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Decision 97-07-006 July 16, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of: THE CITY OF BANNING, a Municipal Corporation, to Acquire the Water System of MOUNTAIN WATER COMPANY, a Public Utility within the City of Banning and for an Order authorized MOUNTAIN WATER COMPANY, to Transfer Said System and to Cease Operations.

Application 96-07-037
(Filed July 9, 1996)

ORIGINAL

Delton J. Dysart, for Mountain Water Company; and Gregory K. Wilkinson and Zachary R. Walton, Attorneys at Law, for City of Banning; applicants.
Steven H. Kennedy, Attorney at Law, for High Valleys Water District, intervenor.
Peter G. Fairchild, Attorney at Law, for the Water Division.

OPINION

Statement of Facts

Mountain Water Company

In 1960, Alfred C. Dysart and Ollie M. Dysart owned extensive ranch and farm acreage west and southwest of the City of Banning (Banning) in Riverside County. Desiring to develop an approximate 12 acres west of Banning and north of U.S. Interstate Highway 10, but unable to obtain water services from the local water purveyor, Banning Water Company, the Dysarts made application to the Commission for authorization to construct and operate their own water utility system to be styled Mountain Water Company (Mountain). By Decision (D.) 61651 issued March 14, 1961, the Dysarts were granted a certificate of public convenience and necessity for this public utility.

Subsequently over the years, by D.65699 and D.75406, respectively issued in 1963 and 1970, the Dysarts were granted extension authorizations to their initial authority; first contiguous to the area north of Highway 10; and further to serve much larger

parcels approximately two miles south of the initial area, and south of Highway 10. Today this southern area embraces the south half of Section 17; the approximate northern half of Section 20, and all of Sections 18 and 19, Township 3 South, Range 1E, San Bernardino Base and Meridian. Thus part of the Mountain system serves a portion of the City while another part serves the larger area outside of the City in the unincorporated areas.[1] The system includes, but is not limited to, 10 active and non-active wells and related reservoirs, 12 hydro pneumatic tanks, approximately 10 miles of mains sized from six to 10 inches in diameter, distribution mains and 235 residential meters. Today, Ollie M. Dysart is the sole owner of Mountain, Alfred Dysart having died five years ago.

In July of 1996, when this application was filed, Mountain was operating at a loss; its last general rate increase having become effective March 31, 1992, to provide a 23.37% increase and a rate of return of 5.16%.

High Valleys Water District

Southeast of Mountain and Banning, stretching across miles of high hills in the San Gorgonio mountains, lies High Valleys Water District (District), a California district organized to operate pursuant to California Water Code §§ 34000 et seq. The district, encompassing 936 parcels, with no developed water source of its own, depends upon purchased water obtained from Mountain to serve its approximate 200 customers. Mountain delivers water to District through a single connection into a reservoir from which District pumps six miles uphill through three pumping stations. District's customers reside between 1,500 to 2,500 feet above the intertie to Mountain. District

[1] Of Mountain's water connections, about 180 are north of Highway 10 and within the city limits of Banning; the remaining 60 connections are in the much larger area south of Highway 10, outside of the city limits.

uses a 210,000-gallon tank, a 22,000-gallon tank, and several smaller tanks, and employs 36 miles of pipe to deliver water to its customers.[2]

District's agreement with Mountain for water service was made on March 8, 1972. It provided that District at its expense would contract a six-inch intertie pipeline from Mountain's facilities to District's facilities, with water provided at a flow of 135 gallons per minute (gpm) at a usable pressure from two of Mountain's wells located in Section 19. The agreement provided a quantity rate structure including a minimum charge. As relevant to this proceeding, Paragraph 3 of this Agreement included the following:

> "Said rates and minimum charge shall be subject to the continuing review of the California Public Utilities Commission and may be changed as said Commission may, from time to time, direct in the exercise of its jurisdiction."

