authorized a revenue increase of 79.7%. However, because of the size of the increase, rates were set to collect revenues only 50% greater than the then current rates would collect. The remaining revenue increases were deferred until 1983 and 1984. Appendix B to D.82-03-023 set out the annual service charge increases and quantity rate increases that would be required to collect the deferred revenues plus interest, beginning January 1, 1983, and January 1, 1984, respectively. The staff believes that CUCC received the step increase that was deferred to 1983; and no party has raised an issue concerning it.⁹ On December 9, 1983, CUCC filed Advice Letter No. 217, dated December 6, 1983, to implement the 1984 step rate increase on January 1, 1984. Advice Letter No. 217 sought a rate increase of

⁹ This is so despite the fact that OII 83-11-09 placed CUCC "on notice that any step increase under D.82-03-023 is subject to refund." (Emphasis added.)

\$54,900. By Resolution No. W-3166 (January 5, 1984) the Commission stayed the step rate increase until further order.

CUCC requests that the Commission vacate the stay of the Guerneville step rate increase and authorize that increase to go into effect. It argues that all alleged claims of mismanagement of the Guerneville System and improper allocation of common expenses are groundless and that the timber harvest revenues should not be imputed to Guerneville's ratepayers. CUCC further asserts that the step rate increase authorized by D.82-03-023 should be implemented without delay and that CUCC should be permitted to amortize through future Guerneville District rates the revenues lost on account of the stay--unwarranted, according to CUCC--of Advice Letter No. 217.

In its opening brief the staff discussed the issue but made no specific recommendation about the handling of the stayed step increase. The issue was not mentioned in its closing brief. No other party addressed the step increase in its briefs.

We will vacate the stay ordered in Resolution W-3166 and authorize CUCC to file an amended Advice Letter No. 217. The amended Advice Letter should:

1. Recompute the January 1, 1984, rate increase in accordance with the method provided in D.82-03-023, Appendix E, and D.82-11-054 (the opinion after rehearing of D.82-03-023) to reflect interest at the rate of 12.04% on the deferred revenue from March 2, 1982, to the proposed effective date of the amended tariffs, compounded annually;
2. Reflect for the future the effect of the reductions in Account 306 required by our discussion of the timber rights issue;
3. Propose rate changes to recover the 1984 deferred revenue increase with interest, as adjusted for the reduction in Account 306; and include CUCC's workpapers describing in detail each step.

- * 12.04% is the overall rate of return found reasonable in D.82-03-023 in A.60220, the last general rate proceeding for the Guerneville District. The same figure is used to compute the revenue requirement for each of the deferred rate increases for 1983 and 1984. (See Appendix E to D.82 03-023).

7. Case 83-12-07

Case 83-12-07 was filed on December 19, 1983, by Kathy Wyrick against CUCC. It raises many of the same issues that were raised in the OII, filed November 30, 1983. C.83-12-07 and OII 83-11-09 were later consolidated. Ms. Wyrick was severely injured in an automobile accident before evidentiary hearing began. Consequently, she did not participate in the hearings. No other person or group was substituted for her as complainant, although the ALJ at prehearing conference offered the opportunity. The complainant in C.83-12-07 has failed to prosecute her complaint. It should therefore be dismissed. Since the complaint of Ms. Wyrick is to be dismissed for lack of prosecution, her request for a finding of eligibility for compensation and notice of intent to claim compensation, dated July 25, 1984, is moot and should be dismissed as well.¹⁰

8. PATRIOTS Eligibility

On August 25, 1986, PATRIOTS filed its pleading, entitled "Notice of Intent to Claim Compensation" under Article 18.6 of the Rules of Practice and Procedure. This Article establishes procedures for awarding reasonable fees and costs to participants in proceedings before this Commission that were initiated on or before December 31, 1984. Since OII 83-11-09 was filed

¹⁰ A copy of this request (without a filing stamp) is in the ALJ's personal file, but the pleading was not docketed, nor does it appear in the formal file.

November 20, 1983, the issue of compensation of participants falls under Article 18.6.

On the issue of financial hardship PATRIOTS states that it represents the ratepayers of Guerneville and that their interests would not otherwise be adequately represented in this proceeding. PATRIOTS denies the staff can be found to be an adequate representative of the ratepayers because it represents the broad public interest, which is a compromise among other interests, including those of the utility and all classes of customers.

PATRIOTS also states that its representation of the ratepayers is obviously necessary for a fair determination in this proceeding, since CUCC is already well represented, and the absence of a ratepayer representative would result in an imbalance in the record. Furthermore, PATRIOTS states that it would be unable to participate effectively in this proceeding absent the availability of compensation awards. It believes that its summary description of its finances demonstrates its inability to bear the cost of effective participation. Finally, PATRIOTS asserts that the separate interest of its constituent groups and individual supporters is small compared to the cost of participation. PATRIOTS claims to represent the interests of about 10,000 customers of CUCC's Guerneville District. It alleges that the economic interests of these individual members are obviously small in comparison to the cost of effective participation.

CUCC on July 17, 1986¹¹ filed its memorandum in response to PATRIOTS' notice of intent to claim compensation. On the issue

¹¹ The filing of PATRIOTS notice was held up in the Docket Office due to formal deficiencies and was not filed until August 25, 1986. In the meantime, CUCC replied to the notice based on the unfiled copy it had received by mail. Its memorandum was therefore filed before the notice itself.

of financial hardship CUCC argues that PATRIOTS has not made any showing of financial hardship within the meaning of the Commission's rules. According to CUCC, all that PATRIOTS states in Appendix A is that since October, 1983 it has received \$8,200 in income and expended approximately \$6,700 on its activities, leaving a fund balance of about \$1,500. Moreover, Appendix A to its notice also states that PATRIOTS' income for the period beginning October 1983 to the present is exclusive of restricted funds. No evidence is offered as to the amount of restricted funds received or what restrictions were imposed by the donors. CUCC points out that PATRIOTS does not address the fact that the staff was working on the same issues that PATRIOTS was interested in and that its interests were adequately represented even if PATRIOTS had not participated.

CUCC also notes that Kathy Wyrick prepared and mailed a pleading entitled "Request For Finding of Eligibility for Compensation and Notice of Intent to Claim Compensation" in this matter, on July 25, 1984, in which she revealed that PATRIOTS had received contributions from the Russian River Chamber of Commerce and the Monte Rio Chamber of Commerce. According to CUCC these facts suggest that PATRIOTS was able to participate without financial hardship. CUCC argues that it can be inferred that the businesses and other members of those organizations, which would appear to have a significant stake in the outcome of this proceeding, have financial resources that could be utilized to support the participation of PATRIOTS in this proceeding if they thought their interest so warranted and that they would be capably represented.

Finally, CUCC argues that PATRIOTS has not proven that the interests of its members in the outcome of this proceeding is small in comparison to the cost of participation. In fact, it appears that the interests of the utility's business customers may

be substantial in comparison to the cost of participation that PATRIOTS purports.

We believe that PATRIOTS has met its burden of showing significant financial hardship in this proceeding. Even if the interests of the staff and PATRIOTS were identical in this proceeding that fact would merely bear on the amount of compensation awarded, not on PATRIOTS' eligibility for an award.

On the issue of the specific budget, required to be filed by Rule 76.23(b), PATRIOTS submitted a total budget for this proceeding as follows:

Advocate Fees (Wyrick, Sinclair, Scoggins) 800 hours @ \$25/hour	= \$20,000
Expert Witness Fees (G. Boudreau)	= \$ 1,500
Other Costs - 15% of Direct Costs*	= <u>\$ 3,225</u>
Total	= \$24,725

*Rough estimate covering long-distance telephone charges, copying, postage, etc. Specific allocations would be provided in compensation filing.

PATRIOTS states that it has been involved in all phases of these consolidated proceedings and that its costs are based on actual expense records and recorded time of intervenors with the exception of the allocation of time for Ms. Wyrick, who has since died and for whom there are no known records. Her time, according to the pleading, is based on a conservative estimate of her contribution. The fee charged is asserted to be a reasonable amount based upon the qualifications of the intervenors, the amount of compensation sought in the proceeding, and competitive fees.

CUCC replied to this issue in its memo. It states that PATRIOTS offered only the most superficial budget even though its participation is now substantially complete due to the status of this matter. CUCC believes that PATRIOTS' failure to satisfy this

requirement alone means that the finding of eligibility it seeks this Commission to make in response to its notice should not be made.

By April 8, 1986, when PATRIOTS filed its closing brief, PATRIOTS had concluded its participation in this proceeding. Its notice of intent was not filed until August 25, 1986, almost five months later. By that time it should have known specifically its costs incurred and the hours expended in the conduct of the case and should have been able to specify in its budget those costs and hours exactly. Instead, it submitted a budget for 800 hours of advocate time which did not break out the time expended by Sinclair and Scoggins. If, as PATRIOTS asserts, its costs are based on actual recorded time of Sinclair and Scoggins, then that portion of the 800 hours claimed which were allocated to them should have been set out and that portion of the 800 hours estimated for Ms. Wyrick should have been set out. In addition, we are not told who "Scoggins" is and how he participated in these proceedings. He made no appearance at the hearings and his name, as far as we know, does not appear on any of the pleadings filed by PATRIOTS. The expert witness fees claimed by Boudreau are not supported by any invoice or cancelled check. The other costs are merely estimated by taking 15% of the other direct costs. Yet, by the time the notice was filed, PATRIOTS had completely incurred all costs for which it was seeking compensation and should have been able to set forth explicitly the various items of costs incurred.

In view of the fact that the budget was submitted well after all work in connection with the proceeding had been completed by PATRIOTS it is not the "specific budget" called for by Rule 76.23(b). Nevertheless, this item more particularly affects the request for compensation and may be dealt with here.

Rule 76.23(c) requires that the participant file a statement of the nature and extent of planned participation in the proceeding. PATRIOTS states that from the initiation of the OII to

the present, it has been an active participant in all phases of these proceedings. Ms. Wyrick's extensive and thorough research laid the foundation, according to PATRIOTS, for submission of testimony and cross-examination of the PUC staff, DHS, Utility Employees, and expert witnesses hired by the utility. PATRIOTS also subpoenaed two witnesses with former business relations with the utility and supplied its own expert witness and numerous exhibits. PATRIOTS representatives attended the prehearing conference and seven days of hearings in San Francisco in 1985 and submitted opening and closing briefs.

CUCC points out that PATRIOTS' brief account of its past participation does not acknowledge that its participation was largely duplicative of the staff's efforts.

We believe that for the purposes of a notice of intent under Rule 76.23 PATRIOTS statement of planned participation is sufficient.

CUCC also argues that the notice of intent is not timely filed, citing Rule 76.23. That rule states that a notice of intent is to be filed as soon after the commencement of the action as is reasonably possible. The Rule then goes on to state that such a filing must be made in any event before the beginning of the evidentiary hearings in the proceeding, or after the evidentiary hearings are completed. CUCC states that this language should not be seized upon as justifying a tardy filing, which was not only after all evidentiary hearings, but after briefing was completed as well. PATRIOTS has offered no explanation for filing when it did. CUCC argues that while the Rule does not fix the last possible date upon which a notice may be filed, there is no suggestion that a party may participate for 2-1/2 years before filing its notice. That time of filing is not as soon as is reasonably possible, which is the requirement of Rule 76.23. CUCC states that for this reason alone the finding of eligibility sought by PATRIOTS should not be made.

Rule 76.23 as presently written gives ambivalent instructions to parties in our proceedings. They are instructed to file their notice of intent: (1) "As soon after the commencement of a proceeding as is reasonably possible", (2) "Before the beginning of the evidentiary hearings in the proceeding", or (3) "After evidentiary hearings are completed". No cut-off date is specified for the filing of the notice of intent. While we believe that the filing of a notice of intent several months after submission is too late to be considered, our own Rules do not require a more timely effort. Accordingly, eligibility should not be denied for untimeliness.

9. Evidentiary Ruling

During hearings PATRIOTS offered Exhibit 45 as evidence. Exhibit 45 is a portion of a lengthy report by the Department of Consumer Affairs on drinking water quality problems facing consumers, and is dated July, 1976. The portion of the report offered by PATRIOTS is page 84, entitled "Consumer Complaint History of 20 CUC Systems". Page 84 purports to tabulate the number of complaints for each of 20 of CUCC's water operations in the State of California for the years 1973, 1974, and 1975. The part of this tabulation that PATRIOTS believes significant is the number of complaints for the Guerneville District, which are 116 for 1973, 240 for 1974, and 501 for 1975. CUCC objected to the receipt of Exhibit 45 and the objection was taken under submission subject to briefing.

PATRIOTS did not brief the admissibility of Exhibit 45 in its opening or closing briefs. Rather, it merely assumed that Exhibit 45 was in evidence and cited its contents in support of its arguments.

CUCC briefed the issue of admissibility in its opening brief. CUCC conceded that the report was probably subject to official notice. However, it argued that the document must still fall under one of the recognized exceptions to the hearsay rule in

order to be admissible. It argued that the contents of the document are hearsay and that PATRIOTS has not established with admissible evidence that it falls within any of the recognized exceptions to the hearsay rule. According to CUCC, there is no evidence whatsoever of who compiled the information, how it was compiled, what it is based upon, or whether it is trustworthy. There is also no evidence concerning what constitutes a complaint reflected on the table. We note also that no witness sponsored the exhibit or offered to be cross-examined as to its meaning or content.

Section 1701 of the Public Utilities Code states that in the conduct of our hearings the technical rules of evidence need not be applied by the Commission. Rule 64 of our Rules of Practice and Procedure states:

"Although technical rules of evidence ordinarily need not be applied in hearings before the Commission, substantial rights of the parties shall be preserved."

We do not believe that the substantial rights of CUCC to cross-examine witnesses against it would be preserved by admitting this proposed exhibit. Accordingly, we will sustain CUCC's objection to the admission of Exhibit 45.

