

Decision 91-09-001 September 6, 1991

SEP 9 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into the adequacy and status of San Gabriel Water Company's water supply.

I.90-05-034 (Filed May 22, 1990)

ORIGINAL

And Related Matter.

Case 89-12-035 (Filed December 22, 1989)

OPINION

Summary

On May 22, 1990, the Commission instituted this investigation into the adequacy and security of the water supply of the Fontana Water Company Division of San Gabriel Valley Water Company (San Gabriel). On May 8, 1991, the Commission modified the order to dismiss the issue of whether Fontana Union Water Company (Fontana), the source of most of San Gabriel's water supply, had become a public utility subject to the Commission's jurisdiction. Following investigation and hearing, the Commission finds that San Gabriel's supply of water is adequate at this time, and that San Gabriel has taken steps to protect the security of its water supply. On June 21, 1991, the United States Bankruptcy Court for the Central Division of California ruled that Fontana is not a public utility. Other issues related to the bankruptcy filing remain before that court. This proceeding is closed.

Procedural Background

On December 22, 1989, San Gabriel filed a complaint¹ with the Commission alleging that its principal source of supply,

1 Case (C.) 89-12-035.

Fontana Union Water Company, had become a public utility subject to the Commission's jurisdiction, and that Fontana's water supply had been dedicated to San Gabriel's public utility customers. Under Section 2707 of the Public Utilities Code, the Commission is authorized to determine whether "any person, firm, or corporation...owning, controlling, operating, or managing any water system or water supply within this State" is a public utility.

On March 28, 1990, Fontana filed a voluntary petition for bankruptcy in the United States Bankruptcy Court for the Central Division of California.² Under Section 362(a)(1) of the Bankruptcy Code, the complaint brought by San Gabriel was automatically stayed.

On May 22, 1990, the Commission on its own motion instituted this investigation into the adequacy and security of San Gabriel's water supply and into Fontana's status as a public utility. The investigation was instituted in keeping with the Commission's position that Section 362(b)(4) of the Bankruptcy Code provides an exception from the automatic stay for proceedings initiated by government agencies to enforce their regulatory powers.

On September 5, 1990, Fontana filed with the Bankruptcy Court a complaint for an injunction and an application for a preliminary injunction to bar the Commission from determining Fontana's status. On November 13, 1990, the Bankruptcy Court granted the temporary injunction.

The Commission appealed the Bankruptcy Court's issuance of the preliminary injunction. The appeal to date has been unsuccessful. On March 12, 1991, the Commission entered into a stipulation with Fontana. The Commission agreed not to adjudicate the issue of Fontana's status unless the Bankruptcy Court, under

² Case No. SB-9002635-MG.

stated conditions, fails to resolve that issue. Fontana agreed to dismiss its complaint for a permanent injunction and to have the preliminary injunction vacated. The parties agreed that the stipulation would have no effect as precedent on the Commission's authority to determine public utility status under the Public Utilities Code.

On March 25, 1991, the Bankruptcy Court approved the stipulation. On May 8, 1991, in Decision 91-05-032, the Commission modified this Order Instituting Investigation to dismiss the issue of whether Fontana is a public utility within the meaning of the California Public Utilities Code.

Issues in this Proceeding

This investigation is the outgrowth of a dispute between San Gabriel and Kaiser Steel Resources, Inc. (Kaiser), the two largest shareholders of Fontana. Fontana was organized in 1912 and has operated as a mutual water company. Kaiser owns 50.88% of the outstanding shares of Fontana. San Gabriel owns 34.54% of the shares. Generally, under laws applicable to a mutual water company, shareholders are entitled to receive at cost water produced by a mutual company in proportion to their respective share ownership. (See, generally, Public Utilities Code § 2705.)

However, since at least 1985, San Gabriel has purchased not just 34.54% but virtually all of Fontana's water production, with the exception of some water purchased by irrigation customers and others.

Kaiser is an entity that emerged on November 15, 1988, from bankruptcy proceedings as the successor-in-interest to Kaiser Steel Corporation. Kaiser is now owned by former creditors of Kaiser Steel. Fifty percent of this ownership is by a trust established to provide medical benefits to some 7,000 retired steelworkers and their families.

Kaiser viewed its ownership interest in Fontana as a source of income. In March 1989, Kaiser entered into a memorandum

of understanding with the Cucamonga County Water District (Cucamonga). Under the memorandum, Cucamonga would acquire a 100-year lease, with option to buy, of all of Kaiser's shares in Fontana, thus entitling Cucamonga to at least 50.88% of water produced by Fontana. The lease provides minimum payments to Kaiser of about \$1.8 million annually, increasing based on inflation and on the water that is available pursuant to Kaiser's shares.

