

ALJ/EA/nb

**ORIGINAL**Decision No. 92360 OCT 22 1980

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of TUSTIN WATER WORKS )  
 and CITY OF TUSTIN WATER CORPORATION )  
 for authorization for CITY OF TUSTIN )  
 WATER CORPORATION to acquire all of )  
 the common stock of TUSTIN WATER )  
 WORKS. }

Application No. 59671  
 (Filed May 19, 1980)

Milford W. Dahl, Attorney at Law, for  
 Tustin Water Works and City of Tustin  
 Water Corporation, applicants.  
Rourke & Woodruff, by James G. Rourke,  
 City Attorney, and Daniel K. Spradlin,  
 Deputy City Attorney, for City of  
 Tustin, interested party.  
Stephen D. Johnson, Attorney at Law, for  
 Santiago Municipal Advisory Council;  
 and Niles P. Koines, Attorney at Law,  
 for County Homeowners Association;  
 protestants.  
Alvin S. Pak, Attorney at Law, and  
Robert M. Mann, for the Commission  
 staff.

O P I N I O NSummary of Decision

This decision authorizes the sale of Tustin Water Works (TWW) common stock pursuant to the agreement (Exhibit C) attached to the application with the modifications contained in Resolution No. 80-31 (Exhibit E), attached to the application, adopted by the city council of Tustin on March 17, 1980 and subject to adoption of Commission staff recommendations stipulated to by the parties.

General

The city of Tustin (City) contends it has the financial ability to back the purchase of TWW by the Tustin Water Corporation (Corporation), including a reserve fund in excess of \$1,000,000. Corporation will issue \$7,600,000 in 25-year tax-exempt bonds at an anticipated interest rate of 8 percent for the following purposes:

Payments to stockholders of TWW	\$3,400,000
Reserve for adjustments to date of closing	200,000
Payoff of existing TWW bonds	2,600,000
Expense of bond issuance and discount	380,000
Establishment of required bond reserve (funds available for future capital improvements or early payoff of bonds)	700,000
Funds for initial capital improvements	320,000
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Total	\$7,600,000

Until the bonds are issued, or three years, whichever occurs first, 1/25 of the purchase price is to be paid annually plus interest at an initial annual rate of 7½ percent. After the bonds are sold, but not later than three years after the closing, the balance will be paid. The interest would increase by 1 percent per year until Corporation issues its lease revenue bonds.

The common stock will be sold to Corporation, a nonprofit entity set up by City, to finance the acquisition of the water system for the benefit of City for \$6,000,000 plus net additions to plant, construction work in progress (not cleared to utility plant), and inventory between June 1, 1979 and the date of transfer. As of the transfer date, payment adjustments will be made for various assets and liabilities of TWW transferred to Corporation. Corporation will be responsible for refund obligations on main extension contracts and for customer deposits. City will operate the system until Corporation issues approximately \$7,600,000 of lease revenue bonds and enters into a long-term lease with City. City will pay allocated net revenues received between TWW's last meter reading date and City's meter reading date. The agreement provides for a \$200,000 increase in the purchase price if the sale is not consummated by October 31, 1980, unless the delay was caused by TWW and/or its shareholders. Outstanding TWW bonds of approximately \$2,600,000 will be paid off with proceeds from the sale. The agreement extends until February 28, 1981.

Pursuant to applicants' request, this Commission will authorize Corporation to acquire TWW's common stock and will incorporate the conditions and limitations included in Resolution No. 80-31. Resolution No. 80-31 revises the purchase agreement with respect to offered employment contracts, setting forth wage and fringe benefits for two management employees of TWW.