We note, in addition to the hearsay objection proffered by CUCC, that the document itself has little, if any, probative value in relationship to the issues of this proceeding. Although PATRIOTS contends that a correlation exists between the increase in complaints between 1973 and 1975 and the harvesting of timber in CUCC's Guerneville watershed, there is no evidence of such a correlation. Exhibit 45 itself contains no reference whatsoever to timber harvesting. No witness in this proceeding has testified that the increase in complaints between 1973 and 1975 was a consequence of timber harvesting in the Guerneville District watershed. Indeed, the exhibit itself shows on its face that

timber harvesting was unlikely to have been the cause of the increased number of complaints. For example, the West Sacramento Water District of CUCC showed an increase from one complaint in 1973 to 720 complaints in 1975. There is no evidence of any watershed lands located in the West Sacramento District or of any timber harvesting there. The same pattern is evident in many of the other districts named in Exhibit 45. Twelve of the districts show zero complaints in 1973 and from as few as 14 complaints to 156 complaints in 1975. Another district shows seven complaints in 1973 and 25 complaints in 1975. Another shows ten in 1973 and 29 in 1975. There is no evidence in this record that timber harvesting was occurring in any of these districts during the years 1973, 1974, and 1975, except for Guerneville. It is pure speculation to suppose that this consistent pattern in most of the 20 CUCC systems addressed in Exhibit 45 is a consequence of timber harvesting.

Comments Under Section 311

On February 22, 1988, PATRIOTS filed its comments on the proposed opinion under Rule 77.1, et seq., of the Rules of Practice and Procedure. The comments consist entirely of reargument of points and issues that were addressed in the briefs. No "factual, legal or technical errors" are pointed out, contrary to the explicit terms of Rule 77.3. At most the comments state that greater weight should have been given to evidence sponsored by PATRIOTS. At the same time PATRIOTS states that: "The evidence in the case is at times contradictory. . . . Statements made by experts about area geohydrology are in disagreement." (Comments, page 2.) PATRIOTS has put its finger on the crux of the matter. The evidence is indeed in conflict. However, we disagree with PATRIOTS' statement that the "weight of the evidence falls in a different direction." (Comments, page 2.) Rather, the evidence, much of it produced through witnesses called by PATRIOTS, overwhelmingly supports the views expressed above. Where the evidence

is in conflict, the Commission acts within its discretion when it favors one view of the evidence over another.

CUCC filed reply comments in response to PATRIOTS' pleading. CUCC's reply refutes each point made by PATRIOTS and shows that its arguments are no more meritorious than those offered on brief. We will not reiterate PATRIOTS' arguments or CUCC's 5-page reply. It is sufficient to state that our findings are supported by the preponderance of credible evidence, and our conclusions are consistent with the findings and with the statutes that we administer.

Findings of Fact

1. Timber harvesting is heavily regulated by various state agencies. Statutory protection measures for watersheds predated the comprehensive regulations adopted in the Forest Practice Act.

2. The primary purpose of that regulation is the protection of water resources.

3. The timber harvesting operation on CUCC's watershed lands in the Guerneville District involved the harvesting of selected mature trees only. No clear-cutting of any parcel was ever involved.

4. Timber harvesting had at most a negligible effect upon water quality in the Guerneville District.

5. High average annual rainfall and steep slopes around the spring sources in the Guerneville District were primarily responsible for high turbidity during the four-month winter season each year.

6. In December 1975 the DHS recommended in a report that the Guerneville District install water treatment facilities for surface water sources, including the processes of turbidity removal, iron and Manganese removal, and disinfection, or abandon the surface water sources.

7. The Guerneville District manager took all the spring sources off of the system in 1976 on his own initiative due to the

high cost of DHS mandated daily turbidity tests on each spring source.

8. Vertical wells drilled in the Russian River alluvium are likely to deliver larger quantities of water than horizontal wells drilled in the upland areas near existing streams or springs.

9. Horizontal wells in the upland areas near existing streams and springs cannot alone supply the Guerneville system during the summertime and heavy demand periods.

10. Timber harvesting and water development in the watershed areas are compatible. The transfer of the timber rights to CRC and the selective harvesting of timber on Guerneville District watershed lands has had no appreciable effect upon water quality in the Guerneville District and will have no such effect either because the harvesting is done in such a way as to protect and preserve water resources or because the spring or stream sources involved will not again be employed in the service of the customers of the District.

11. The timber rights are neither useful nor necessary in the performance of CUCC's duties to the public in the Guerneville District.

12. The timber rights that CUCC transferred to CRC were in rate base as part of the watershed lands.

13. The timber rights had value at the time they were transferred to CRC.

14. If the timber rights had not been severed from the watershed lands and transferred to CRC, an unregulated affiliate of CUCC, the revenues from the timber harvesting would have accrued to the benefit of the ratepayers, thus reducing CUCC's revenue requirement.

15. CUCC transferred the timber rights to CRC in anticipation of timber harvesting revenues being received, which revenues would accrue to the benefit of the ratepayers without such transfer.

16. CUCC failed to reflect the effect of the transfer of timber harvesting rights in its plant accounts.

17. CUCC concealed the transactions involving the transfer of Guerneville District's watershed timber rights from the Commission by failing to reflect the effects of those transactions in Account 306.

18. CUCC earned a return on the value of the timber rights in rate base while at the same time diverting the harvesting revenues to the benefit of the shareholders of its parent company.

19. There is a high probability of finding large quantities of water in the Russian River alluvium in or adjacent to the Russian River that can supply all of the needs of the Guerneville District.

20. There is a lower probability of finding large quantities of water in the upland areas adjacent to the Russian River valley which could supply all of the needs of the system.

21. The Russian River is subject to flooding and to various kinds of contamination by virtue of sewage spills and other accidents.

22. New vertical or horizontal wells drilled in the upland areas could supply an unknown quantity of water that could be used to meet a portion of the Guerneville system requirements and/or supply emergency water in the event of flooding or other contamination of the Russian River area.

23. The aggregate potential contribution of upland wells cannot be determined without further exploration and test drilling.

24. Wells in tributary valleys might be able to supply a substantial portion of CUCC water system needs.

25. The aggregate potential contribution of wells in tributary valleys cannot be determined without further exploration and test drilling.

26. CUCC is following previously adopted recommendations and orders of the Commission and its staff in allocating its costs of its California operations.

27. The complainant in C.83-12-07 has failed to prosecute her complaint.

28. PATRIOTS has met its burden of showing significant financial hardship and is eligible to file a request for compensation.

29. It is reasonable to require CUCC to submit regular reports concerning its affiliate transactions.

Conclusions of Law

1. The transfers by CUCC of timber rights in the watershed parcels to CRC were not void ab initio.

2. The timber rights were in rate base as part of CUCC's Guerneville District watershed lands at the time of the transfers.

3. CUCC should be ordered to report to the staff the original costs of the six watershed parcels, to reduce Account 306 by those amounts, and to reflect those reductions of rate base in an Advice Letter rate decrease.

4. CUCC should be ordered to report to the staff the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar effect of those adjustments in each year since 1971.

5. CUCC should also be ordered to compute an interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and to propose a method whereby the total of overcollections and interest components may be amortized through rates to the benefit of the ratepayers.

6. CUCC did not err under § 851 by transferring the timber rights in certain Guerneville District watershed lands to CRC.

7. CUCC has waived any error in D.82-05-038 by failing to pursue its administrative and judicial remedies before that decision became final.

8. CUCC's request that the Commission should review, revise or rescind D.82-05-038 should be denied.

9. CUCC should be ordered to hire a competent independent geohydrologist to explore off-river sources of water before it is authorized to drill wells in the Russian River alluvium.

10. CUCC should be authorized to drill wells in the Russian River alluvium should the ordered exploration reveal the absence of economically feasible off-river water sources.

11. The staff should be directed to propose the CRC adjustment in future rate proceedings involving CUCC operations in California.

12. The stay of the step-rate increase should be vacated and CUCC should be authorized to file an amended Advice Letter 217 in accordance with the instructions in the discussion.

13. The complaint in C. 83-12-07 should be dismissed for lack of prosecution.

14. The request for finding of eligibility mailed by Kathy Wyrick should be dismissed as moot.

15. The objection of CUCC to the admission of Exhibit 45 should be sustained.

16. CUCC should be required to report quarterly to the Commission Advisory and Compliance Division giving the following:

- a. Full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.
- b. A report of any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Citizens Utilities Company of California (CUCC) shall report to the Commission Advisory and Compliance Division (CACD) the original costs of the six watershed parcels from which CUCC severed timber harvesting rights, shall reduce Account 306 by those amounts, and shall reflect those reductions of rate base in an Advice Letter rate decrease filing.

2. CUCC shall report to CACD the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar affect of those adjustments in each year since 1971. CUCC shall also compute an interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and shall propose a method whereby the total of overcollections and interest components may be amortized through rates to the benefit of ratepayers. If CUCC and CACD can agree upon the appropriate dollar figure and the method of amortizing it, then CUCC shall file an Advice Letter to accomplish the required rate reduction. If no agreement can be reached within 120 days from the effective date of this order, then Water Utilities Branch shall petition the ALJ to set further hearings to take evidence on the issues involving the amortization of these overcollections.

3. CUCC's request to review, revise, or rescind D.82-05-038 is denied.

4. CUCC is ordered to hire a competent and independent geohydrologist familiar with local conditions to explore potential off-river sources of water, especially those associated with tributary streams feeding into the Russian River, and to evaluate

the potential for developing or redeveloping horizontal and/or vertical wells on CUCC's upland watershed lands.

5. CUCC is ordered to report to the Commission on the outcome of such exploration within one year of the effective date of this interim order so that the Commission can determine whether CUCC should be authorized to drill the three high production wells in the Russian River alluvium recommended by its engineering consultant.

6. Water Utilities Branch shall propose the CRC adjustment recommended in these proceedings in any future rate proceedings involving CUCC's California operations.

7. The stay of CUCC's 1984 step-rate increase ordered in Resolution W-3166 is hereby vacated; and CUCC is authorized to file an amended Advice Letter 217 in accordance with the instructions stated in the discussion.

8. PATRIOTS is eligible to claim compensation in this proceeding under Rule 76.25.8. The complaint in C.83-12-07 is dismissed.

9. CUCC's objection to the receipt into evidence of Exhibit 45 is sustained.

10. Application 60220 remains open for further proceedings after receipt of the geohydrologist's report ordered in Ordering Paragraph 5.

11. CUCC is ordered to report quarterly to the Commission Advisory and Compliance Division according to the following requirements:

- a. CUCC shall give full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.

- b. CUCC shall report any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

This order is effective today.

Dated April 27, 1988, at San Francisco, California.

STANLEY W. HULETT
President
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

I will file a concurring statement.

/s/ DONALD VIAL
Commissioner

I will file a written dissent.

/s/ FREDERICK R. DUDA
Commissioner

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


Victor Weissor, Executive Director

DONALD VIAL, Commissioner, Concurring:

I voted to support this order, but wish to express my view that the majority should have taken stronger action on the issue of the timber revenues. In retrospect, I think that it was unfortunate that the debate in this case has focused on whether the timber rights were necessary and useful to the utility at the time they were transferred to the unregulated affiliate. More important, in my view, is the general conduct of this company with respect to this affiliate transaction. The evidence plainly shows that Citizens did the following:

1. It transferred the timber rights to the affiliate without notifying the Commission, despite the fact that there was at least an arguable case that the transfer required approval under P.U. Code Section 851.

2. No conditions were attached to the transfer that might have helped to ensure that the future interests of the ratepayers were protected. Such conditions could have been especially important if Citizen's affiliate had ever transferred the rights to a third party totally unaffiliated with the utility, and might have provided an important supplement to more general statutory protections for the environment, on which this order places heavy reliance.

3. The utility used improper, and probably deceitful, accounting for the transaction. The timber rights were assumed to have zero value when they were transferred away from the utility, yet over the next ten years the affiliate earned \$323,000 in revenues from timber sales.

This order does correct the accounting impropriety, and prospective reporting requirements are placed upon Citizens' affiliate transactions. Yet this decision also allows Citizen's shareholders to retain all of the proceeds of the timber sales.

My concern is that, despite all the bad acting on the part of the utility in this transaction, we are allowing it to retain 100% of the fruits which the affiliate reaped as a result of these dubious efforts. I do not want this order's failure to change the disposition of these revenues to become a signal to other companies who are now vigorously pursuing diversification, a signal that this Commission is reluctant to punish even companies that show a disregard for the interests of their ratepayers. The majority's order is too modest an admonition to Citizens for its past behavior.

In addition to the accounting adjustment in the utility's rate base, I would have preferred to return to ratepayers the timber revenues for the years through 1976, when the watershed in question was abandoned for economic reasons. This resolution would have denied Citizens' shareholders the timber revenues in those years during which Citizens' disregard for its customers had at least the potential to harm those ratepayers.


Donald Vial, Commissioner

San Francisco, California
April 27, 1988

FREDERICK R. DUDA, Commissioner, dissenting.

I dissent from the position taken by the majority that CUCC's transfer of Guerneville District timber rights to its affiliate CRC without Commission approval did not violate Public Utilities Code Section 851. I also dissent from the accounting treatment utilized by the majority to remedy CUCC's failure to properly account for the timber rights transfers at the time they occurred.

I believe that the Commission's determination whether a transfer of utility assets without Commission approval violates Section 851 must be based on an analysis of the facts that existed at the time the transfer occurred, and not on a review of the short-term impact of the transfer on utility operations a number of years later.

The primary question before us is: Was CUCC justified in transferring its timber rights to CRC in 1971 through 1973 on the ground that those rights were not necessary or useful to the utility?

CUCC transferred Guerneville District timber rights to CRC in six transactions during the years 1971 through 1973. These timber rights were attached to land on which a number of active springs, wells, and other surface water sources used to supply water to CUCC's Guerneville water system were located. Since CUCC did not abandon its upland water sources until 1976, and since timber was harvested on these lands from 1971 through 1980, it is clear that timber was being harvested at the same time the land the timber was on was being used to supply water to the Guerneville system.