And Paragraph 7 states:

> "Agreement Subject to Approval of Public Utilities Commission. This Agreement is subject to approval by the Public Utilities Commission of the State of California, and shall be at all times during its term subject to such changes or modifications as said Commissions may, from time to time, direct in the exercise of its jurisdiction."[3]

A dispute subsequently arose between District and Mountain concerning which wells were to provide water to District. The quantity produced by the two wells designated by Mountain was in doubt. On May 31, 1991, District sued in Superior Court of Riverside County (Case 212012) and obtained a stipulated judgment requiring observance of their 1972 agreements, but also expanding the number of wells that

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[2] District's bond debt is $709,150. Of its 36 miles of pipe, 23 miles are in failing condition, and it expends 67% of its annual budget for pipe replacement; thereby reducing its water loss from 70% seven years ago to 35% today.

[3] By Resolution No. W-1370, the Commission approved Mountain's Advice Letter No. 7 providing for the sale of water to District at rate and charges to be authorized by the Commission.

Mountain could use to provide water to District to include Mountain's wells Nos. 4, 5, 6, 7, 8, 10, 11, and 12; all located south of Highway 10. The flow rate of 135 gpm was continued unchanged.

The City of Banning

Banning, located astride in part, but largely north of Highway 10 in Riverside County, is a municipal corporation since February 6, 1913 under the General L... State of California. Since September 26, 1963, Banning has maintained ... wholly owned municipal water system today serving appr... residential, commercial, and industrial custom... majority of the City system was acqui... Rates for municipal ser...

CORRECTION !!

THE PREVIOUS DOCUMENT(S) MAY HAVE BEEN FILMED INCORRECTLY .....

RESHOOT FOLLOWS

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The City of Banning

Banning, located astride in part, but largely north of Highway 10 in Riverside County, is a municipal corporation since February 6, 1913 under the General Law of the State of California. Since September 26, 1963, Banning has maintained and operated a wholly owned municipal water system today serving approximately 8,400 metered residential, commercial, and industrial customers, mostly within the City's limits. The majority of the City system was acquired from Banning Water Company years ago. Rates for municipal service are set by the City Council after hearings.

The City is a water producer in the San Gorgonio Pass Area having authority to extract water from wells located within the City and also to receive water from the State Water Project. Seventy percent of the City's present water supply is taken from its shallow 80-100 foot deep wells in a five-mile long area known as the Banning Canyon. The City maintains its own Public Works Department, Water Division, with a staff of 10 under an Operations Manager (including four certified operators of Grade 2 or 3). Its annual Water Department budget is $3.9 million. In the San Gorgonio Pass Area, the groundwater subsystem is complex and litigation over water is prolific.

The Present Situation

The City has long been interested in acquisition of Mountain. Its master plan calls for ultimate development from its present 24,000 population in its sphere of influence to approximately 60,000. As a full service city with its own water, electric,

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[4] Although Paragraph 1 of the Agreement and Release states: "This modification to the 1972 Agreement will require approval of the Public Utilities Commission," and Public Utilities (PU) Code § 851 requires prior authorization from the Commission before encumbrances of any part of a utility's system necessary or useful in the performance of the utilities' duties to the public be valid, this Agreement was not submitted to the Commission by Advice Letter or erwise for Commission authorization, and accordingly is not enforceable.

wastewater, etc., systems, the City desires to make sure that it will have the necessary infrastructure to handle this expansion. It uses its existing dozen shallow wells to the fullest extent possible because pumping that water is cheap. When drought occurs, these shallow wells go dry and the City switches over to its four deep wells. At 1,000 feet pumping these wells is more expensive. While Mountain also has shallow wells, its deep wells are of great interest to Banning. Two of Mountain's deep wells were recently drilled and are not being used because they are unneeded. Already drilled, if owned by City, Banning would not have to acquire property, water rights and incur the costs to drill.

Following the death of Alfred Dysart, the founder of Mountain, his family eventually concluded that the water system should be sold. In February of 1996, Delton J. Dysart (Dysart), who has managed the system in the intervening years since Alfred's death, approached both the Banning City Manager and Paul McAndrews, District's president, offering to sell. Banning's Public Works Director Paul Toor, a licensed professional engineer, was directed to contact Dysart. Discussions followed.