Obviously, if Cucamonga begins taking 50% or more³ of the water produced by Fontana, then the amount of Fontana water available to San Gabriel will be reduced substantially.

It was this possibility that prompted the Commission to open this investigation. The Fontana Division of San Gabriel supplies water to 28,500 ratepayers (approximately 100,000 persons) in a 52-square-mile area. San Gabriel alleged that if Fontana diverted the major share of its water supply to other parties, or if Fontana failed to adequately maintain its production facilities, then San Gabriel would not have sufficient water to meet its customers' needs. The Commission sought to learn what action, if any, was required to safeguard the interests of those who depend on San Gabriel for their water.

The last of a number of prehearing conferences in this matter was conducted on January 9, 1991, in Los Angeles. Hearings were scheduled for March 19, 1991. The Water Utilities Branch (Branch) of the Commission Advisory and Compliance Division was directed to complete and file its investigation report (Branch Report) on February 11, 1991. San Gabriel was directed to serve an updated supplement to its earlier compliance filings. At hearing, Branch presented one witness to testify on its report. San Gabriel

3 Since Cucamonga may acquire a controlling interest in Fontana, it presumably could claim the right to sell to itself or to third parties that percentage of Fontana water that Fontana was not legally obligated to deliver to shareholders.

presented 3 witnesses, and Cucamonga presented 1 witness. Fontana and Kaiser appeared and participated in examination of the witnesses. Southern California Edison Company appeared as an interested party.

With Fontana's status removed as an issue in this proceeding, it is clear that there are, essentially, only two factual issues that must be addressed. These are:

1. Does San Gabriel face a water supply emergency because of the potential loss of water from Fontana?
2. Has San Gabriel developed alternative sources of water supply to meet the needs of its service community?

Briefs addressing these and other matters were filed by Branch, San Gabriel, Fontana, Kaiser, and Cucamonga on May 24, 1991, at which time this matter was deemed submitted for decision.

Discussion

1. Does San Gabriel face a water supply emergency because of the potential loss of water from Fontana?

At the time of the complaint and of the Order Instituting Investigation, there was concern that San Gabriel's Fontana Division could suddenly lose the majority of its water supply. San Gabriel requires 31,000 acre feet of water annually to serve 100,000 persons in its service area. If confined to its 34.54% share of Fontana water, San Gabriel would receive only 18,800 acre feet of water annually from Fontana, depending on the amount of water available. Fontana previously had provided virtually all of San Gabriel's supply.

A number of developments, however, have eased concern about any sudden loss of water supply. First, the parties apparently have taken steps to maintain the status quo during pending litigation. Second, the Bankruptcy Court has acted to protect, at least for the time being, much of San Gabriel's

entitlement to Fontana water.⁴ Finally, San Gabriel has begun an extensive well-drilling program intended to increase its sources of water.

As a result, all parties--including San Gabriel and Branch--agree that San Gabriel's Fontana Division does not face a water supply emergency in the near future. (Branch Report, at 4; Concurrent Brief of San Gabriel, at 4.) Branch concludes instead that "[San Gabriel] faces a water cost increase problem rather than a supply dilemma." (Concurrent Brief of Branch, at 2.)

As Branch notes, San Gabriel is receiving the water it requires, but at a higher price than San Gabriel has paid in the past. Fontana on November 15, 1989, increased its basic water rate from \$45.37 to \$93.78 per acre foot for all water purchases except those from Chino Basin wells, where the rate was increased to \$220.21 per acre foot. By Advice Letter 252, filed August 14, 1990, San Gabriel sought and was granted an offset rate increase of \$1.15 million annually, resulting in an increase in the average customer bill from \$19.41 to \$22.62 monthly. San Gabriel's well-drilling program and other measures to assure supply are likely to result in additional costs to customers.

The cost of Fontana water paid by San Gabriel and the allotment of Fontana water which San Gabriel will be able to claim are issues pending before the Bankruptcy Court. (Branch Report, at 14.) In large part, these matters will depend on resolution of the Fontana status issue. San Gabriel argues that Fontana's water supply is or should be dedicated to public use, and that Fontana by its actions has become a public utility subject to the Commission's regulatory jurisdiction. (Ex. 3, p. 2 of Ex. A.) Fontana argues

⁴ By order dated August 28, 1990, the Bankruptcy Court granted to San Gabriel, on an interim basis extending through June 30, 1991, the right to receive 34.54% of Fontana water pumped from Chino Basin, the major source of Fontana's production.

that it is a mutual water company, not subject to Commission jurisdiction, and that its primary obligation is to supply water at cost to its owners in proportion to their ownership shares. (Brief of Fontana, at 5; Tr. 20.) The parties also have submitted competing plans of reorganization for consideration by the Bankruptcy Court. (Ex. 3, p. 2 of Ex. A.)