Timber harvesting near sources of surface water can adversely affect water resources. In two minor instances, timber harvesting on CUCC lands did just that. In one instance, logging road construction broke a pipe leading from a water source to the utility system. In the second instance, mud from a logging road cut washed into a spring. These events, although minor, would not have occurred but for the timber harvesting. These events show that control over timber harvesting on watershed lands is useful in maintaining safe and efficient water company operations.

CUCC lost control over timber harvesting in its Guerneville District when it transferred Guerneville District timber rights to CRC. The timber rights deeds contain no provisions designed to safeguard the watershed.

The biggest problem with CUCC's argument that its timber rights transfers did not threaten its watershed because timber harvesting is so stringently regulated is the fact that at the time these transfers occurred timber harvesting regulations in California contained few if any effective environmental safeguards.

Until 1974, timber harvesting in California was regulated under the 1946 Forest Practice Act, as amended in 1970 (former Public Resources Code (PRC) Sections 4521-4618). In 1971, the court in Bayside Timber Company v. Board of Supervisors of San Mateo County, 20 C.A. 3d 1 (1971), held that the forest practices rules provisions of the 1946 Forest Practice Act represented an unconstitutional delegation of legislative power to a regulated industry. The Bayside court found that the timber industry had the sole power to determine whether there were any restrictions on the environmental damage that could result from timber harvesting operations: "It follows that without agreement of the "private timber ownership," no power in California has

authority to impose rules to insure reasonable environmental and public protection from logging abuses" (Bayside, supra, 20 C.A. 3d at 10).

Writing in September, 1971, the court noted that: "Some of the necessary forest practices and controls for which no standards are set, relate to: "soil erosion control, water quality and watershed control, flood control,...mass soil movements, submission of logging plans, location and grade of logging roads and skid trails, excavation and fill requirements,....slash and debris disposal, haul routes and schedules, hours and dates of logging, and performance bond requirements." Bayside Timber Company v. Board of Supervisors, Id. at 10, Fn 19. (emphasis added).

The Z'Berg-Nejedley Forest Practices Act was enacted in 1973, and became effective in 1974. The Z'Berg-Nejedley Act includes safeguards for the protection of water resources and provides the basis for the present environmentally sound regulation of timber harvesting in California.

Reviewing the facts, I find that CUCC transferred to an affiliate the timber rights on lands on which a number of in-use surface water sources were located, that timber harvesting on these watershed lands took place while those water sources continued to be used for utility purposes, that the first three years of timber harvesting were subject to the inadequate standards of the 1946 Forest Practice Act and not to the environmental safeguards now provided by the Z'Berg-Nejedly Forest Practices Act, that poorly regulated timber harvesting operations on land on which functioning water sources are located could adversely affect the water supplied by those sources, and that retention of timber rights on such lands could enable the landowner to protect in-use water sources from any adverse timber harvesting impacts. I am compelled by these facts to conclude that CUCC transferred to its affiliate timber rights useful for

the protection of in use water sources on its Guerneville District watershed, and that the transfer of such useful assets without our approval constituted a violation of Public Utilities Code Section 851.

I am not convinced that CUCC's 1976 abandonment of its upland water sources retroactively justifies its timber rights transfers by rendering the connection between upland timber harvesting and CUCC's utility operations so remote as to make it impossible to characterize the timber rights as necessary or useful, even if we assume for the sake of argument that Section 851 does not require us to evaluate the usefulness of the Guerneville timber rights to CUCC at the time the utility transferred these assets to CRC.

In determining whether utility natural resource assets remain necessary or useful, we must look at the foreseeable long term future of those assets and their potential impact on utility operations. There are several reasons why CUCC's upland timber rights remain useful to its utility operations.

First, it is possible that CRC or some future purchaser of the timber rights might not adhere to timber harvesting regulations as stringently as CRC has so far and that such an unfortunate occurrence might have an adverse impact on the watershed in question. Since the deeds transferring timber rights to CRC contain no language designed to preclude the transfer of these rights to others or to ensure that timber harvesting or other resource extraction is conducted in a manner that will not threaten the watershed, we cannot assume that CRC will not transfer these rights to others or that the deeds from CRC to others would contain any restrictions designed to protect the watershed. In the absence of such restrictions, CUCC is forced to rely on governmental regulation as a shield against

environmentally unsound timber harvesting. I would take official notice of the fact that people do not always obey governmental regulations.

Second, it is possible that timber harvesting regulations could be changed, or governmental agency budgets cut, in such a manner that their value as a shield against watershed destruction would be substantially reduced. The simple fact that the environmentally protective Z'Berg Nejedly Forest Practices Act only became effective in 1974 points out that regulations we now take for granted have not been there forever. While it seems unlikely that these regulations will be altered soon to provide less environmental protection than at present, the mere fact that these laws are not static principles etched in stone, but are instead flexible documents subject to change over time, leads me to conclude that it is possible that the governmental shield against watershed destruction could be weakened someday. And it is certainly foreseeable that agency budget cuts could someday have an adverse impact on environmental protection.

Given these possibilities, it cannot truly be said that the timber rights are not necessary or useful in maintaining the watershed for use in utility operations. Continued utility ownership of timber rights on watershed lands gives a utility a much more certain opportunity to control the harvesting of that timber resource than is possible where that resource is owned and controlled by another.

I agree with staff that the transfer of timber rights associated with watershed lands to other parties jeopardizes CUCC's control over its water resources. Such jeopardy was more direct in the past, when timber harvesting took place on lands with water sources then providing water to CUCC's Guerneville system, than it is now that these sources are no longer in current use. The record is not adequate to determine for certain the impact that poorly managed timber harvesting on

CUCC's upland watershed could have on its planned Russian River wells. Nonetheless, no one disputes that the watershed lands themselves continue to be used and useful to the utility because they capture water for providing utility services, even though the spring or surface diversion sources on those lands may not be used. It is possible that timber harvesting on these lands could affect this usefulness.

I believe that retention of timber rights is necessary for the safe and reliable operation of CUCC's Guerneville District water systems. These timber rights would be useful to CUCC in protecting its watershed from damage from any future timber harvesting operations, especially if CUCC redevelops upland sources of water as a result of the exploration required by this decision or as a result of the failure of the proposed Russian River wells to perform as well as expected during foreseeable periods of flooding or contamination.

I believe we should direct CUCC to take steps necessary to ensure that the recorded title for the lands in question reflect that timber rights rest with CUCC's Guerneville District and not with CRC, just as we did in D.82-05-038 with regard to the timber rights in CUCC's Felton District (9 CPUC 2d 197, (1982)).

Disposing of the Section 851 issue does not, however, end the matter. We must next determine the appropriate accounting treatment of such transactions.

The majority correctly notes that CUCC knew or should have known that if the timber rights had not been severed from the watershed lands and transferred to CRC, an unregulated affiliate, the revenues from the timber harvesting would have accrued to the benefit of the ratepayers, thus reducing CUCC revenue requirement. It appropriately infers that CUCC transferred the rights to avoid this result and that the transfers were made in anticipation of timber harvesting revenues

being received. Where the majority errs is in its attempt to correct CUCC's improper diversion of timber harvesting revenues to shareholders.

I believe that we should require CUCC to use the net present value of the timber harvesting revenues to write down its entire Guerneville District land account, and not just the proportion of the account attributable to the land on which the transferred timber rights were located. Once the land account is exhausted, the remaining timber revenues should be used to reduce gross revenue requirement, including taxes, excessively collected from ratepayers. These remaining revenues should not be given to the utility's parent company shareholders. Our decision today should be designed to place ratepayers in approximately the same position they would have been in had CUCC properly accounted for its timber harvest operations; it should not, as the majority decision does, permit utility shareholders to benefit from their misappropriation of timber harvesting revenues.

In conclusion, I believe that CUCC violated Section 851 since retention of the timber rights and the attendant control over the watershed was necessary to ensure safe operation of the utility system at the time the timber rights transfers occurred. Determinations of the necessariness or usefulness of utility assets for Section 851 purposes should be made before and not after the assets are transferred. Furthermore, it is not appropriate for the Commission to retroactively ratify the timber rights transfers simply because no serious harm to the watershed has thus far resulted from CRC's timber harvesting operations or because the 1973 Z'Berg-Nejedley Forest Practices Act now

OII 83-11-09 et al.
D.88-04-068

provides some assurance that future timber harvesting will most likely be conducted in a manner that will not harm the watershed. Retention of the timber rights is still necessary or useful to CUCC in preventing any future timber harvesting operations from damaging its watershed.


Frederick R. Duda, Commissioner

April 27, 1988
San Francisco, California

Decision 88 04 068 APR 27 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's
own motion into the practices of
Citizens Utilities Company of
California, its operating divisions
and its subsidiaries, with regard
to the transfer of real property
rights and the management of its
watershed resources.

OII 83-11-09
(Filed November 30, 1983)

Kathy Wyrick, Intervenor,
Complainant,

v.

Citizens Utilities Company of
California, and subsidiary
companies and corporations,
Sacramento Water Works, Jackson
Water Works, Larkfield Water
Company, Felton Water District,
Montara Water District, Guerneville
Water District, Washington Water
and Light Co.,

Case 83-12-07
(Filed December 19, 1983)

Defendants.

In the Matter of the Application
of Citizens Utilities Company of
California for authority to increase
rates and charges for water service
in its Guerneville Water District.

Application 60220
(Filed January 27, 1981)

E. Garth Black and John H. Engel, Attorneys at Law, for respondents.
James Squeri, Attorney at Law, for Kathy Wyrick, complainant and interested party, and for PATRIOTS, interested party.
Kathy Wyrick, for herself, complainant, and for PATRIOTS, interested party.
Jack Crlenjak, Attorney at Law, Carlos E. Beneman, and Harry Smith, for Ferndale Intervention Team and Ratepayers of Montara-Moss Beach Water District;
Phyllis J. Betz and Nicholas R. Tibbetts, for Congressman Douglas H. Bosco; Richard Massa, Attorney at Law, for City of Jackson; Edgar L. Shiffrin, for himself; Rosemary H. Morgan, Attorney at Law, for the County of Sonoma; Ron Sonenshine and Neil Sinclair, for PATRIOTS; and David J. Byers, Attorney at Law, for Half Moon Bay Properties and Farralon Vista Associates; interested parties.
Freda Abbott, Attorney at Law, and Douglas Long, for the Division of Ratepayers Advocates.

SECOND INTERIM OPINION

1. Introduction

This proceeding involves three consolidated proceedings. Order Instituting Investigation (OII) 83-11-09 is an investigation into the practices of Citizens Utilities Company of California (CUCC) and its operating districts and subsidiaries. Consolidated with the investigation is Application (A.) 60220, the most recent general rate proceeding involving CUCC's Guerneville Water District. In its OII the Commission reopened A.60220 to consider ratemaking treatment of revenues generated by timber harvesting in the Guerneville Water District watershed. The third proceeding is the complaint of Kathy Wyrick against CUCC and its subsidiaries. The Commission ordered in D.84-02-066 that C.83-12-007 be consolidated with the other two proceedings.

This decision deals principally with the issues in this proceeding that are specific to the Guerneville Water District. A later decision will address all issues remaining in this proceeding and close the file. Issues that are specific to the Montara-Moss Beach District that arise out of these proceedings have been transferred by ruling of the Administrative Law Judge (ALJ) to A.85-06-010, an application of CUCC for an order restricting the addition of consumers in the Montara-Moss Beach District. A final order in that proceeding will close out all issues pertaining to Montara-Moss Beach.

2. Procedural Background

On February 16, 1984, the Commission issued D.84-02-066 which, among other things, set forth the issues to be addressed in this proceeding. They are as follows:

- a. Whether CUCC has transferred any real property interests, including mineral and timber rights, (assets) without Commission approval in violation of Public Utilities Code (PU) § 851;
- b. What, if any, ratemaking adjustments are appropriate with respect to each CUCC entity subject to our jurisdiction;
- c. Whether CUCC has prudently managed water sources in the best interests of its ratepayers; and
- d. Whether common expenses among CUCC entities are being properly allocated for ratemaking and what, if any, orders should we make to ensure a reasonable allocation procedure is adopted and followed.

A prehearing conference was held March 26, 1984, in which a schedule for the submission of prepared testimony and exhibits was established by the ALJ and hearings were scheduled to begin October 30, 1984. Requests to postpone the initial hearing date were received from various parties, principally consumers or their representatives, which resulted in taking the matter off calendar.

On January 28, 1985, a second prehearing conference was held. Thereafter, hearings before ALJ Baer began on May 28, 1985 and continued on May 29, 30, and 31, July 1, October 7, 8, 9, 10, and 11. Hearings concluded on November 18, 1985. The matter was submitted subject to the filing of concurrent opening and closing briefs. CUCC, the Public Staff Division (PSD), PATRIOTS, and Congressman Douglas H. Bosco filed concurrent opening briefs on or about December 26, 1985; opening briefs were also filed by the Department of Health Services (DHS) on January 15, 1986 and by the Ferndale Intervention Team and Ferndale Chamber of Commerce (FIT) on March 28, 1986. The PSD, FIT, and CUCC filed concurrent briefs on or about March 31, 1986 while PATRIOTS filed its closing brief on April 8, 1986.

3. Timber Harvest Revenues

a. Evidence

On February 28, 1981, Citizens Utilities Company of California (CUCC), a California corporation, filed Application (A.) 60285 seeking authority to increase rates in its Felton Water District (Felton) in Santa Cruz County. The record in A.60285 revealed certain intercompany transactions involving Felton and Citizens Resources Company (CRC), a Delaware corporation.¹ By deed recorded August 19, 1974, CUCC transferred timber rights to 7 of 9 parcels of public utility watershed property in its Felton District to CRC. Also, in 1974 CRC signed a timber management contract with an expert forester. Pursuant thereto, CRC harvested 2,303,000 board feet of lumber in 1976, 1978, and 1979.