Dysart meanwhile had concluded that a sale to Banning would be preferable, both to Mountain's customers and to the Dysart family with its extensive real estate holdings in the area at issue. His conclusion was that the City could provide much more reliable water service and with its greater financing capability could better provide for infrastructure, replacements, and repairs, whereas District, with its extremely high rates and taxes would be a poor supplier. Accordingly, on February 26, 1996, Dysart offered to sell to Banning. On March 12, 1996, after considering terms on three separate occasions, and after its staff had inspected the system and its books, and based upon Toor's professional analysis, Banning's City Council accepted Dysart's offer. The basic terms were memorialized in an "Acceptance of Offer of Sale of Mountain Water Company by the City of Banning" executed by the parties as of March 22, 1996. The agreement gave Banning the option to pay the full $875,000 purchase price within one year or allow the City to finance the purchase over a period of 10, 20, or 30 years.

On March 25, 1996, Dysart wrote to McAndrews confirming their March 23, 1996 telephone conversation wherein Dysart informed District of the family's commitment to sell to Banning.

On April 2, 1996, Dysart wrote the City, stating that Mountain had been operating at a loss for the past three years, and that in the event the proposed sale did not go through, Mountain would be applying to the Commission for a general rate increase of at least 33% to offset operating costs.

On April 23, 1996, Banning filed with the Riverside County Clerk a Notice of Exemption wherein it stated that the purchase project, posing no environmental problems (the water system remaining the same without expansion or upgrades), the Project was categorically exempt pursuant to Sections 15301 and 15302 of the implementing regulations under the California Environmental Quality Act (CEQA) of 1970 (Cal. Public Resources Code §§ 21000, et seq.)

Thereafter Banning's staff, assisted by retained outside counsel, and Mountain jointly prepared an application to be submitted to the Commission to obtain approval of the sale and transfer. With prior public notice in the Record-Gazette (a paper of general circulation in the Banning area) of public hearing, the Banning City Council after such public hearing in the City Council Chambers on May 14, 1996, unanimously adopted Resolution No. 1996-62 requesting the Public Utilities Commission to approve the sale of Mountain to Banning. The Council provided further that a copy of the parties' joint application would be made available in the City Clerk's office for public inspection.

Application 96-07-037

On July 9, 1996, Banning and Mountain filed Application (A.) 96-07-037 with the Commission. Seeking an ex parte order, the application, inter alia, recites a purchase price of $875,000; the fact of a $10,000 good faith deposit; provision for payment of $150,000 of the purchase price to be paid upon closing with the remainder to be paid with 8% per annum interest within 12 months of closing unless a Supplemental Agreement is entered by the parties; and includes Banning's agreement to honor the

Mountain obligation to serve District as set forth in the agreements of August 29, 1972 and March 8, 1992. The application notes that even if the transfer did not materialize, Mountain would require a 30% increase in order to reach a break-even point as it currently is operating at a loss. But with an authorized transfer, a reliable supply of water to the present Mountain customers would be attained with a small increase in rates spread over four to six years, and that these new rates would not at any time exceed the rates paid Banning by Banning's existing customers.

As an additional consideration to the Dysarts, by the application Banning would agree to waive water meter capital connection fees within the Mountain service area for residential housing developed by members of the Dysart family. The waiver would expire when the aggregate amount reached $1 million or the expiration of 30 years following close of escrow.

Banning also acknowledged that Mountain Air Mobile Home Estates (approved for 201 lots with 131 already constructed) purchases water through a master meter, and may continue development with all distribution facilities beyond the meter belonging to Mountain Air, subject to a 30-year limit to complete the additional submetering.

Apart from the public notice provided in the Record-Gazette of the Banning City Council meeting of May 14, 1996, and public opportunity provided by that Council meeting during which the Council considered and authorized the application to be jointly submitted together with Mountain to the Commission, and the Council's action in providing a copy of the joint application in the City Clerk's office for public inspection, notice of the filing of the joint application appeared in the Commission's Daily Calendar of July 29, 1996. No protests or comments were received by the Commission during the 30-day period provided for such by the Commission's Rules of Practice and Procedure.