The resolution contains the following commitments:

"BE IT FURTHER RESOLVED the City Council of the City of Tustin declares its policies in the operation of the facilities of the Tustin Water Works shall include the following:

- "1. To preserve and improve water service for both domestic and fire protection within the City of Tustin and those portions of the service area lying in unincorporated portions of the County of Orange.
- "2. To honor all customer deposits in accordance with presently existing Public Utility Commission regulations.
- "3. To assume and honor all existing Main Extension Agreements.
- "4. To continue water rates at their same level and hereafter to only modify such water rates as may be required by increased costs of energy, water and operating costs, together with the cost of necessary capital improvements.
- "5. To maintain water rates and service without discrimination between customers lying inside or outside the City of Tustin.
- "6. To make improvements in the water system on a reasonable system of priorities without regard to the location of improvements inside or outside the City of Tustin.

"BE IT FURTHER RESOLVED that the City will offer employment to the present employees of the Tustin Water Works in order to obtain the benefit of their expertise and assure the continuation of a satisfactory level of service to customers."

The effect of the stipulation is to limit offset rate increases for purchased water, groundwater taxes, and purchased power to 5 percent until midnight on June 30, 1981.

Hearings

The Commission received letters from individuals and groups protesting the requested sale. After notice, a prehearing conference was held in Los Angeles on July 7, 1980 before Administrative Law Judge Levander to ascertain the nature of the protests and to attempt to resolve them without hearing. This attempt was unsuccessful. Testimony and statements in support of and in opposition to granting the application were presented at five days of hearings held in Santa Ana and in Los Angeles between August 18 to 22, 1980. The matter was submitted on August 22, 1980 subject to the receipt of late-filed exhibits (which have been received) and of concurrent briefs. Exhibits 2 through 22<sup>1/</sup> have been received. After the filing of briefs, protestants and City filed a stipulation on September 19, 1980 agreeing to adoption of the staff recommendations as a basis for settling the dispute.

The stipulated agreement makes protestants' motion for reopening this proceeding moot.

Applicants' Trial Brief

The city attorney of Tustin filed a trial brief on behalf of City, of Corporation, and of TWW at the commencement of hearings. The brief argues that: (a) the primary question to be determined in a transfer proceeding is whether the proposed transfer would be adverse to the public interest; (b) in determining whether the proposed transfer will be injurious to the public interest, the Commission may consider: the effect of the transfer upon the quality of service to be provided (Riccardo Tunzi (1944) 45 Cal RRC 143), the qualifications of the transferee (City Transfer & Storage Co. (1945) 46 Cal RRC 5), the financial ability of the transferee and the

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<sup>1/</sup> The draft of the minutes of the Irvine Ranch Water District, Exhibit 22, has been approved.

position of the present owner (Ada H. March (1958) 56 Cal PUC 387), and that the transfer will not financially burden the utility customers (Southern California Edison Co. (1964) 63 Cal PUC 262; (c) the Commission should not be concerned with political issues raised by protestants; and (d) applicants' evidence will demonstrate that the proposed transfer will not only improve present water services for all consumers at no increase in cost, it will also enhance the long-term financial security of the system and make available funds needed for capital improvements.

City states that:

"Resolution 80-31 is patent evidence of the City's recognition of its legal obligations as enunciated by the California Supreme Court in County of Inyo v. Public Utilities Com., 26 Cal.3d 155 (1980):

""[a] city which acquires the water system of another community incurs an obligation to deal fairly with its customers in that community and to provide them with reasonable service at reasonable rates." See South Pasadena Land, etc. Co. 1908 152 Cal. 579, 587-588, 594 93 P. 490. Such an acquiring city, as to the water dedicated to the use of the outside community, holds 'title as a mere trustee, bound to apply it to the use of those beneficially interested.' (Id. at p. 594; see Durant v. City of Beverly Hills, supra, 39 Cal.App.2d 133, 138. Consequently, the county can sue to enjoin rates which are themselves 'unreasonable, unfair, or fraudulently or arbitrarily established' (Durant v. City of Beverly Hills, supra, 39 Cal.App.2d 133, 139), or which discriminate without a reasonable and proper basis (Elliott v. City of Pacific Grove, supra, 54 Cal. App.3d 53, 59) (Emphasis supplied.)"