The Commission found in Decision (D.) 82-05-038 that timber harvest revenues from Felton's watershed lands were \$266,549

¹ CRC and CUCC are subsidiaries of Citizens Utilities Company (CUC), a Delaware corporation. However, CRC does not operate public utilities in this state and is not subject to Commission regulation.

for the years 1978 and 1979. It also found that watershed lands from which timber was harvested are included in Felton's rate base, and are necessary and useful² to Felton's utility functions; Commission authority to transfer timber and mineral rights to CRC was never obtained. (9 CPUC 2d at 209.)

The Commission concluded that the transfer of timber and mineral rights from Felton to CRC was void.³ It ordered CUCC to arrange for transfer of those rights back to Felton; and it amortized the timber harvesting revenues of \$266,549 over 12 years, thus reducing Felton's revenue requirement by \$22,213 each year.

In D.82-05-038 the Commission also ordered CUCC to file, on a district-by-district basis:

- "a. A list of all property and assets transferred between the particular district and [CRC] going back to the date [CUCC] acquired the...district....

2 Significantly, in its brief CUCC did not contend that the pertinent watershed lands or the part consisting of timber rights were neither necessary nor useful in Felton's performance of its duty to the public so as to obviate application of Public Utilities (PU) Code § 851; and CUCC did not seek rehearing on the § 851 issue or on the Commission's disposition of the timber harvesting revenues.

3 "No public utility...shall sell, ..., or otherwise dispose of...the whole or any part of its..., plant, system, or other property necessary or useful in the performance of its duties to the public, ..., without first having secured from the commission an order authorizing it so to do. Every such sale...[or] disposition...made other than in accordance with the order of the commission authorizing it is void. . . .

"Nothing in this section shall prevent the sale...or other disposition by any public utility of property which is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value; ..." (PU Code § 851.)

- "b. A list of all property and assets transferred to CRC which [were] thereafter sold, transferred, harvested, or leased by CRC; ..." (9 CPUC 2d at 211.)

CUCC filed the required data on July 6, 1982. Based upon that filing and the record and decision in A.60285, the Commission on November 30, 1983 issued OII 83-11-09. The Commission stated therein that:

"...it appears that CUCC may have violated [§] 851 by unilaterally transferring assets to CRC from its other operating districts listed in its compliance filing."

It then ordered an investigation "into the practices of CUCC, its operating districts, and its subsidiaries with regard to the transfer of real property rights and the management of its watershed resources." In particular the Commission ordered:

"4. This investigation will consider:

- "a. Whether for each district or subsidiary CUCC has violated [PU] Code [§] 851. To this end it will be necessary to consider whether the transferred parcels and assets were necessary or useful in the performance of the utility's duties to the public. Each respondent shall carry the burden of proof that its properties transferred were not useful or necessary."

On February 16, 1984, the Commission issued D.84-02-066 to clarify the scope of the investigation and to establish procedures and schedules to be observed before hearings began. D.84-02-066 summarized the § 851 issue as follows: "whether CUCC has transferred any real property interests, including mineral and timber rights, (assets) without Commission approval in violation of [PU] Code § 851." This restatement of the § 851 issue defined the term "asset" in Ordering Paragraph 4.a. of the OII to include the timber and mineral rights transfers that were to be one of the main

objects of the investigation. D.84-02-066 also required CUCC to submit a report with detailed information on each transfer.

CUCC described the timber rights transferred to CRC in its Asset Report (Exh. 7), submitted in compliance with D.84-02-066. The individual transactions involving the Guerneville Water District are summarized, as follows:

<u>Asset Report Parcel No.</u>	<u>Parcel Size In Acres</u>	<u>Date of Transfer</u>
I-15	80	November 16, 1971
I-16	80	November 16, 1971
I-17	23.9	November 16, 1971
I-19	278	July 5, 1971
I-22	240	November 16, 1971
I-28	<u>175</u>	September 11, 1973
Total	876.9	

In each of these cases the transfer involved only timber rights on unimproved real estate. The underlying fee to each parcel remained in CUCC.

The Asset Report contained additional information as to each of the parcels identified above, as follows:

- "B. The rights were not included in rate base and had no value to be recorded in plant-in-service.
- "(a) The cumulative amount of return calculated was zero.
- "(b) Commission authorization to transfer the [timber] rights was not required and was not obtained because the rights were not used and useful when transferred.
- "(c) The book value at acquisition was zero.

"(d) The market value when transferred was zero.

"(e) The consideration received upon transfer was zero.

"(f) The expenses of transfer were zero.

"(g) The amount reflected as a reduction to the plant account upon transfer is zero.

"C. The [timber] rights were transferred to [CRC].

"D. The proceeds received by CRC by year are:

<u>Year</u>	<u>Gross Income*</u>	<u>Costs/Expenses</u>	<u>Net Income (Loss)</u>
1971	\$ 17,016	\$ -	\$ 17,016
1972	1,055	-	1,055
1973	51,337	-	51,337
1974	43,807	-	43,805
1975	43,524	-	43,524
1976	13,892	-	13,892
1977	33,145	1,481	31,664
1978	57,638	2,951	54,687
1979	30,608	855	29,753
1980	37,916	1,052	36,864
1981	-	605	(605)
1982	-	-	-
1983	-	1,016	(1,016)
Total	\$329,938	\$7,960	\$321,978

*Gross income from timber harvesting on all parcels, Items I-15, I-16, I-17, I-19, I-22, and I-28.

"E. The rights are still held by CRC." (Exh. 7, pp. 18-19.)

CUCC's witness O'Brien explained in his prepared testimony what he meant when he designated an item of real property or an interest in real property as "not used and useful." He first noted that the statutory language in § 851 is "necessary or useful." However, interim D.84-02-066 used the language "used and useful." In his testimony and in the Asset Report, which he sponsored, he adopted the "used and useful" phraseology of D.84-02-066. When he says that a piece of property or plant is not used and useful in

providing utility service, he means that such property is not performing any utility function and the removal of the property does not affect the providing of utility service. (Exh. 47, p. 11.)

The initial determination that an item of property was not used and useful was made by CUCC's operating people who know the system and how it is operated. Then, for purposes of his testimony and the Asset Report, O'Brien went over each transfer with CUCC's operating people and satisfied himself that their initial determinations were correct.

CUCC's position as to the Guerneville timber rights is that no action by the Commission is required. Since, in CUCC's view, the timber rights were not necessary or useful, Commission approval of the transfers was not required. Therefore, it would be inappropriate for the Commission to void the transfers of timber rights or to take any ratemaking action with respect to them.

CUCC takes the same position vis-a-vis the timber rights in Felton transferred to CRC and reconveyed by CRC to CUCC in compliance with D.82-05-038 in A.60285. CUCC asks the Commission to reconsider that disposition and to vacate its orders: (1) requiring the reconveyance of timber rights from CRC to CUCC, and (2) attributing the timber harvesting proceeds to Felton's operating income over a 12-year period. In CUCC's view this is an appropriate result because: (1) the timber harvesting rights had no asset value assigned to them, (2) were never included in rate base, and (3) were not necessary in providing utility services.

On cross-examination O'Brien distinguished between the land parcels themselves and the timber harvesting rights on those parcels. O'Brien testified that the land parcels, i.e. the watershed areas, continue to be used and useful to the utility because they capture water for providing utility services. This is so even though the spring or surface diversion sources on those

parcels may not be used. In his opinion⁴ the water captured in the watershed areas would still be applicable to the utility's other water supply sources, such as those wells down by the Russian River.

In contrast to the land parcels, however, the timber rights, according to O'Brien, do not provide the utility service as does the land by virtue of the water flowing under or over it. O'Brien denied that the timber or timber rights needed to be retained to protect the watershed lands, stating that the evidence in the proceeding showed that any forestry work that was done was done to enhance the watershed lands and was in no way detrimental to them.

PATRIOTS subpoenaed Loren Montgomery Berry to testify in support of its recommendations. Berry is a forester, land manager, and owner of Berry's Sawmill. He has been CUCC's forester and land manager since 1968, but is not now under contract. He has been a forester for over 40 years and has been registered in the State of California as a forester for many years. Berry harvested timber for CUCC from 1968 to 1980, during which time he was never cited for a violation of the regulations of any state agency.

According to Berry, timber harvesting is heavily regulated by various state agencies. The Department of Forestry and the Water Quality Control Board require specific and stringent measures to be taken before timber may be harvested. Berry gave one example. After working for 6 weeks to evaluate a piece of property in Cazadero and after coming up with the functional equivalent of an environmental impact report with erosion control built in, a preharvest meeting was held on the property. In attendance were two forestry men, one geologist, one water quality man, one Fish & Game

⁴ He admitted that he was not a geologist and suggested that the questions about the usefulness of the land parcels should have been put to the geologist.

man, a representative of the Sonoma County Planning Department, three of the landowners, the logger, Berry, and Berry's son, Jim (also a forester). The purpose of the meeting was to evaluate what the proposed harvesting would do to the water source. Berry opined that California has the toughest environmental guidelines in the nation as far as protecting water and natural resources.

Timber harvesting is very strictly regulated under the Z'berg-Nejedly Forest Practice Act of 1973 (California Public Resources Code section 4511 et. seq.), which specifically includes safeguards for the maintenance of water resources. Before harvesting can occur a timber harvesting plan must be submitted, held open for public comment, and approved by the appropriate state agencies. The plan must provide the names and addresses of the timber owners and operators, as well as detailed descriptions of the area to be harvested, the methods and equipment to be used, and any special procedures to be followed to reduce erosion. The plan must also include expected commencement and completion dates of the harvesting. The statutes provide for very strict penalties for anyone making material misstatements in a filed plan, and require inspections to ensure that an approved plan is followed.

These plans, and the underlying laws and regulations, distinguish between watershed property that is being used as a water source for commercial uses and a watershed that is, for instance, in the middle of a national forest that has no commercial use associated with it. Different guidelines, distances, and practices apply to watershed used as a water source for people. In the timber harvesting plans identified in this proceeding, Berry applied the more stringent guidelines when working around water source points. The services he provided to CUCC as a forester and land manager consisted of:

1. Surveying CUCC's property with the best management practices in mind, keeping in mind the priority of the springs, which in turn relied on a good watershed.

2. Putting in fire trails and access roads.
3. Removing fire fuel, i.e., dead wood.
4. Cutting mature trees on a selection basis only.
5. Patrolling the roads in the wintertime to keep trespassers off and to maintain the integrity of the watershed.

Berry was particular to correct any reference by counsel to "logging" operations. He was not involved in logging, but rather in the harvesting of selected mature trees only. When asked whether his harvesting methods include clear cutting any parcel, he replied "never" and stated that his methods only involved selective thinning.

Berry described several steps taken to ensure the integrity and purity of the CUCC watershed, as follows:

1. Working no closer than 150 feet to a known water source. However, this distance can be extended to 1/4 mile if the work is above a stream;
2. Felling trees away from the water source;
3. Culvertizing crossings;
4. Building access roads to minimize erosion by proper sloping and sizing; and
5. Inspecting by state agencies, both during harvesting by surprise inspections, and after harvesting.

Berry stated that it was possible that selective timber harvesting can enhance waterflow of surface sources of domestic water supply on timberland. However, he had no way of telling whether his harvesting actually had that effect. He did understand that it was part of his contract with Citizens to maintain the purity and integrity of its domestic water supplies. His function was to observe the guidelines established by the Department of

Forestry regarding harvesting and working within certain distances from springs, which he did. Water Quality, Fish & Game, and Department of Forestry then inspected his work, for which he never received a single citation.

Berry stated that he never discussed his forest management practices with any representative of Citizens. Instead, Berry testified: "We've just fulfilled our obligations at all times." Those obligations are established by the forest practice laws. Berry volunteered that it was a strange thing that he had never discussed his practices with Citizens but explained that:

1. California has by far the toughest environmental laws in the nation, and almost everything is run by the state;
2. CUCC was relying on Berry to ensure that the requirements of state law were observed; and
3. Forest practice laws are very complicated and extensive, and unless a person has spent many years in the field, he would just be a novice at it.

In other words, Berry was the expert and CUCC personnel were the novices. They relied upon him to understand and comply with the law. He testified that the agencies give the guidelines; he complied rigidly with them; and he was never cited for a violation of those guidelines.

PATRIOTS subpoenaed another witness, Gerald A. Griffith, whose testimony corroborated Berry's in part. Griffith is a water company manager by profession. During the past year he worked for Millview County Water District. From May 15, 1973, until June 15, 1984, he worked for CUCC, first as manager of Guerneville (1974-1981) and then as superintendent over four systems: Guerneville, Larkfield, Felton, and Montara (1981-1984). He left CUCC to take the job at Millview. He is not now employed by CUCC. He has a degree in biology. His work experience before coming to CUCC

included about 20 years in laboratory work (industrial chemistry) in various industries, (rockets, missiles, and food), three years running an anodizing plant, and cancer research. He was also an efficiency expert for Macheshim Chemical Company in Beer-Sheva, Israel. He is a class 4 water operator and teaches the certification course for water operators at Santa Rosa Junior College.

When Griffith first became manager of Guerneville in 1974, he was told to keep an eye on Berry's harvesting operations and to make sure he stayed well away from CUCC's springs and generally followed good practice. Griffith admitted that he was no logger and had no authority on logging, but from his perspective Berry had a model operation. He testified that Berry has a reputation of probably being the best logger in California.

Griffith had occasional contact with Berry regarding trespassers on CUCC watershed lands. Berry would come in or call Griffith to let him know about trespassers Berry had encountered and run off. These trespassers were frequently wood poachers, cutting timber for themselves without permission. Griffith recounted:

"I had one [wood poacher] tell me it was perfectly all right to cut the timber because he got permission from Jerry Griffith."

One of the things that Griffith's superiors warned him about was letting anybody cut undersized timber. Sixteen inches was the minimum. He went out with a tape measure one day to check up on Berry's operation, and the smallest stump he found was 18 inches. Griffith believes that Berry did an outstanding job.

He could only remember two instances when Berry's operations had any effect on the water company. In one case at Villa Grande Spring he found that early rains had washed some mud from a road embankment into the spring. That was the only case he

cited where he thought that logging had directly contributed to the amount of mud in the water supply.