However, well after the protest period, by a letter dated October 25, 1996, District stated its concerns that if the City assumed control of Mountain, Banning might increase rates to District inconsistent with the terms of District's March 8, 1972 supply agreement with Mountain. Accordingly, District requested to be allowed to participate in any future process on the joint application.

Staff Advice of Participation

On August 14, 1996, the Small Water Branch of the Commission staff, noting that the proposed purchase price was more than twice the total capitalization of Mountain, and concerned that this would raise important issues relating to valuation of utility plant, sought time to prepare a report.[5] However, no report was submitted.

Mountain Water Company's September 27, 1996 Advice Letter

On September 27, 1996, Mountain filed a "Draft Advice Letter" seeking authorization to increase its rates by 62.8% in 1997 so as to attain a 10% rate of return.

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[5] Although the Commission's jurisdiction in water utility acquisitions does not extend to municipally owned utilities, the Small Water Branch was concerned that a purchase price so substantially in excess of Mountain's rate base (rate base being the purchase price benchmark usually urged by Branch in sale-transfer of privately owned water utilities to another privately owned utility purchaser) would serve to weaken Branch's posture in private venture transfer proceedings, and sought delay while urging Banning to obtain an outside appraisal. Banning was persuaded, and engaged the appraisal services of Montgomery-Watson Engineering. Different considerations motivate and govern municipal utilities than do privately owned utilities. The appraiser focused on the value of an acquisition to Banning rather than upon the value of the assets to Mountain. The City's earnings from acquisition will not be based upon historical cost less depreciation. Moreover, depreciated replacement costs for the very desirable wells in being provide a more accurate estimate of the City's avoided future construction costs than do depreciated historical costs.

The appraiser concluded that since the City's operating costs after integration would be less than Mountain's (both from Banning's access to lower cost electricity and operating economies of scale), a Capitalized Earnings valuation based upon the difference between expected rate revenues and reduced cost of service would be appropriate. In addition, Mountain's assets can also be used to serve City's customers outside the city and outside Mountain's service area, so that the City would be investing in assets it otherwise would have to construct. But the appraiser also gives some weight to Reproduction Cost Less Depreciation (RCLD) since some of the City's motivation for purchase goes beyond the expected cash flows. The purchase furthers Banning's goal of providing water supplies throughout the City, thereby ensuring greater service reliability for all residents; improves operation flexibility by integration; integrates water service planning with land-use planning, and increases fire flows.

The appraiser calculated RCLD valuation for both the North and South Mountain systems was approximately $2,640,000. The Capitalized Earnings valuation for both was $1,680,000. Using 10% of the RCLD valuation and 90% of the Capitalized Earnings valuation, the appraiser opinioned the overall asset value to Banning to be $1,776,000. This asset value to Banning is approximately double the agreed upon $875,000 purchase price.

Notice of the proposed increase and date of a public meeting on the increase was provided each Mountain customer by mail. Approximately 70 customers attended the December 5,1996 meeting. Twenty of these protested the magnitude of Mountain's requested increase. A Small Water Branch representative attended and explained the Commission's ratesetting procedure.

In January 1997, Branch issued its report following its independent analysis. Branch's analysis provided a different view of revenues, operating expenses, and rate base from that offered by Mountain. Mountain decided to adopt Branch's view which provided for a 35.09% increase resulting in the 10% rate of return sought by Mountain. Branch's analysis retained the 33% service charge recovery of fixed costs already provided by Mountain's existing rate design because that recovery was almost identical to present residential charges of Banning. By keeping the same rate, Staff concluded there would be little or no impact on Mountain's customers when the application sale would take place. The quantity rate for all water used was set at $0.865 per 100 cubic feet.

On February 5, 1997, By Resolution W-4023, the Commission authorized Branch's version which provided for additional annual revenues of $53,963 in 1997 for Mountain, and brought its rate of return to 10%.