The Bankruptcy Court has scheduled trial dates through the end of August 1991 on these and other issues, and additional trial dates may become necessary.⁵ While nothing is certain where litigation is involved, the consensus of all parties is that San Gabriel is assured of receiving all or most of the water it needs from Fontana during at least the period of the Bankruptcy Court proceedings. Branch's investigation, and the record before us, establish that no water supply emergency exists at this time. As discussed below, additional sources of supply are becoming available this year and next.

2. Has San Gabriel developed alternative sources of water supply to meet the needs of its service community?

While litigating the supply and price of its Fontana source of water, San Gabriel management also has developed additional sources of supply. At hearing, San Gabriel President Michael L. Whitehead and other San Gabriel witnesses described the division's program to add ten wells to San Gabriel's system. To implement the program, San Gabriel in December 1989 entered into a stipulation with the Chino Basin Watermaster to become a party to the Chino Basin Judgment, thereby allowing it to drill wells in and extract water from the Chino Basin. The stipulation was approved in January 1990 by the Superior Court which oversees the

⁵ On June 21, 1991, the Bankruptcy Court ruled that Fontana is not a public utility because it has not dedicated its water rights, services or facilities to public use. San Gabriel on July 1, 1991, appealed this decision.

administration of the Chino Basin Judgment. (Ex. 4, pp. 7 of Ex. 1.)

San Gabriel's witnesses testified that 2 of the 10 wells have been completed and are equipped to produce 2,800 gallons per minute. The company hopes to add at least 6 additional wells this year and 2 more in early 1992. While well drilling can be hit or miss, it is San Gabriel's hope that the 10 wells will each produce an average of 2,500 gallons per minute.

San Gabriel states that the new wells are intended to supplement, not replace, the existing source of supply in a growing service area. However, Branch and Fontana each note that if the new well program is successful, it could replace a potential loss of San Gabriel's current supply. Fontana states:

"Assuming all 10 wells average 2,500 GPM, they would be capable of producing approximately 40,000 acre feet of water per year. This is almost 10,000 acre feet more than San Gabriel's current and predicted total demand of 31,000 acre feet per year (Exh. 2, p. 11.) Even if San Gabriel were only able to produce one-half of this amount (20,000 acre feet), it would still have added enough production capacity to cover the reduction in water it fears will result if Fontana Union is found to be a mutual water company and delivers to Cucamonga its proportionate share of Fontana Union water." (Fontana Brief, at 10.)

In addition to the well-drilling program, San Gabriel is upgrading its booster pumps to permit it to use the water from the new wells, and from existing Fontana wells, throughout the San Gabriel system.

Again, ratepayers are likely to be affected. The cost of the new wells and booster pump enhancement may exceed \$5 million. (Ex. 4, at 12.) These costs will be included in San Gabriel's capital construction budget and will be before the Commission in the company's next general rate case. Additionally, by becoming a party to the Chino Basin Judgment, San Gabriel must pay for water

extracted from the basin at replenishment rates set by the Chino Basin Watermaster. Branch testified that this cost is now \$117.55 per acre foot. San Gabriel's witness testified that the Chino Basin replenishment cost could become as high as \$591 per acre foot under the Metropolitan Water Division's (MWD) conservation plan. (Ex. 3, p. 9, 10 of Exhibit A.)

San Gabriel also has developed alternate sources of water with nearby water suppliers on an emergency standby basis. Agreements have been made with the West San Bernardino County Water District and the City of Rialto on an exchange basis, contemplating the return of any water used by San Gabriel. An agreement with the City of San Bernardino contemplates the purchase of water at rates between \$95 and \$120 per acre foot.

Finally, Cucamonga General Manager Thomas Shollenberger testified that if his district acquires Fontana water through Cucamonga's lease of Kaiser shares, it is likely to offer part of that supply to third parties, including San Gabriel. Cucamonga sold small quantities of water to San Gabriel in 1989 and 1990 at a rate of \$257 per acre foot, representing the MWD rate plus 15%. Cucamonga's water, however, would be available to third parties only if it is not needed by Cucamonga's customers.

In summary, the record shows that San Gabriel by the end of this year will be able to replace at least a substantial part of any lost Fontana supply if San Gabriel's new wells are successful. Additionally, on an emergency basis, San Gabriel can obtain water from three nearby water districts. Cucamonga represents another potential source of supply. All of these alternative sources of supply carry with them increased costs.