He also thought that there was a case where a road crossing caused a line to crack. However, he considered this "no big deal," as it merely involved fixing the line with a clamp. He did not believe that any complaints resulted from this incident.

Griffith testified that mud in the water was a fairly standard thing every winter. Every time it rained the springs turned muddy. When that would occur he would turn off the springs and pump well water up to the higher tanks that are normally filled by springs. The springs were unusable for four months each year during the rainy season because of the high annual rainfall averaging 46-1/2 inches per year and twice in his memory reaching 100 inches per year.

In 1976 on his own initiative Griffith took all the spring sources off of the system. He did this because of the high cost of doing DHS mandated daily turbidity tests on each spring source. He began the daily testing procedures on July 1, 1976, and continued them for 48 days until he determined that he did not have the manpower to continue. The testing required 12 man-hours per day and the cost of that effort exceeded the value of the water supply by five times. When the springs were usable (other than in the four months of the rainy season) they only provided at best 3% of the total water supplies. In the dry months of August and September that percentage fell to 1%.

The testing procedure involved obtaining a sample of water and returning to the office to perform the test. If the sample passed the test the employee could go to the next spring. However, if the sample failed, he would return to the same spring for a second sample. Many of the springs are inaccessible by vehicle and require long walks to and from a road.

On the issue of timber rights the staff witness in prepared testimony stated only that:

"The transfer of...timber...rights of watershed properties to other parties jeopardizes CUCC's control over water resources. These rights are necessary for the safe and reliable operation of the water systems. In view of this, all these property rights should be retained by CUCC." (Exh. 16, p. 4.)

The staff appended to its report (Exh. 15) a December 1975 report by the Water Sanitation Section of the California Department of Health. The report contains information pertinent to the issue of timber harvest revenues.

In 1975 the system derived its water from 11 wells and 13 surface stream diversions. Water is diverted from these 13 points by dams across stream beds. The water from the surface sources flows by gravity to the distribution system. All surface water sources are disinfected by means of chlorinators before the water enters the distribution system. Water from the surface stream diversions is not filtered to reduce turbidity, however. The watersheds of the surface sources are not patrolled and are accessible to the general public.

The DHS concluded, inter alia, that the system does not meet the requirements of California's laws and regulations as to water quality. Turbidity was specifically mentioned. DHS also concluded that: "The use of surface stream water from unprotected watersheds without treatment other than disinfection does not provide adequate treatment."

The DHS recommended that CUCC:

- "1. Complete the chemical, trace elements, and general physical analyses required for all water sources. On completion of these analyses, the Company should sample each source monthly and complete analyses made for those constituents found to be present in excess of allowable concentrations; such as iron, manganese, turbidity, and color."

* * *

- "3b. Installation of a duplicate chlorinator, an audible or visual alarm, a turbidity recorder, and a water supply turn-out for each of the [13] surface water sources."

* * *

- "4. Install water treatment facilities for surface water sources including the processes of turbidity removal, iron and manganese removal, and disinfection; or abandon the sources." (Emphasis added.) (Exhibit 15, Appendix C, p. 5.)

David Clark, District Engineer for the DHS, sponsored prepared testimony on behalf of DHS. He did not mention the surface water sources in his Exhibit 22. He recommended that "if the PUC determines that [CUCC] must return revenues from the sale of timber to the ratepayers, it is strongly recommended that the return[ed revenues] be directed to financing improvements necessary to meet [the requirements of] the Health and Safety Code." (Exh. 22, p. 4.) However, he sponsored no direct evidence in support of this recommendation.

Clark was principally concerned with actions to correct deficiencies in the system. He stated that on November 1, 1983, DHS requested that CUCC conduct a complete engineering study of its system to address certain deficiencies he listed. CUCC completed the engineering study (Exhibit 23) and sent it to DHS on May 17, 1985. In Clark's opinion the study adequately addresses each of the deficiencies in the system (except for fire flow questions which were not requested) and proposes an improvement program to resolve them. DHS now intends to negotiate in cooperation with the Commission the priority and time schedule for implementing the corrective actions proposed in the study.

During cross-examination, Clark testified that the improvements proposed by CUCC's consulting engineers in Exhibit 23 were acceptable to him and that his office requested that CUCC implement them immediately. Exhibit 23 does not call for further

development of the upland spring or stream sources, but rather for new wells to be developed in the alluvium near the Russian River. In terms of quantity of water, vertical river wells would be expected, in Clark's opinion, to deliver larger quantities of water than horizontal wells drilled in the uplands near existing streams. In Clark's view horizontal wells in the uplands would not alone supply the Guerneville system during the summertime and heavy demand periods. If the existing surface water collection system were developed and expanded, the surface water would require full treatment in order to meet state requirements; but the cost of that treatment would render the source uneconomical.

The conclusion of this report, with which Clark agrees, is that Guerneville cannot afford alternative water supplies. The report, therefore, opts to develop the wells in the river alluvium, where prospects for finding large quantities of potable water are good, rather than to develop existing surface water sources in the upland areas.

b. Discussion of Timber Rights

Some may believe that the timber rights issue cannot be disposed of until it is first determined whether CUCC should develop new water supplies in the river alluvium or in the hills around the spring sources. However, it is clear from the evidence summarized above that timber harvesting and water development in the watershed areas are compatible. The testimony of CUCC's former forester and former Guerneville District manager, sponsored by PATRIOTS, showed that timber harvesting is highly regulated with a primary goal of preserving water resources. It also showed that CUCC's harvesting had only negligible effects upon the spring sources or the water system as a whole. Rain caused some mud to wash into one spring from a road cut and one pipeline was cracked where a road crossed over it. The cracked pipeline required only a simple repair and did not result in any complaints. In fact, irrespective of the single instance cited where mud from a road cut

washed into a spring, all of the springs were shut down for four months of each year during the rainy season because of debris washed into them by natural runoff. The rainfall is excessive in the winter and the slopes are steep. No one has even suggested that this condition is other than a natural phenomenon.

Responsible timber harvesting, as the record indisputably shows was performed on the Guerneville District watershed lands, is compatible with the use of those lands for water production. The harvesting in this instance was limited to selective thinning of mature trees only. The harvesting was performed with particular care to prevent any degradation of water sources or supplies in the Guerneville District watershed area. All harvesting is heavily regulated and is done pursuant to license in each case. On-site inspections, before, during, and after harvesting, are conducted by state agencies to ensure that water resources are protected and that harvesting is conducted in accordance with the regulations applicable thereto and the terms of the license. No clear cutting of any area of the watershed lands was involved here. Berry was careful in his testimony to state that he was involved in selective harvesting only, not "logging". To the extent that that term may tend to suggest clearcutting, this record does not show any clearcutting was performed on CUCC's Guerneville District watershed lands. Irrespective of the regulation of other state agencies, were the evidence to show that watershed lands were being denuded of all commercially exploitable trees in a manner that would destroy or impair water sources or supplies used by or necessary for a public utility water company we would not hesitate to take action to protect those sources. However, the evidence in this case does not show that logging or clearcutting has taken place or that the harvesting that has been accomplished has impaired the

spring sources in the Guerneville District watershed lands.⁵ The management of watershed lands by a skilled forester, including selective harvesting, may actually enhance the watershed by cutting dead and diseased trees and removing fire fuel, preventing wood poaching, and enhancing growth of young trees by cutting mature trees.

Since the harvesting of timber is compatible with water production in the Guerneville District watershed lands, why are the timber rights in those lands so "necessary or useful in the performance of its duties to the public" that CRC should be forced to reconvey them and to disgorge the timber harvest receipts for the benefit of the ratepayers? Moreover, if we ultimately determine that CUCC acted in a reasonable and prudent manner in abandoning the spring sources in favor of wells in the river alluvium and in choosing to develop more wells there, then it is immaterial whether harvesting affects the spring sources, since the springs would no longer be a factor in providing water for the system.

The testimony by CUCC that the timber rights are not in rate base and the testimony by the staff and others that they are in rate base does not bear on this point. The language of Section 851 is not couched in such terms. The key issue is not how the property is accounted for but how it is used. It is clear from the evidence that the timber rights are neither "useful" nor are they "necessary in the performance of [CUCC's] duties to the public." That is, if tree A is cut down, hauled away, and sold, will that disposition affect the water service rendered to the public in the Guerneville District? We have determined that it will not affect

⁵ In recent years, before the springs were discontinued as water sources in 1976, they only produced at most 3% of the water supply for the Guerneville District.

such service, whether we assume the springs become again a source of water for the system or whether they remain abandoned.

Accordingly, we conclude that the transfer by CUCC of timber rights in its watershed lands to CRC was of property neither useful nor necessary in the performance of CUCC's duties to the public in the Guerneville District and that such transfers were not void ab initio.

It is interesting to note that the second paragraph of Section 851 states that:

"Nothing in this section shall prevent the sale ...or other disposition by any public utility of property which is not necessary or useful in the performance of its duties to the public, and any disposition of property by a public utility shall be conclusively presumed to be of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser, lessee or encumbrancer dealing with such property in good faith for value; ..."

The initial determination whether the item of property is necessary or useful is for the utility to make. Where the disposition is to a purchaser in good faith and for value it is conclusively presumed to be property that is not useful or necessary. Where, as here, the disposition is to neither a purchaser, lessee, nor encumbrancer and is not for value there is at most a rebuttable presumption that the disposition is of property that is neither necessary nor useful. In any event the issue is a factual one that the Commission may review. In this case the evidence, as opposed to the conclusions of witnesses and the arguments of counsel, overwhelmingly favors the initial determination of CUCC that the timber rights were neither necessary nor useful.

Disposing of the Section 851 issue does not, however, end the matter. We must next determine whether the transactions in which timber rights were transferred from CUCC to CRC were properly

accounted for. The staff testimony regarding the appropriate accounting treatment of such transactions is cogent and we rely for the most part on it. Summarizing his accounting testimony, the staff accounting witness stated:

"Thus, if the land is in Plant Held For Future Use when sold, the gain is above-the-line (to the ratepayers' benefit) but if it is sold from Plant in Service or from non-utility plant the gain is below-the-line (to the shareholders' benefit)." (Exhibit 9, p. 17, paragraph 42, as amended.)

If this statement of the requirements of the Uniform System of Accounts (USOA) is not clear enough, the same witness reiterated the same matter in more detail under cross-examination by CUCC. (Tr. 1:93-98.) Actually, there is no dispute among the parties as to the requirements of the USOA. They do differ, however, on whether the timber rights were in rate base or not. CUCC, as we indicated above, asserted that the timber rights were not included in rate base and had no value to be recorded in plant-in-service. We do not accept this naked assertion as fact, for it is contrary to the fundamental principles of real property law. When CUCC acquired the watershed lands from which timber rights were later severed, it acquired them in fee simple absolute. Its title to those lands included all rights associated with such titles, e.g. water, timber, mineral and development rights. The original cost of such lands was not allocated among the various rights associated with land ownership when that cost was entered upon the books of account of the Guerneville District of CUCC. The USOA does not call for such an allocation. Thus, the timber rights were in rate base as part of the watershed lands.

Since the timber rights were in rate base when transferred, the value of those rights should have been reflected in the plant accounts of the Guerneville District when the transfers occurred. They were not so reflected because, as CUCC's witness testified, the utility did not consider them to be part of

the rate base and, in any event, did not ascribe to them any value. Neither of these conclusions was reasonable. CUCC knew or should have known that if the timber rights had not been severed from the watershed lands and transferred to CRC, an unregulated affiliate, the revenues from the timber harvesting would have accrued to the benefit of the ratepayers, thus reducing CUCC revenue requirement. We infer that CUCC transferred the rights to avoid this result and that the transfers were made in anticipation of timber harvesting revenues being received. One of the transfers occurred on July 5, 1971, and four more on November 16, 1971. In 1971 CRC received \$17,016 of net proceeds from timber harvesting. The dates of transfer and receipt of revenue are contemporaneous, making it improbable that CUCC and CRC did not expect to receive income as a consequence of the transfers and almost simultaneous harvesting.

Since revenues were expected from the harvesting, it follows that the timber rights had market value. Beyond the mere assertion that the timber rights had no market value when transferred, CUCC offered no other evidence on the issue of their value when transferred. There is evidence in the record from which a value can be derived, however. Exhibit 7 shows the net revenues from harvesting received by CRC each year between 1971 and 1980. They total \$323,600, or an average of \$32,360 per year for the 10 year period. By capitalizing those revenues at CUCC's most recently authorized rate of return (12.04%) we derive a market value of \$269,771.⁶ We do not, however, adopt this figure as the fair market value of the timber rights when transferred. It is nevertheless one measure of the value of those rights and is useful to show what order of magnitude their value might attain.

⁶ The formula for deriving market value from annual revenues is: Market value = annual revenue/rate of return.

How then should the value of the timber rights be reflected on the books of the Guerneville District? Had the timber rights been sold for fair market value with the knowledge of the Commission, sale revenues would have gone to shareholders in keeping with our policy that the proceeds of non-utility plant sales do not belong to ratepayers. Since no sale has occurred here, there is no gain to disburse. There is, however, a presumptive value for the timber rights included in the rate base associated with the land parcels in question. In the absence of a valuation of this amount, we will attribute the timber harvesting revenues to the original cost of the 6 parcels involved, and reduce the balances associated with these parcels to zero. The 1973 annual report for the Guerneville District shows that the balance in Account 306 (Land and Land Rights) at year end was \$76,060. Some part of that balance represents the original costs of the 6 watershed parcels. CUCC will be ordered to report to the staff the original costs of the 6 watershed parcels, to reduce Account 306 by those amounts, and to reflect those reductions of ratebase in an advice letter rate decrease.