Effect of Resolution W-4023 on the Application

The effect of the new Mountain rate was to bring it into line with Banning's existing rates. Banning operates a three-tiered rate structure based upon amount consumed. The new Mountain rate is almost precisely the average of Banning's three-tiered rates.[6] Before Resolution W-4023, the jointly filed application indicated that

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[6]

Banning Rates for Consumption	Quantity Rate/Ccf
0 Ccf to 9 Ccf	$0.750
10 Ccf to 29 Ccf	0.880
over 30 Ccf	0.950
Mountain Water Company rates for consumption	$0.865

Banning might be required to institute a rate increase if it acquired Mountain and that increase would be spread over four to six years. Now, with the two systems approximately in line, Banning indicates that there is no need for any rate increase at this time, and none is anticipated, other than increases reflecting increases in the Consumer Price Index, over the next three to five years. These would apply to the City's existing customers and Mountain's erstwhile customers including District.

The February 13, 1997 Prehearing Conference

Although in the absence of a timely filed protest, there existed no legal or procedural impediment to processing the joint application ex parte, Administrative Law Judge (ALJ) John B. Weiss set a prehearing conference to afford all interested parties opportunity to learn what they wanted to about the application, and to place on record their comments. Banning and staff wanted to clarify the purchase price considerations. District wanted clarification on Banning's intentions with regard to the Mountain-District 1972 Agreement. The conference was conducted in Los Angeles on February 13, 1997, and representatives from Banning, Mountain, District and Staff participated.[7] The ALJ accepted Closing and Reply Briefs. Upon receipt of the latter on March 14, 1997, the matter was submitted for decision.

Discussion

PU Code § 851 provides that no public utility other than a common carrier by railroad may sell the whole or any part of its system necessary or useful in the performance of its public duties without first having obtained authorization to do so from this Commission.

While Banning and its municipal water system are not now and never have been subject to the jurisdiction, regulation, supervision, or control of the Commission, the

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[7] At the conference, District asserted it did not file a protest because it was misled by Banning's repeated assurances March 25,1996, May 7, 1996, September 25, 1996, and in the application, that Banning would continue to provide water service to District in accord with the 1972 Agreement.

City joins public utility Mountain in this application for the limited purpose of satisfying the requirements of Rule 35 of the Commission's Rules of Practice and Procedure.

In the usual private investor transfer and sale proceeding, the function of the Commission is to protect and safeguard the interest of the public. The concern is to prevent impairment of the public service by the transfer of utility property and functions into the hands of parties incapable of performing an adequate service at reasonable rates or upon terms which would bring about the same undesirable result (*So. Cal Mountain Water Co.* (1912) 1 CRC 520).

The Commission wants to be assured that the purchaser is financially capable of the acquisition and of satisfactory operation thereafter; that the ratepayers in both entities will not be harmed by the transaction, and that the result will be in the overall public interest. If the Commission considers it necessary, it may impose conditions upon its approval of the proposed sale and transfer, and unless the parties accept these conditions, the proposed sale and transfer cannot be consummated.

But where the proposed sale and transfer is to a municipality, its corporation, or to another governmental entity, our consideration necessarily differs. A City's operation of its water system is not within the jurisdiction of this Commission, the Legislature not having exercised its constitutional authority to grant the Commission such jurisdiction. While in a <u>voluntary</u> sale of a regulated public utility to a municipality, the valuation must be subject to Commission approval, the Commission's interest as to the purchase price is limited. If the Commission deems the price to be so unreasonably high that it could create an untenable and precarious financial condition for the City as would serve to jeopardize future operations, adequate service, or force unreasonable or discriminatory rates for the erstwhile public utility customers, the sale could be considered to be adverse to the public interest. The Commission may in such instance elect either to refuse approval of a voluntary sale, or impose conditions

However, even if whatever the circumstances the Commission denied authorization for a voluntary sale, or imposed conditions, a city can abandon the proposed voluntary sale acquisition, and proceed unilaterally to simply take the public

utility property by eminent domain (Code of Civil Procedure § 1240.010). In such case, the Superior Court determines the just compensation to be paid to the public utility by the city, and the Commission has no standing and is not even entitled to be heard, either on its own behalf or on behalf of the public utility customers involved (*People ex rel. PUC v. City of Fresno* (1967) 254 Cal.App.2d 76; petition for hearing denied by Supreme Court November 22, 1967).