"Id. at 159.

"Even more recently these principles were again restated in Hewitt v. Rincon Del Diablo Municipal Water District, 107 Cal. App. 3d 78 (1980):

"'Hewitts' contention that there will be rates based upon expenses incurred or assumed by city, which have nothing to do with Rincon, assumes a fully integrated single water system will not benefit Rincon or result in improved water service at the lowest cost. This assumption is contrary to the findings of the contracting parties, as expressed in their declaration of intent and the other recitals in the merger agreement.'"

"As pointed out by City, the citizens of Escondido are no more anxious to pay higher water rates than necessary to assure good water service than are those Rincon water users who are not citizens of the City.

"This same argument was raised in the County of Inyo v. Public Utilities Commission (1980) 26 Cal. 3d 154 (161 Cal. Rptr. 172, 604 P. 2d 566) at page 158, footnote 2, in the Supreme Court, recognizing that non-resident customers of municipally owned utilities are not without rights to protection against unreasonable and discriminatory water rates charged as stated at page 159:

"' [A] City which acquires a water system of another community incurs an obligation to deal fairly with its customers in that community and to provide them with reasonable service at reasonable rates.' (Citation)"

"Such an acquiring City, as to the water dedicated to the use of the outside community, holds 'title as a mere trustee, bound to apply it to the use of those beneficially interested.' (Citation)"

"Consequently, the County can sue to enjoin rates which are themselves 'unreasonable, unfair, or fraudulently or arbitrarily established' (Citation) or which discriminate without a reasonable and proper basis (Citation).

"Id. at 86-87.

"The fact that a portion of the territory served by the water system is located outside the Tustin city limits does not preclude or inhibit acquisition of the entire system by the City. See, City of North Sacramento v. Citizens Util. Co. of Calif., 192 Cal. App. 2d 482, 13 Cal. Rptr. 538 (1961); People by Public Utilities Commission v. City of Fresno, 254 Cal. App.2d 76, 62 Cal. Rptr. 79 (1967)."

System Improvements

The old steel mains in the system, which comprise approximately 20 percent of the distribution system footage, and steel services, which comprise approximately 15 percent of the services, should be replaced over a period of time to reduce system leaks. A portion of the distribution system contains undersized water mains which do not provide adequate fire flows. At least half of the mains slated for replacement are in county territory. In addition, high nitrate concentrations in some of the company well supplies must be blended or replaced to reduce the nitrate concentrations of water supplied to TWW's customers. The City engineer and the water system superintendent testified that main replacements will be made to meet system requirements based on good engineering practices, within budget limitations, not on political considerations.



There is not a critical need for a replacement of the old distribution system on a crash basis.

Protestants testified that increases in payroll and related benefits and in bond interest rates would require further rate increases or that improvements would not be made, and that City should include depreciation expense in its projections. Protestants overstated the impact of the payroll-related expenses because they were unaware that approximately \$75,000 in payroll costs is included in capitalized items and the study of City's bonding consultant did not delete approximately \$41,000 in payroll expense paid to two of TWW's officers and shareholders who would not become City employees.<sup>2/</sup> TWW's controller and assistant secretary testified that due to warmer and drier than normal weather, TWW's sales, gross revenues of approximately \$2,692,000, and net revenues were higher than projected.

The agreement permits Corporation to wait up to three years before issuing its bonds. It can attempt to wait until more favorable bond rates are available. For the initial year, interest expense would be below Corporation's projection if no bonds are issued.

City intends to go forward with the short-term improvements planned by TWW and to develop a long-range improvement plan. However, there are areas with marginally low pressure in the city of Orange (Orange). City has indicated a willingness to discuss selling that portion of the system to Orange because higher pressures can be supplied to this area from the Orange

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<sup>2/</sup> The City manager, City engineer, and City treasurer would replace TWW's top management.

water system. In the event that such a transfer is not effectuated in a reasonable period of time, City should explore various possibilities for improving that service, such as purchasing water from Orange through a pressure-activated connection, installation of elevated storage and booster pumps, in-line boosting, or installing hydropneumatic facilities.