Furthermore, since CUCC unreasonably failed to reduce Account 306 when the transactions occurred, rates have reflected a balance in Account 306 in the \$76,000 range since 1971. CUCC will be ordered to report to the staff the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar effect of those adjustments in each year since 1971. In addition, CUCC will be ordered to compute an interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and to propose a method whereby the total of overcollections and interest components may be amortized through rates to the benefit of the ratepayers. If CUCC and the staff can agree upon the

appropriate dollar figure and the method of amortizing it, then an advice letter filing can accomplish the required rate reduction. If no agreement can be reached, then we will set further hearings to take evidence before issuing a decision on this issue.

We have not required CUCC or CRC to disgorge timber harvesting revenues, having concluded that CUCC did not err under Section 851 by transferring the timber rights in certain watershed lands to CRC. CUCC's mistake was in concealing the transactions from the Commission by failing to reflect the effects in Account 306. CUCC attempted to, and did, earn a return on the value of those rights in rate base while at the same time diverting the harvesting revenues to the benefit of the shareholders of its parent company. CUCC cannot have it both ways. Had title to the timber rights remained in CUCC, the timber harvesting revenues would have accrued to the benefit of the ratepayers, according to the requirements of the uniform system of accounts. Having transferred those rights lawfully, CUCC has diverted those revenues to the shareholders.

We are concerned that our ability to monitor CUCC's transactions with its affiliates has been inadequate in the past to prevent surprises like those that have come to light in these proceedings. We will take no punitive action against CUCC (although we believe that a case could be made for such action), but we will ensure that we are able in the future to track closely CUCC's affiliate transactions. In order to allow for this monitoring, we will require CUCC to report quarterly to the Commission Advisory and Compliance Division according to the following requirements:

1. CUCC shall give full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.

2. CUCC shall report any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

Before leaving the issue of timber rights, we should consider and dispose of CUCC's request that D.82-05-038 in A.60285 be vacated insofar as it requires CRC to reconvey timber rights to the Felton District and imputes timber harvesting revenues to Felton's operating revenues over a 12 year period. As we noted above (mimeo. p. 5, fu. 2) in the Felton case (9 CPUC 2d 197, 204 (1982)) CUCC "... does not contend that the pertinent watershed lands or the part consisting of timber rights are not necessary or useful in Felton's performance of its public utility duty to the public so as to obviate application of PU Code § 851." Accordingly, CUCC did not brief the Section 851 issue nor did it seek rehearing on that issue or on the disposition of the timber harvesting revenues. This is not the case with the instant proceeding. CUCC made the argument that it did not make in Felton and the evidence supports CUCC's position and the result we have reached.

But returning to CUCC's request re Felton, D.82-05-038 is now final. If the orders in D.82-05-038 were erroneous, those errors have been waived.⁷ Accordingly, we will not review, revise, or rescind D.82-05-038.

4. Management of Water Resources

a. Plant Improvements Required in Guerneville District

CUCC proposes and PSD and DHS agree that River Meadows System should be interconnected with the Monte Rio System. In addition, chlorination at Monte Rio should be improved and the El

⁷ Section 1709 provides: "In all collateral actions or proceedings, the orders and decisions of the commission which have become final shall be conclusive."

Bonita wells should be replaced. In addition to these improvements PSD and DHS recommend that test wells should be drilled to explore the possibility of redeveloping the springs as water sources. CUCC does not favor the PSD's recommendation to redevelop the upland spring sources. Rather, to the extent that the development of future water resources is even an issue in this proceeding, CUCC contends that its plans to develop new wells and other plant facilities near the Russian River should be approved and that other proposals to develop supplemental water resources in the spring areas would be duplicative and unnecessary.

PATRIOTS requests that the Commission order Citizens to restore the valuable alternative supplies existing in the watershed areas, using the timber harvest revenues plus interest to pay for the development.

The position of the DHS changed between the hearings and the filing of opening briefs. At hearing DHS recommended that CUCC should investigate new well sites along the Russian River that had potential for better water quality or provide treatment for the El Bonita wells. It was the understanding of DHS that it was technically and economically infeasible to develop well sites off-river. After reviewing the testimony DHS changed its position.⁸ It now believes that the prospect of developing an alternate source of supply away from the Russian River is much greater than was reported in the Brown and Caldwell study and should be explored. DHS now recommends that in order to provide the maximum public health protection to the consumers in the Guerneville area, the Commission should direct CUCC to fully explore the feasibility of

⁸ This was done through the DHS brief, which procedure is improper for two reasons: (1) DHS did not file an appearance form, is not a party to these proceedings, and may not file a brief, and (2) no person, whether or not a party, may change its testimony after the record has closed, thus depriving the other parties of their right to confront and cross-examine that person.

developing an off-river source of horizontal and/or vertical wells. Furthermore, in this exploration DHS recommends that CUCC should hire a competent hydrogeologist with experience in this area to direct the construction of horizontal and/or vertical test wells and then evaluate their performance as to quality and quantity over a 12-month period.

The County of Sonoma in its opening brief concurred with the arguments and conclusions in the opening brief filed by PATRIOTS and joins with PATRIOTS in requesting the Commission to grant the relief requested in PATRIOTS' brief.

Congressman Douglas H. Bosco did not address the issue of development of off-river water sources in his opening brief. The FIT did not address any Guerneville-specific issues in its opening brief.

b. Discussion

It is undisputed that the Guerneville District requires about 1,000 gallons per minute to supply its needs on a maximum demand day. Relying on its consulting engineers, CUCC proposes to drill three wells in the Russian River alluvium which would be expected to yield 500 gallons per minute per well. Thus, two wells would supply enough water to meet maximum demand while the third well would be used as standby. CUCC's expert hydrogeologist testified that there were no large aquifers in the upland areas above the Russian River in the Guerneville District. She was unwilling to risk her client's funds on drilling for large quantities of water in the upland areas when there was a high probability of finding large quantities of water in the Russian River alluvium near areas where CUCC's present wells are now in service.

PATRIOTS' expert witness Boudreau testified from his personal experience with roughly 1,000 well drilling projects in Franciscan rock that highly-fractured Franciscan sandstone, chert, and greenstone can yield as much as 500 to 600 gallons per minute,

and that much of the upland area along the Russian River consists of these potentially permeable rocks. He noted further that problems of turbidity and high iron and manganese in upland spring water could be greatly reduced by producing the water from properly drilled and constructed wells, cased with PVC instead of iron pipe. Boudreau acknowledged, however, that wells yielding in the 500 gallon per minute range were the exception rather than the rule in the Franciscan formation. Thus, the probability of finding wells yielding hundreds of gallons per minute in the upland areas is fairly low.

PATRIOTS' would prefer that Russian River water not be used to supply CUCC's Guerneville District. One of PATRIOTS' primary reasons for this preference is the undeniable fact that the Russian River is subject to various kinds of contamination by virtue of sewage spills and other kinds of accidents. A second reason for PATRIOTS' preference is its belief that it may well be possible to procure water that is free from such potential contamination from upland sources at less cost than water from the large Russian River wells proposed by CUCC. PATRIOTS' believes it is at least worth exploring this possibility through a relatively inexpensive exploration effort before making the large financial commitment involved in the Russian River wells.

The staff and DHS do not unconditionally oppose the company's plan, supported by its engineering consultant, to drill three high production wells in the Russian River alluvium. What is at stake is merely the proposal of staff, supported by DHS in its brief only, to first require CUCC to explore for water in the upland regions and other off-river areas.

There is a high probability that commercially exploitable quantities of water in the range of 500 gallons per minute per well can be obtained by drilling wells in the Russian River alluvium. Unfortunately, the Russian River is subject to periodic flooding and contamination. While modern well design, construction, and

treatment could most probably overcome whatever potential hazards that untreated Russian River water may pose, we can certainly understand the reluctance of PATRIOTS, DRA, and DHS to rely on such water for 100% of the Guerneville District's needs without first exploring off-river water sources further.

New vertical or horizontal wells drilled in the upland areas could supply an unknown quantity of water that could be used to meet a portion of the Guerneville system requirements and/or to supply emergency water in the event of flooding or other contamination of the Russian River area. While individual wells in these areas are unlikely to be able to supply more than a fraction of the overall system needs, the aggregate potential contribution of wells of these types cannot be determined without further exploration and test drilling. Unfortunately, it appears likely that a fairly large number of upland wells would be needed to produce as much water as the three Russian River wells proposed by CUCC.

Fortunately, the record in this proceeding suggests that there may be sources of water in the Guerneville District that meet the essential needs of both sides of the upland versus Russian River wells controversy. PATRIOTS' witness Boudreau noted in Exhibit 61 that wells capable of yielding over 100 gallons per minute of good quality water have been drilled in the alluvium along tributary creeks feeding into the Russian River. He states that wells of this magnitude have been drilled in the alluvium along Fife Creek, and might similarly be drilled along the Hurlbut, Dutch Bill, and other alluvium filled valleys whose ground water is not derived from the Russian River. Wells in these tributary valleys are fed from local rainfall within their own watersheds, and thus seem likely to be free of the contamination potential associated with Russian River wells. On the other hand, the potential yields of wells closely associated with a tributary stream seem likely to be an improvement over those which would

result from the majority of upland wells. Off-river wells in tributary valleys thus appear to have a number of potential advantages over both the Russian River wells proposed by CUCC and the redeveloped upland water sources desired by PATRIOTS.

While we recognize that CUCC's proposed Russian River wells would almost certainly supply adequate water for its Guerneville District system, we also recognize the possibility that CUCC's optimism regarding the ability of the Russian River sources to produce clean water in the event of river flooding or contamination may turn out to be unfounded. Since it is possible that upland or other off-river sources in tributary valleys could supply a portion of CUCC's system needs and/or provide a useful source of water should any authorized Russian River wells become contaminated, we find it necessary to order CUCC to hire an independent geohydrologist to explore potential off-river sources in the manner suggested by staff, PATRIOTS, and DHS. We would like the geohydrologist to pay particular attention to potential water sources associated with tributary streams flowing into the Russian River. If this exploration reveals the absence of economic off-river sources of water, CUCC will be authorized to proceed with the proposed Russian River wells.

We will also order CUCC to maintain the upland watershed in good condition so that upland sources can be redeveloped and expanded should the need arise.

5. Common Expenses

In OII 83-11-09, dated November 30, 1983, the Commission stated that: "This investigation will consider... Whether adjustments should be made in the allocation of common expenses among CUCC's districts and subsidiaries." (Paragraph 4.f.)

The Commission next addressed the issue of common expenses in an interim order, D.84-02-066, dated February 16, 1984. It stated that the investigation was started to address four topics, the fourth of which was whether common expenses among CUCC

entities are being properly allocated for ratemaking and what, if any, order should be made to ensure a reasonable allocation procedure is adopted and followed. The Commission ordered its staff to submit the results of its analysis of common expense allocation, and any recommendations within 180 days of the date of the order.

In response to the direction of the Commission contained in OII 83-11-09 and in D.84-02-066, the Public Staff Division (PSD) sent Douglas Long, Financial Examiner IV, to Stamford, Connecticut to audit Citizens Utilities Company, the holding company, and its various regulated and unregulated subsidiaries. Long was the same staff member who had supervised the previous audit of the holding company and its subsidiaries in connection with a general rate increase proceeding involving CUCC's telephone division. That audit, involving four person-weeks of staff time, occurred less than two years before Long's most recent audit.

Long's Exhibits 9, 10, and 11 summarize the findings of his audit as they relate to this proceeding. They show that he conducted a much more comprehensive audit than the Commission's decisions and orders required. He not only audited the allocation of common expenses but examined the entire allocation process involving CUCC's California operations. He stated that the costs incurred at Stamford, the office of Citizens Utilities Corporation, are allocated to its operating divisions and subsidiaries using four different allocations. These included direct charges, accounting charges, administrative and general expenses charged to construction, and general charges.

Direct charges are billed directly to the operating divisions and subsidiaries which receive direct benefit from the work performed. Examples of direct charges are toll study costs, rate case costs, and internal audit costs.

Accounting charges are billed directly to the operating divisions and subsidiaries which receive direct benefit from the

work performed at Stamford. Accounting for all California utilities owned by Stamford is performed in Redding, California. No accounting charges were billed by Stamford to its California utilities in 1981 or 1983, the last two years reviewed in A.82-09-052 (CUCC's telephone division) and for this OII.

Administrative and general expenses charged to construction are billed to operating divisions and subsidiaries on their percentage of total construction costs. The function of the construction overhead is to charge the properties for construction-related services performed by Stamford. Examples of administrative and general expenses charged to construction are direct charges related to construction, supervision, and general overhead. In 1983 the A&G charges to construction were 8.57% of budgeted construction expenditures.

General charges to the operating divisions and subsidiaries are allocated on a four-factor method. General charges are amounts which are not charged directly to operating divisions and subsidiaries and which are not generated by construction. The four-factor method produces a numerical average of each operating division's and subsidiary's percentage to total plant, total payroll, total operating and maintenance expenses, and total customers.

Long's current review at Stamford showed no material changes in expenses or procedures that need to be addressed in this proceeding. Stamford has improved the data processing direct allocations since the last audit. Any subsequent rate cases are the correct venue for staff versus company expense estimation differences, according to Long.

Long had only one recommendation with respect to the allocation of expenses in Stamford. He stated that the officers of CRC are also officers or employees of Stamford. Their time and expenses are recorded in Stamford expenses and then allocated to the districts and subsidiaries. CRC is not charged with expenses

from Stamford. The utility rightly points out that CRC would have a miniscule allocation if it were included in the four-factor general allocation process because it has no payroll of significance, no customers, minimal plant and little operating and maintenance expenses. However, according to Long, there is a real cost of doing business for CRC and that is the pieces of time used on CRC transactions, reporting requirements, and miscellaneous activity. In his opinion the correct way to capture this cost is through direct charges by CRC employees at Stamford, which would reduce the balance remaining to be allocated through the four-factor method. This is so because all utility operations personnel at Stamford directly charge their time whenever possible.