Conclusion

Branch has monitored developments affecting San Gabriel and its customers. It concludes that San Gabriel's management has been diligent in protecting its Fontana Water Company division's source of supply and in acquiring alternatives to that source of

supply. The issues are no less important than when the original investigation began, but the record demonstrates that there is no need for extraordinary action by the Commission at this time.

Accordingly, we conclude that this investigation may now be closed. The record will be reexamined as part of San Gabriel's general rate case. If developments in the Bankruptcy Court warrant, we will reopen the record to deal with any matter, including the Fontana status issue, that is within the Commission's jurisdiction.

We also will dismiss San Gabriel's complaint case (C.89-12-035), since the issues there are now before the Bankruptcy Court. However, the dismissal of C.89-12-035 is without prejudice to refiling should Fontana's public utility status come before us at a later time. C.89-12-035 will be consolidated in this proceeding pursuant to Rule 55.

Comments on the Proposed Decision

Comments on the proposed decision of the administrative law judge were filed by parties on August 5, 1991. No reply comments have been received. No substantive changes were proposed. A number of minor changes were suggested to more accurately reflect the record and to correct errors. Where appropriate, we have made changes in the text of the proposed decision to correct errors and to make those changes supported by the record.

Findings of Fact

1. San Gabriel supplies water to 28,500 customers in a 52-square-mile area.
2. San Gabriel's service area includes a population of approximately 100,000 in portions of the Cities of Fontana, Rancho Cucamonga, Rialto, and adjoining unincorporated areas of San Bernardino County.
3. San Gabriel since at least 1985 has received virtually all of its water from the Fontana Union Water Company.

4. Fontana supplies water from 23 wells and 1 creek located in 3 adjudicated water basins and 1 nonadjudicated water basin. An adjudicated water basin is a source of water that has been subject to judicial determination of supply rights.

5. Fontana was organized in 1912 as a mutual water company to provide water to its shareholders.

6. Kaiser owns 50.88% of the outstanding shares of Fontana. San Gabriel owns 34.54% of the shares.

7. Since 1985, San Gabriel has purchased all of Fontana's annual water production except for some purchases by irrigation customers and others. Approximately 98% of San Gabriel's water supply was purchased from Fontana.

8. Wells providing water for Fontana are located in four areas. For the year ending June 30, 1990, Chino Basin wells supplied 43% of production, Lytle Creek supplied 20%, Lytle Creek Basin wells supplied 22%, Colton-Rialto Basin wells supplied 11%, and a well in a nonadjudicated area supplied 5%.

9. Under operating agreements, San Gabriel operates and maintains 23 wells owned by Fontana, and Fontana's Lytle Creek diversion facilities. San Gabriel serves certain irrigation customers on behalf of Fontana.

10. Fontana is a party to the Chino Basin pool of water purveyors. There are 21 parties in the Chino Basin pool, each of them entitled to a yearly percentage of the Chino Basin's initial operating safe yield.

11. In March 1989, Kaiser and Cucamonga entered into a memorandum of understanding whereby Cucamonga by virtue of a 100-year lease would acquire Kaiser's majority interest in Fontana, including Kaiser's rights as a shareholder to Fontana Water.

12. On November 15, 1989, Fontana increased its basic water rates to customers from \$45.37 to \$93.78 per acre foot, except for water from Chino Basin wells, which increased to \$220.21 per acre foot.

13. San Gabriel in December 1989 filed C-89-12-03 with the Commission contending that Fontana had become a public utility and had dedicated its water supply to San Gabriel's public utility customers.

14. In March 1990, Fontana filed for protection under Chapter 11 of the Bankruptcy Code.

15. The Commission issued this Order Instituting Investigation on May 22, 1990.

16. By Advice Letter 252, filed August 14, 1990, San Gabriel sought and was granted an offset rate increase of \$1,155,200, with 75.5% of that amount to cover the increased cost of purchased water.

17. By order of the United States Bankruptcy Court for the Central Division of California, dated August 28, 1990, San Gabriel was granted the right to purchase 34.54% of Fontana's 1990-1991 Chino Basin water rights.

18. By order of the Bankruptcy Court, dated November 13, 1990, the Commission was enjoined from investigating or resolving the issue of Fontana's status as a public utility.

19. Current demand for water from San Gabriel is approximately 31,000 acre feet per year (13,500,000 Ccf annually).

20. Based on historical use trends, San Gabriel now has a potential maximum day consumption of 53.6 million gallons and a maximum production capability of 56.6 million gallons. San Gabriel can support at least 29,940 service connections. San Gabriel has approximately 28,500 service connections.