#### Public Participation

Protestants questioned the adequacy of notice given by City on the acquisition and were concerned that the city council would follow its past practices and not permit them to be heard on water matters because they were not City residents. Protestants from county areas oppose annexation to City to be heard on water matters. City represented that adequate public notice would be provided for normal business meetings of Corporation or by the city council on water matters and that county residents would be heard. Short notice would be given for taking emergency actions, which would not include adoption of a budget.

The five councilmen would appoint the five-man Corporation Board of Directors. There would be an alternating majority of directors between City and county residents. Given the present City-county population mix, that apportionment is reasonable.

#### Further Discussion

The representations on nondiscriminatory treatment made by City and/or Corporation discussed above should be considered in the context of City's obligations under the Inyo decision. In that context the interests of county residents will be protected. However, there is no mechanism available for them to elect members of the city council unless they choose to annex

to City. The California Constitution permits City to serve water outside of its corporate limits. City proposes to integrate TWW's employees into its work force on a reasonable basis.

In this proceeding there is a willing buyer and a willing seller. No other public water agency has indicated any intent to interfere with the sale. No public utility has indicated an interest in acquiring TWW for 1.6 times rate base. The staff notes, and we concur, that:

". . . Although the \$6 million purchase price was greater than rate base,<sup>1</sup> it was far less than the reproduction cost new less depreciation value (RCNLD) of the plant-in-service.<sup>2</sup> (R.T. 234; Exhibit 4, Table 4.) Moreover, the evidence in this proceeding shows that the proposed sale price is considerably lower than the capitalized earnings value of the system to its shareholders (Exhibit 4, p.3), thereby demonstrating that the City and its constituent water users are receiving full value for their purchase money."

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"<sup>1</sup>/ Witness Jensen testified that rate base as of December 31, 1979, was \$3.8 million. (R.T. 512.)

"<sup>2</sup>/ While the Commission in a recent case declined to use the RCNLD method of valuation, it was uncontroverted by any party that the City, were it to condemn the TWW system, could face a potential RCNLD-derived price tag. Moreover, the Commission in the referenced decision found that the poor service rendered by the condemnee and the dilapidated state of its facilities justified a less-than-RCNLD valuation. See Washington Water & Light Co., \_\_\_\_\_ CPUC \_\_\_\_\_ (1979), rehearing denied, \_\_\_\_\_ CPUC \_\_\_\_\_ (1979), petition for writ of review denied, December 6, 1979. (Application No. 57906, Decisions Nos. 89360 and 89767.)"

Negotiations over many years were not brought to a conclusion until City felt it could acquire TWW without increasing rates. In this era of high inflation, with tremendous increases on energy costs (which are a major component of water production and delivery costs) and large increases in payroll costs, either City or TWW would require additional revenues to adequately maintain service.

The 5 percent limitation for City's offset increases, expiring on July 1, 1981, i.e., effective through June 30, 1981, proposed by staff and stipulated to by City and protestants, is a reasonable condition and will be adopted in this decision.

Findings of Fact

1. An agreement, Exhibit C attached to the application, was entered into by City, Corporation, and TWW providing for the sale of TWW common stock to Corporation for \$6,000,000 subject to various adjustments. TWW will become a nonprofit corporation merged into Corporation.
2. City will lease the water system from Corporation, will collect revenues, and will operate the system.
3. The Tustin city council adopted Resolution No. 80-31 on March 17, 1980 adopting that agreement with certain modifications regarding wage and benefits to be offered to two management personnel of TWW. Resolution No. 80-31 contains a policy declaration for operating the water facilities to provide, preserve, and improve water service, to maintain water rates and service without discrimination between customers inside and outside of City, and to offer employment to TWW employees to benefit from their expertise and assure a satisfactory continuity of service.