Long stated that, since Stamford does not record the time spent on CRC he proposed that a minimum charge should be assigned to CRC amounting to one week per year. One week per year is only 40 hours out of about 2,000 work hours each year. In his opinion 40 hours seems to be the reasonable minimum that CRC officers must require to fulfill their duties to CRC. Long used 1983 recorded data to develop a minimum adjustment. He recommended in subsequent rate cases that CUCC and/or Stamford should have the option of justifying detailed direct charges or accepting a minimum charge for CRC to reduce Stamford costs to be allocated by the four-factor formula. His suggested adjustment to reduce Stamford costs is \$18,400. This adjustment would have, for example, an impact on the Guerneville District of \$125 per year, on the Montara-Moss Beach District of \$68 per year, on the telephone district of \$4,180 per year, and on the Sacramento Water District of \$879 per year.

We believe it would be appropriate to implement the CRC adjustment in any future rate proceedings involving CUCC's California operations. We will direct our staff to propose such an adjustment in those proceedings. We note that in its opening brief CUCC stated that current allocation procedures do provide for direct charges to CRC. Apparently CUCC already agrees with the

staff's proposal. However, the actual adjustments can be quantified and adopted in future proceedings.

Congressman Douglas H. Bosco, PATRIOTS, and FIT believe that the staff audit was inadequate. We are convinced, however, that the staff audit, considered in conjunction with the previous audit involving four person-weeks in the telephone general rate case, was sufficient for our purposes. We believe that Citizens is following previously adopted recommendations and orders of the Commission and its staff respecting the allocation of its costs to its California operations.

PSD's other recommendations involving later Stamford audits conducted or performed jointly with other states and its recommendation that a regulatory review of CUCC's water operations in California should be combined into one proceeding should be refined at the staff level and presented to the Commission at some later time. It seems clear to us that any joint audits must be with the consent and cooperation of other states. The staff should correspond and meet with state regulatory staff members in other jurisdictions to determine if there is any interest in this proposal. The PSD and the Water Utilities Branch of the Evaluation and Compliance Division should consult with one another with regard to the combining of CUCC water rate proceedings into a single proceeding. If it is the staff view in general that the proposal should be adopted, then the staff should propose such a measure to the Commission by memo and we may order the utility to file its water rate proceedings in a series of applications filed concurrently. This order may issue by resolution.

6. Step Rate Increase for 1984

OII 83-11-09 reopened A.60220 (general rate proceeding for the Guerneville District) to:

- a. Investigate the appropriate ratemaking treatment for the timber revenues described in CUCC's compliance filing;

- b. Consider the appropriate ratemaking treatment for any other illegal or imprudent actions of the types described in the OII; and,
- c. Consider the appropriateness of granting the January 1, 1984, step increase authorized by D.82-03-023, dated March 2, 1982, in A.60220.

We address item c. in this section.

This OII was issued on November 30, 1983, one month before the 1984 step rate increase might become effective according to the terms of D.82-03-023. CUCC had not yet filed an advice letter seeking to implement the 1984 step increase authorized by D.82-03-023.

By D.82-03-023 in A.60220 (filed January 27, 1981) the Guerneville District was authorized a revenue increase of 79.7%. However, because of the size of the increase, rates were set to collect revenues only 50% greater than the then current rates would collect. The remaining revenue increases were deferred until 1983 and 1984. Appendix B to D.82-03-023 set out the annual service charge increases and quantity rate increases that would be required to collect the deferred revenues plus interest, beginning January 1, 1983, and January 1, 1984, respectively. The staff believes that CUCC received the step increase that was deferred to 1983; and no party has raised an issue concerning it.⁹ On December 9, 1983, CUCC filed Advice Letter No. 217, dated December 6, 1983, to implement the 1984 step rate increase on January 1, 1984. Advice Letter No. 217 sought a rate increase of

⁹ This is so despite the fact that OII 83-11-09 placed CUCC "on notice that any step increase under D.82-03-023 is subject to refund." (Emphasis added.)

\$54,900. By Resolution No. W-3166 (January 5, 1984) the Commission stayed the step rate increase until further order.

CUCC requests that the Commission vacate the stay of the Guerneville step rate increase and authorize that increase to go into effect. It argues that all alleged claims of mismanagement of the Guerneville System and improper allocation of common expenses are groundless and that the timber harvest revenues should not be imputed to Guerneville's ratepayers. CUCC further asserts that the step rate increase authorized by D.82-03-023 should be implemented without delay and that CUCC should be permitted to amortize through future Guerneville District rates the revenues lost on account of the stay--unwarranted, according to CUCC--of Advice Letter No. 217.

In its opening brief the staff discussed the issue but made no specific recommendation about the handling of the stayed step increase. The issue was not mentioned in its closing brief. No other party addressed the step increase in its briefs.

We will vacate the stay ordered in Resolution W-3166 and authorize CUCC to file an amended Advice Letter No. 217. The amended Advice Letter should:

1. Recompute the January 1, 1984, rate increase in accordance with the method provided in D.82-03-023, Appendix E, and D.82-11-054 (the opinion after rehearing of D.82-03-023) to reflect interest at the rate of 12.04%* on the deferred revenue from March 2, 1982, to the proposed effective date of the amended tariffs, compounded annually;
2. Reflect for the future the effect of the reductions in Account 306 required by our discussion of the timber rights issue;
3. Propose rate changes to recover the 1984 deferred revenue increase with interest, as adjusted for the reduction in Account 306; and include CUCC's workpapers describing in detail each step.

- * 12.04% is the overall rate of return found reasonable in D.82-03-023 in A.60220, the last general rate proceeding for the Guerneville District. The same figure is used to compute the revenue requirement for each of the deferred rate increases for 1983 and 1984. (See Appendix E to D.82 03-023).

7. Case 83-12-07

Case 83-12-07 was filed on December 19, 1983, by Kathy Wyrick against CUCC. It raises many of the same issues that were raised in the OII, filed November 30, 1983. C.83-12-07 and OII 83-11-09 were later consolidated. Ms. Wyrick was severely injured in an automobile accident before evidentiary hearing began. Consequently, she did not participate in the hearings. No other person or group was substituted for her as complainant, although the ALJ at prehearing conference offered the opportunity. The complainant in C.83-12-07 has failed to prosecute her complaint. It should therefore be dismissed. Since the complaint of Ms. Wyrick is to be dismissed for lack of prosecution, her request for a finding of eligibility for compensation and notice of intent to claim compensation, dated July 25, 1984, is moot and should be dismissed as well.¹⁰

8. PATRIOTS Eligibility

On August 25, 1986, PATRIOTS filed its pleading, entitled "Notice of Intent to Claim Compensation" under Article 18.6 of the Rules of Practice and Procedure. This Article establishes procedures for awarding reasonable fees and costs to participants in proceedings before this Commission that were initiated on or before December 31, 1984. Since OII 83-11-09 was filed

¹⁰ A copy of this request (without a filing stamp) is in the ALJ's personal file, but the pleading was not docketed, nor does it appear in the formal file.

November 20, 1983, the issue of compensation of participants falls under Article 18.6. ^c

On the issue of financial hardship PATRIOTS states that it represents the ratepayers of Guerneville and that their interests would not otherwise be adequately represented in this proceeding. PATRIOTS denies the staff can be found to be an adequate representative of the ratepayers because it represents the broad public interest, which is a compromise among other interests, including those of the utility and all classes of customers.

PATRIOTS also states that its representation of the ratepayers is obviously necessary for a fair determination in this proceeding, since CUCC is already well represented, and the absence of a ratepayer representative would result in an imbalance in the record. Furthermore, PATRIOTS states that it would be unable to participate effectively in this proceeding absent the availability of compensation awards. It believes that its summary description of its finances demonstrates its inability to bear the cost of effective participation. Finally, PATRIOTS asserts that the separate interest of its constituent groups and individual supporters is small compared to the cost of participation. PATRIOTS claims to represent the interests of about 10,000 customers of CUCC's Guerneville District. It alleges that the economic interests of these individual members are obviously small in comparison to the cost of effective participation.

CUCC on July 17, 1986¹¹ filed its memorandum in response to PATRIOTS' notice of intent to claim compensation. On the issue of financial hardship CUCC argues that PATRIOTS has not made any

¹¹ The filing of PATRIOTS notice was held up in the Docket Office due to formal deficiencies and was not filed until August 25, 1986. In the meantime, CUCC replied to the notice based on the unfiled copy it had received by mail. Its memorandum was therefore filed before the notice itself.

showing of financial hardship within the meaning of the Commission's rules. According to CUCC, all that PATRIOTS States in Appendix A is that since October, 1983 it has received \$8,200 in income and expended approximately \$6,700 on its activities, leaving a fund balance of about \$1,500. Moreover, Appendix A to its notice also states that PATRIOTS' income for the period beginning October 1983 to the present is exclusive of restricted funds. No evidence is offered as to the amount of restricted funds received or what restrictions were imposed by the donors. CUCC points out that PATRIOTS does not address the fact that the staff was working on the same issues that PATRIOTS was interested in and that its interests were adequately represented even if PATRIOTS had not participated.

CUCC also notes that Kathy Wyrick prepared and mailed a pleading entitled "Request For Finding of Eligibility for Compensation and Notice of Intent to Claim Compensation" in this matter, on July 25, 1984, in which she revealed that PATRIOTS had received contributions from the Russian River Chamber of Commerce and the Monte Rio Chamber of Commerce. According to CUCC these facts suggest that PATRIOTS was able to participate without financial hardship. CUCC argues that it can be inferred that the businesses and other members of those organizations, which would appear to have a significant stake in the outcome of this proceeding, have financial resources that could be utilized to support the participation of PATRIOTS in this proceeding if they thought their interest so warranted and that they would be capably represented.

Finally, CUCC argues that PATRIOTS has not proven that the interests of its members in the outcome of this proceeding is small in comparison to the cost of participation. In fact, it appears that the interests of the utility's business customers may be substantial in comparison to the cost of participation that PATRIOTS purports.

We believe that PATRIOTS has met its burden of showing significant financial hardship in this proceeding. Even if the interests of the staff and PATRIOTS were identical in this proceeding that fact would merely bear on the amount of compensation awarded, not on PATRIOTS' eligibility for an award.

On the issue of the specific budget, required to be filed by Rule 76.23(b), PATRIOTS submitted a total budget for this proceeding as follows:

Advocate Fees (Wyrick, Sinclair, Scoggins) 800 hours @ \$25/hour	- \$20,000
Expert Witness Fees (G. Boudreau)	- \$ 1,500
Other Costs - 15% of Direct Costs*	- <u>\$ 3,225</u>
Total	- \$24,725

*Rough estimate covering long-distance telephone charges, copying, postage, etc. Specific allocations would be provided in compensation filing.

PATRIOTS states that it has been involved in all phases of these consolidated proceedings and that its costs are based on actual expense records and recorded time of intervenors with the exception of the allocation of time for Ms. Wyrick, who has since died and for whom there are no known records. Her time, according to the pleading, is based on a conservative estimate of her contribution. The fee charged is asserted to be a reasonable amount based upon the qualifications of the intervenors, the amount of compensation sought in the proceeding, and competitive fees.

CUCC replied to this issue in its memo. It states that PATRIOTS offered only the most superficial budget even though its participation is now substantially complete due to the status of this matter. CUCC believes that PATRIOTS' failure to satisfy this requirement alone means that the finding of eligibility it seeks this Commission to make in response to its notice should not be made.

By April 8, 1986, when PATRIOTS filed its closing brief, PATRIOTS had concluded its participation in this proceeding. Its notice of intent was not filed until August 25, 1986, almost five months later. By that time it should have known specifically its costs incurred and the hours expended in the conduct of the case and should have been able to specify in its budget those costs and hours exactly. Instead, it submitted a budget for 800 hours of advocate time which did not break out the time expended by Sinclair and Scoggins. If, as PATRIOTS asserts, its costs are based on actual recorded time of Sinclair and Scoggins, then that portion of the 800 hours claimed which were allocated to them should have been set out and that portion of the 800 hours estimated for Ms. Wyrick should have been set out. In addition, we are not told who "Scoggins" is and how he participated in these proceedings. He made no appearance at the hearings and his name, as far as we know, does not appear on any of the pleadings filed by PATRIOTS. The expert witness fees claimed by Boudreau are not supported by any invoice or cancelled check. The other costs are merely estimated by taking 15% of the other direct costs. Yet, by the time the notice was filed, PATRIOTS had completely incurred all costs for which it was seeking compensation and should have been able to set forth explicitly the various items of costs incurred.

In view of the fact that the budget was submitted well after all work in connection with the proceeding had been completed by PATRIOTS it is not the "specific budget" called for by Rule 76.23(b). Nevertheless, this item more particularly affects the request for compensation and may be dealt with here.

Rule 76.23(c) requires that the participant file a statement of the nature and extent of planned participation in the proceeding. PATRIOTS states that from the initiation of the OII to the present, it has been an active participant in all phases of these proceedings. Ms. Wyrick's extensive and thorough research laid the foundation, according to PATRIOTS, for submission of

testimony and cross-examination of the PUC staff, DHS, Utility Employees, and expert witnesses hired by the utility. PATRIOTS also subpoenaed two witnesses with former business relations with the utility and supplied its own expert witness and numerous exhibits. PATRIOTS representatives attended the prehearing conference and seven days of hearings in San Francisco in 1985 and submitted opening and closing briefs.

CUCC points out that PATRIOTS' brief account of its past participation does not acknowledge that its participation was largely duplicative of the staff's efforts.

We believe that for the purposes of a notice of intent under Rule 76.23 PATRIOTS statement of planned participation is sufficient.

CUCC also argues that the notice of intent is not timely filed, citing Rule 76.23. That rule states that a notice of intent is to be filed as soon after the commencement of the action as is reasonably possible. The Rule then goes on to state that such a filing must be made in any event before the beginning of the evidentiary hearings in the proceeding, or after the evidentiary hearings are completed. CUCC states that this language should not be seized upon as justifying a tardy filing, which was not only after all evidentiary hearings, but after briefing was completed as well. PATRIOTS has offered no explanation for filing when it did. CUCC argues that while the Rule does not fix the last possible date upon which a notice may be filed, there is no suggestion that a party may participate for 2-1/2 years before filing its notice. That time of filing is not as soon as is reasonably possible, which is the requirement of Rule 76.23. CUCC states that for this reason alone the finding of eligibility sought by PATRIOTS should not be made.