The Commission in this proceeding does not conclude that a basis exists for either denial of the application or for the imposition of conditions.

While the purchase price agreed upon by the parties is substantially in excess of the rate base proposed by our staff and recently adopted by the Commission in Resolution W-4023, a city council and its professional staff is better qualified than this Commission to determine the City's requirements and the value to the city of the proposed acquisition.[1] The price a city is willing to pay is a discretionary matter for the Council to determine, and the terms are a matter for the parties to agree upon.

Banning is a long established General Law California city that for the past 33 years has operated and maintained its own municipal water system, and today serves over 8,000 customers. Its Public Works Department is well staffed and headed by a licensed professional engineer with degrees in civil engineering and public

[1] The City's experienced professional manager of its water department operations and its appraiser stressed that the measure of an appropriate purchase price was the value to the city and not rate base. A significant factor to them both was that staff's rate base evaluation (taken from Resolution W-4023) had excluded the costs of two new deep wells recently drilled by Mountain; staff having concluded that these represented excess capacity for Mountain's present needs and should be excluded from rate base. Banning's manager stated that staff's valuation of theses excluded wells was substantially less than what City's cost would be to acquire sites, dig the wells, and equip them in that arid area. The wells provide capacity the City would otherwise have to obtain were there no sale. Some other considerations were that Banning's existing staff suffice to operate the integrated system (a savings of almost $80,000); pumping costs would be lower; the City's fire insurance ratings would improve, and the City gains the ability to influence its long-term growth and development.

administration. The Water Department's annual budget is $3.9 million. The City's present sphere of influence includes approximately 24,000 persons, with a projected ultimate development to approximately 60,000 people. The City anticipates it will incur approximately $126,000 in annual debt services over 10 years to finance the acquisition of Mountain under one financing mechanism it might use, borrowing the purchase price (if the Water Department elects to pay the full-purchase price to the Dysart family within one year) from the city capital funds. Or the City may elect to finance the purchase, paying the Dysarts over a 10, 20, or 30-year period, making its payments through additional revenues generated by the purchase. The City believes it can cover virtually all of the debt service attributable to the purchase price through the differential between the revenue streams (now that Mountain's current rate is the average of Banning's rates) and lowered operating costs reflecting efficiencies, economics of scale,[9] and repairs to Mountain's system.

Banning stated that it will not have to raise the rates to Mountain's customers (including Mountain's District customer) above the $0.865 per Ccf presently charged by Mountain (this the result of February 1997 increase authorized by Resolution W-4023 to bring Mountain's rate of return closer to the norm for Class D water utilities). Banning repeatedly has stated it can hold these rates for three to five years, subject only to the same Consumer Price Index (CPI) increments which would be available to Mountain were there to be no acquisition. Since rates will not change for this initial period, and as

[9] The City will integrate the Mountain system into its own and operate both with City's present employees. It will not have to operate the Mountain system as a stand-alone system which would be the case if another buyer was involved. The Dysart personnel presently operating Mountain are part-time employees of Dysart's 5,000-arce ranch, and after the purchase will be employed only on the ranch. With lower electric costs for pumping and reduced outlay for management salaries, additional economies are achieved. The City will also utilize its canyon shallow wells to the optimum, reserving as possible Mountain's deep wells to take advantage of lower pumping costs.

all future rate settings after acquisition would be determined by the Banning City Council, and as such Council rates must be fair, just, and non-discriminatory (*American Microsystems Inc. v. City of Santa Clara* (1982) 137 CA3d 1037, 1041), Mountain's present customers, including the District, are reasonably sure of fair treatment.[10]