4. Two management employees who are also shareholders of TWW do not plan to become City employees. Their functions will be assumed by the City manager, the City treasurer, and the City engineer.

5. Applicants, Corporation, and TWW requested Commission approval of the conditions and limitations set forth in Resolution No. 80-31 as a condition of the authorization of the sale of TWW's common stock. City concurs in that request.

6. Applicants, TWW and Corporation, City (interested party), and objectors (protestants) filed an agreement and stipulation, dated September 19, 1980, agreeing that the transfer and operation proposed be approved subject to the following conditions:

I(a) Rates outside of City shall not exceed rates within City.

(b) There would be a moratorium on rate increases except to the extent that TWW would have been permitted to increase rates under the advice letter filing procedures set forth under the Commission's General Order No. 96-A, but not higher in aggregate than 5 percent. The moratorium would expire on July 1, 1981, i.e., it would be effective through midnight of June 30, 1981.

II Objectors withdraw each, every, and all of their objections and oppositions to the approval of the transfer subject to the above conditions.

7. The agreement (Exhibit C attached to the application), as modified by Resolution No. 80-31 adopted by the city council of Tustin and by the stipulation dated September 19, 1980, is reasonable.

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8. There would be a \$200,000 addition to the purchase price of TWW's stock if the authority sought is not authorized by October 31, 1980. Payment of this amount would decrease funds available for making system improvements.

Conclusions of Law

1. City explicitly recognizes its legal obligations to deal fairly with customers located outside of its corporate boundaries as enumerated by the California Supreme Court in the Inyo decision, supra, through the adoption of Resolution No. 80-31, and through the above-described representations made at the hearings.

2. City has the capability to take over the operations of TWW and to secure financing through Corporation.

3. Corporation should be authorized to purchase the common stock of TWW subject to the modifications of the agreement set forth in Finding 7 herein.

4. The effective date of the decision should be the date hereof to avoid a \$200,000 increase in the purchase price for TWW's common stock.

O R D E R

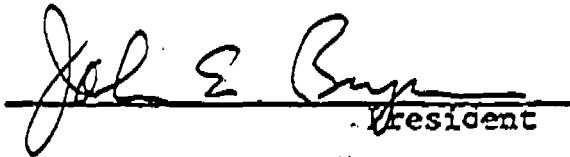
IT IS ORDERED that:

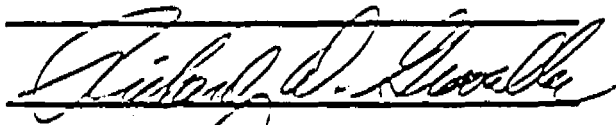
1. Tustin Water Corporation is authorized to acquire all of the common stock of Tustin Water Works (TWW) pursuant to the modifications to the agreement set forth in Finding 7 herein.

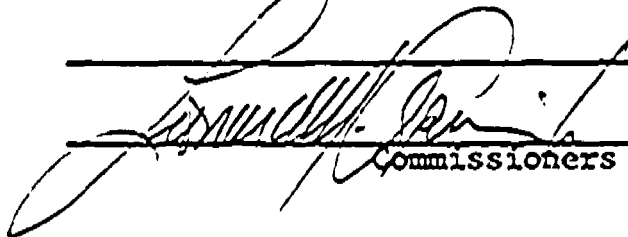
2. The city of Tustin shall not increase rates for water service before July 1, 1981 except for increases in rates for purchased water, pumping taxes, and for purchased energy costs. Any increases made before July 1, 1981 shall not increase water rates by more than five percent in the aggregate above TWW's presently effective rates.

The effective date of this order is the date hereof.

Dated OCT 22 1980, at San Francisco, California.

  
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Resident

  
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Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

Commissioner Claire T. Dadrick, being necessarily absent, did not participate in the disposition of this proceeding.