21. In January 1990, San Gabriel became a party to the Chino Basin Judgment, allowing it to drill wells in and extract water from the Chino Basin.

22. San Gabriel has completed 2 wells in the Chino Basin. Six additional wells are scheduled for completion in 1991, and 2 wells are to be drilled in 1992.

23. It is San Gabriel's intention that the 10 new wells in the Chino Basin will each be capable of producing an average of about 2,500 gallons per minute.

24. San Gabriel has initiated a program to upgrade its booster pumps to permit efficient use of water from its new wells and from wells it operates on behalf of Fontana.

25. San Gabriel has entered into agreements for acquiring water on an emergency standby basis with West San Bernardino County Water Division, the City of Rialto, and the City of San Bernardino.

26. Cucamonga intends to offer for sale a portion of its water that is excess to Cucamonga's needs. The water would be offered for sale to other parties, including San Gabriel.

27. Because of drought conditions, San Gabriel in 1990 asked its customers to voluntarily reduce water consumption by 10%. In March 1991 it urged customers to conserve water by another 10%. San Gabriel has encouraged water conservation through newspaper advertisements, bill inserts and community workshops, and it has distributed conservation kits at schools and at public meetings.

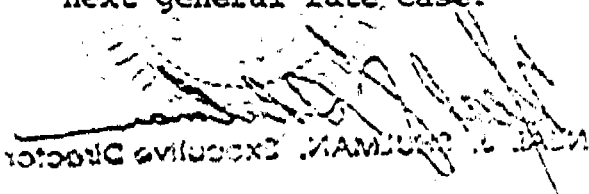
Conclusions of Law

1. San Gabriel does not at this time face an emergency in obtaining an adequate supply of water to serve its customers, and the Commission should not now implement emergency procedures on behalf of those customers.

2. San Gabriel has developed alternative sources of water that afford some protection against the utility's loss of Fontana water, and the Commission should not at this time require emergency measures to develop additional alternatives.

3. San Gabriel has implemented a water conservation program, and no further conservation or rationing requirements should be directed by the Commission at this time.

4. This investigation should be closed, but San Gabriel should provide a supplementary update on this record as part of its next general rate case.



5. San Gabriel's complaint case (C.89-12-035) should be consolidated in this proceeding and closed without prejudice to its refiling should the issue of Fontana's public utility status come before the Commission at a later time.

6. Since no further action by the Commission is required at this time, this order should be made effective without delay.

ORDER

IT IS ORDERED that:

- 1. This proceeding is closed.
- 2. San Gabriel Valley Water Company, Fontana Water Company Division (San Gabriel) is directed to file a supplementary report on the status of issues in this proceeding as part of San Gabriel's next general rate case.
- 3. Case 89-12-035 is consolidated with this proceeding and is dismissed without prejudice to its refiling should the issue of the public utility status of Fontana Union Water Company come before the Commission at a later time.

This order is effective today.
Dated September 6, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I abstain.

/s/ G. MITCHELL WILK
Commissioner

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

Neal J. Shulman
NEAL J. SHULMAN, Executive Director
PB

APPENDIX A

List of Appearances

Respondents: Nossaman, Guthner, Knox & Elliott, by Jose E. Guzman Jr., Attorney at Law, for San Gabriel Valley Water Company; Hufstadler, Kaus, & Ettinger, by Burton J. Gindler, Nancy C. Brown, and Donna R. Harvey, Attorneys at Law, for San Gabriel Valley Water Company; Mc Cutchen, Doyle, Brown & Enersen, by A. Crawford Greene and William J. Newell, Attorneys at Law, for Fontana Union Water Company; Gendel, Raskoff, Shapiro & Quittner, by Herbert Katz, Attorney at Law, for Fontana Union Water Company; Timothy J. Ryan, Attorney at Law, for San Gabriel Valley Water Company; Hughes, Hubbard & Reed, by Cynthia M. Cohen, Attorney at Law, for San Gabriel Valley Water Company; and Brian T. Corrigan, Attorney at Law, for Fontana Union Water Company.

Interested Parties: Best, Best & Krieger, by Eric Garner, Attorney at Law, for Cucamonga County Water District; Barton C. Gaut, Attorney at Law, for Cucamonga County Water District; Tuttle & Taylor, by Jeffrey Hamerling, Attorney at Law, for Kaiser Resources, Inc.; Frank A. Mc Nulty, Attorney at Law, for Southern California Edison Company; and Alf W. Brandt, Attorney at Law, for Kaiser Steel Resources.

Commission Advisory and Compliance Division: Lawrence O. Garcia, Attorney at Law, and Daniel R. Paige.

(END OF APPENDIX A)