Rule 76.23 as presently written gives ambivalent instructions to parties in our proceedings. They are instructed to file their notice of intent: (1) "As soon after the commencement of

a proceeding as is reasonably possible", (2) "Before the beginning of the evidentiary hearings in the proceeding", or (3) "After evidentiary hearings are completed". No cut-off date is specified for the filing of the notice of intent. While we believe that the filing of a notice of intent several months after submission is too late to be considered, our own Rules do not require a more timely effort. Accordingly, eligibility should not be denied for untimeliness.

9. Evidentiary Ruling

During hearings PATRIOTS offered Exhibit 45 as evidence. Exhibit 45 is a portion of a lengthy report by the Department of Consumer Affairs on drinking water quality problems facing consumers, and is dated July, 1976. The portion of the report offered by PATRIOTS is page 84, entitled "Consumer Complaint History of 20 CUC Systems". Page 84 purports to tabulate the number of complaints for each of 20 of CUCC's water operations in the State of California for the years 1973, 1974, and 1975. The part of this tabulation that PATRIOTS believes significant is the number of complaints for the Guerneville District, which are 116 for 1973, 240 for 1974, and 501 for 1975. CUCC objected to the receipt of Exhibit 45 and the objection was taken under submission subject to briefing.

PATRIOTS did not brief the admissibility of Exhibit 45 in its opening or closing briefs. Rather, it merely assumed that Exhibit 45 was in evidence and cited its contents in support of its arguments.

CUCC briefed the issue of admissibility in its opening brief. CUCC conceded that the report was probably subject to official notice. However, it argued that the document must still fall under one of the recognized exceptions to the hearsay rule in order to be admissible. It argued that the contents of the document are hearsay and that PATRIOTS has not established with admissible evidence that it falls within any of the recognized

exceptions to the hearsay rule. According to CUCC, there is no evidence whatsoever of who compiled the information, how it was compiled, what it is based upon, or whether it is trustworthy. There is also no evidence concerning what constitutes a complaint reflected on the table. We note also that no witness sponsored the exhibit or offered to be cross-examined as to its meaning or content.

Section 1701 of the Public Utilities Code states that in the conduct of our hearings the technical rules of evidence need not be applied by the Commission. Rule 64 of our Rules of Practice and Procedure states:

"Although technical rules of evidence ordinarily need not be applied in hearings before the Commission, substantial rights of the parties shall be preserved."

We do not believe that the substantial rights of CUCC to cross-examine witnesses against it would be preserved by admitting this proposed exhibit. Accordingly, we will sustain CUCC's objection to the admission of Exhibit 45.

We note, in addition to the hearsay objection proffered by CUCC, that the document itself has little, if any, probative value in relationship to the issues of this proceeding. Although PATRIOTS contends that a correlation exists between the increase in complaints between 1973 and 1975 and the harvesting of timber in CUCC's Guerneville watershed, there is no evidence of such a correlation. Exhibit 45 itself contains no reference whatsoever to timber harvesting. No witness in this proceeding has testified that the increase in complaints between 1973 and 1975 was a consequence of timber harvesting in the Guerneville District watershed. Indeed, the exhibit itself shows on its face that timber harvesting was unlikely to have been the cause of the increased number of complaints. For example, the West Sacramento Water District of CUCC showed an increase from one complaint in

1973 to 720 complaints in 1975. There is no evidence of any watershed lands located in the West Sacramento District or of any timber harvesting there. The same pattern is evident in many of the other districts named in Exhibit 45. Twelve of the districts show zero complaints in 1973 and from as few as 14 complaints to 156 complaints in 1975. Another district shows seven complaints in 1973 and 25 complaints in 1975. Another shows ten in 1973 and 29 in 1975. There is no evidence in this record that timber harvesting was occurring in any of these districts during the years 1973, 1974, and 1975, except for Guerneville. It is pure speculation to suppose that this consistent pattern in most of the 20 CUCC systems addressed in Exhibit 45 is a consequence of timber harvesting.

Comments Under Section 311

On February 22, 1988, PATRIOTS filed its comments on the proposed opinion under Rule 77.1, et seq., of the Rules of Practice and Procedure. The comments consist entirely of reargument of points and issues that were addressed in the briefs. No "factual, legal or technical errors" are pointed out, contrary to the explicit terms of Rule 77.3. At most the comments state that greater weight should have been given to evidence sponsored by PATRIOTS. At the same time PATRIOTS states that: "The evidence in the case is at times contradictory. . . . Statements made by experts about area geohydrology are in disagreement." (Comments, page 2.) PATRIOTS has put its finger on the crux of the matter. The evidence is indeed in conflict. However, we disagree with PATRIOTS' statement that the "weight of the evidence falls in a different direction." (Comments, page 2.) Rather, the evidence, much of it produced through witnesses called by PATRIOTS, overwhelmingly supports the views expressed above. Where the evidence is in conflict, the Commission acts within its discretion when it favors one view of the evidence over another.

CUCC filed reply comments in response to PATRIOTS' pleading. CUCC's reply refutes each point made by PATRIOTS and shows that its arguments are no more meritorious than those offered on brief. We will not reiterate PATRIOTS' arguments or CUCC's 5-page reply. It is sufficient to state that our findings are supported by the preponderance of credible evidence, and our conclusions are consistent with the findings and with the statutes that we administer.

Findings of Fact

1. Timber harvesting is heavily regulated by various state agencies.
2. The primary purpose of that regulation is the protection of water resources.
3. The timber harvesting operation on CUCC's watershed lands in the Guerneville District involved the harvesting of selected mature trees only. No clear-cutting of any parcel was ever involved.
4. Timber harvesting had at most a negligible effect upon water quality in the Guerneville District.
5. High average annual rainfall and steep slopes around the spring sources in the Guerneville District were primarily responsible for high turbidity during the four-month winter season each year.
6. In December 1975 the DHS recommended in a report that the Guerneville District install water treatment facilities for surface water sources, including the processes of turbidity removal, iron and Manganese removal, and disinfection, or abandon the surface water sources.
7. The Guerneville District manager took all the spring sources off of the system in 1976 on his own initiative due to the

high cost of DHS mandated daily turbidity tests on each spring source.

8. Vertical wells drilled in the Russian River alluvium are likely to deliver larger quantities of water than horizontal wells drilled in the upland areas near existing streams or springs.

9. Horizontal wells in the upland areas near existing streams and springs cannot alone supply the Guerneville system during the summertime and heavy demand periods.

12. Timber harvesting and water development in the watershed areas are compatible. The transfer of the timber rights to CRC and the selective harvesting of timber on Guerneville District watershed lands has had no appreciable effect upon water quality in the Guerneville District and will have no such effect either because the harvesting is done in such a way as to protect and preserve water resources or because the spring or stream sources involved will not again be employed in the service of the customers of the District.

13. The timber rights are neither useful nor necessary in the performance of CUCC's duties to the public in the Guerneville District.

14. The timber rights that CUCC transferred to CRC were in rate base as part of the watershed lands.

15. The timber rights had value at the time they were transferred to CRC.

16. If the timber rights had not been severed from the watershed lands and transferred to CRC, an unregulated affiliate of

delete
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CUCC, the revenues from the timber harvesting would have accrued to the benefit of the ratepayers, thus reducing CUCC's revenue requirement.

17. CUCC transferred the timber rights to CRC in anticipation of timber harvesting revenues being received, which revenues would accrue to the benefit of the ratepayers without such transfer.

18. CUCC failed to reflect the effect of the transfer of timber harvesting rights in its plant accounts.

19. CUCC concealed the transactions involving the transfer of Guerneville District's watershed timber rights from the Commission by failing to reflect the effects of those transactions in Account 306.

20. CUCC earned a return on the value of the timber rights in rate base while at the same time diverting the harvesting revenues to the benefit of the shareholders of its parent company.

21. There is a high probability of finding large quantities of water in the Russian River alluvium in or adjacent to the Russian River that can supply all of the needs of the Guerneville District.

22. There is a lower probability of finding large quantities of water in the upland areas adjacent to the Russian River valley which could supply all of the needs of the system.

23. The Russian River is subject to flooding and to various kinds of contamination by virtue of sewage spills and other accidents.

24. New vertical or horizontal wells drilled in the upland areas could supply an unknown quantity of water that could be used to meet a portion of the Guerneville system requirements and/or supply emergency water in the event of flooding or other contamination of the Russian River area.

25. The aggregate potential contribution of upland wells cannot be determined without further exploration and test drilling.

26. Wells in tributary valleys might be able to supply a substantial portion of CUCC water system needs.

27. The aggregate potential contribution of wells in tributary valleys cannot be determined without further exploration and test drilling.

28. CUCC is following previously adopted recommendations and orders of the Commission and its staff in allocating its costs of its California operations.

29. The complainant in C.83-12-07 has failed to prosecute her complaint.

30. PATRIOTS has met its burden of showing significant financial hardship and is eligible to file a request for compensation.

31. It is reasonable to require CUCC to submit regular reports concerning its affiliate transactions.

Conclusions of Law

1. The transfers by CUCC of timber rights in the watershed parcels to CRC were not void ab initio.

2. The timber rights were in rate base as part of CUCC's Guerneville District watershed lands at the time of the transfers.

3. CUCC should be ordered to report to the staff the original costs of the six watershed parcels, to reduce Account 306 by those amounts, and to reflect those reductions of rate base in an Advice Letter rate decrease.

4. CUCC should be ordered to report to the staff the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar effect of those adjustments in each year since 1971.

5. CUCC should also be ordered to compute an interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and to propose a method whereby

the total of overcollections and interest components may be amortized through rates to the benefit of the ratepayers.

6. CUCC did not err under § 851 by transferring the timber rights in certain Guerneville District watershed lands to CRC.

7. CUCC has waived any error in D.82-05-038 by failing to pursue its administrative and judicial remedies before that decision became final.

8. CUCC's request that the Commission should review, revise or rescind D.82-05-038 should be denied.

9. CUCC should be ordered to hire a competent independent geohydrologist to explore off-river sources of water before it is authorized to drill wells in the Russian River alluvium.

10. CUCC should be authorized to drill wells in the Russian River alluvium should the ordered exploration reveal the absence of economically feasible off-river water sources.

11. The staff should be directed to propose the CRC adjustment in future rate proceedings involving CUCC operations in California.

12. The stay of the step-rate increase should be vacated and CUCC should be authorized to file an amended Advice Letter 217 in accordance with the instructions in the discussion.

13. The complaint in C. 83-12-07 should be dismissed for lack of prosecution.

14. The request for finding of eligibility mailed by Kathy Wyrick should be dismissed as moot.

15. The objection of CUCC to the admission of Exhibit 45 should be sustained.

16. CUCC should be required to report quarterly to the Commission Advisory and Compliance Division giving the following:

1. Full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.

2. A report of any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Citizens Utilities Company of California (CUCC) shall report to the Commission Advisory and Compliance Division (CACD) the original costs of the six watershed parcels from which CUCC severed timber harvesting rights, shall reduce Account 306 by those amounts, and shall reflect those reductions of rate base in an Advice Letter rate decrease filing.

2. CUCC shall report to CACD the extent to which the Guerneville District adopted results of operations reflected excessive balances in Account 306 in all years since 1971, the adjustments to those results of operations required to reflect the reduced balances in Account 306, and the dollar affect of those adjustments in each year since 1971. CUCC shall also compute an

interest component on the overcollection for each year, assuming an interest rate of 12%, compounded annually, and shall propose a method whereby the total of overcollections and interest components may be amortized through rates to the benefit of ratepayers. If CUCC and CACD can agree upon the appropriate dollar figure and the method of amortizing it, then CUCC shall file an Advice Letter to accomplish the required rate reduction. If no agreement can be reached within 120 days from the effective date of this order, then Water Utilities Branch shall petition the ALJ to set further hearings to take evidence on the issues involving the amortization of these overcollections.

3. CUCC's request to review, revise, or rescind D.82-05-038 is denied.

4. CUCC is ordered to hire a competent and independent geohydrologist familiar with local conditions to explore potential off-river sources of water, especially those associated with tributary streams feeding into the Russian River, and to evaluate the potential for developing or redeveloping horizontal and/or vertical wells on CUCC's upland watershed lands.

5. CUCC is ordered to report to the Commission on the outcome of such exploration within one year of the effective date of this interim order so that the Commission can determine whether CUCC should be authorized to drill the three high production wells in the Russian River alluvium recommended by its engineering consultant.

6. Water Utilities Branch shall propose the CRC adjustment recommended in these proceedings in any future rate proceedings involving CUCC's California operations.

7. The stay of CUCC's 1984 step rate increase ordered in Resolution W-3166 is hereby vacated; and CUCC is authorized to file an amended Advice Letter 217 in accordance with the instructions stated in the discussion.

8. PATRIOTS is eligible to claim compensation in this proceeding under Rule 76.25.8. The complaint in C.83-12-07 is dismissed.

9. CUCC's objection to the receipt into evidence of Exhibit 45 is sustained.

10. Application 60220 remains open for further proceedings after receipt of the geohydrologist's report ordered in Ordering Paragraph 5.

11. CUCC is ordered to report quarterly to the Commission Advisory and Compliance Division according to the following requirements:

1. CUCC shall give full particulars concerning any sale, lease, or assignment of any utility property, goods, right, or encumbrance to any CUCC affiliate.

2. CUCC shall report any changes to corporate guidelines concerning relationships or transactions between CUCC and its affiliates.

This order is effective today.

Dated APR 27 1988, at San Francisco, California.

I will file a concurring statement.

DONALD VIAL
Commissioner

STANLEY W. HULETT
President

DONALD VIAL
G. MITCHELL WILK
JOHN B. O'NEAL
Commissioners

I will file a written dissent.

FREDERICK R. DUDA
Commissioner