District, while it filed no timely protest, now opposes Commission approval of the application, or in the alternative seeks a conditioned approval to require prior Commission approval for future Banning rate increases. It argues that it relies upon the terms of its Commission approved 1972 agreement with Mountain for its sole source of water supply, and that approval of the application and transfer of Mountain's assets to Banning would be an unlawful breach of the 1972 agreement and an unconstitutional impairment of contract in that a City council determination of future rates shifts the burden of proof on increases to District and changes the standard of review from the Commission's independent judgment to Superior Court abuse of discretion. As District stated in its October 25,1996 letter, Banning "may attempt to increase the rates for water delivered to the District in a manner inconsistent with the terms of the District's contractual arrangements."

District's contentions fail because no perpetual right was granted District by Commission approval of the 1972 contract; rather our approval was merely an affirmation of the law that under provisions of PU Code § 454, as a regulated public utility, Mountain would require prior Commission authorization for future rate changes. Paragraph 3 of that agreement clearly set forth that rates "may be changed as said Commission may, from time to time, direct in the exercise of its jurisdiction." But the Commission's jurisdiction ceases when a sale and transfer to a municipality is

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[10] District's water system, located where it is and across the higher elevations involved, necessarily will always be a high cost operation. But its residents made the election to reside where they do, and must accept the fact that as water purchasers, they cannot reasonably expect others to subsidize their high cost operation with water at rates less than the rates provided the water purveyor's own residents.

authorized. Paragraph 7 of the agreement contemplated changes or modifications as the Commission might direct in the agreement in the exercise of its jurisdiction.

As time passes, conditions and circumstances change. And when in the discretion of the Commission the overall public interest is better served, even though the result is to pass jurisdiction to another governmental agency as we conclude to be desirable in the present situation, prior Commission orders or decisions may be rescinded, altered, or amended so as to obtain this result."[11] Here, although despite notice, District was not a timely protestant, there was a noticed opportunity afforded by the ALJ to be heard, and both District's attorney and president eloquently pleaded their position, and amplified these views on briefing. While judicial review of the rates set by a City council may not provide protections comparable to the rate proceedings conducted under the jurisdiction of the Commission,[12] as the California Supreme Court observed in *County of Inyo v. Public Utilities Commission* (1980) 26 C3d 154, the Court still concluded that established doctrine declares that "In the absence of legislation otherwise providing, the Commission's jurisdiction to regulate public utilities extends only to the regulation of privately owned utilities." The Court concluded that there was no statutory authority which sanctioned Commission power to exercise a bifurcated rate regulation leaving a city the power to fix water rates for its residents and delegating to the Commission the power to fix rates for non-residents.

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[11] PU Code § 1708 provides: "The commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order of decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision."

[12] Under Commission jurisdiction, an independent expert staff investigates and recommends while the Commission renders an independent decision on the record. Under Superior Court jurisdiction, rates established by the rate setting City council are presumed to be reasonable (*Hansen v. City of Buenaventura* (1986) 42 C3d 1172, 1180), and a protestant bears the burden of proof that the rates set by a city are "unreasonable."

The 1972 Mountain-District agreement as approved by the Commission, included a provision that the rates for such service would be set by this Commission. Those who made that contract with those provisions necessarily had to have made it always subject to the power of the Commission at a later time to terminate them should the Commission deem such termination of the provisions desirable in the overall public interest. As the United States Supreme Court in *Sutter Butte Canal Co. v Railroad Commission* (1929) 279 US, 125, 49 Sup. Ct. 325, 13 L.Ed. 637, observed, such contracts are made subject to the possibility that even if valid when made, the Commission might by exercising its power, tender them invalid.

Accordingly, even if Banning fully intended to defer rate setting to the Commission after consummation of the sale and transfer, *County of Inyo* supra makes it clear it could not do so nor could the Commission accept the responsibility. And as the Commission concludes that a sale and transfer of Mountain's public utility water system to Banning, and the operation and maintenance of the system thereafter by Banning, would all be in the overall public interest, the Commission will exercise its power to invalidate the requirement in the 1972 agreement that the Commission determine the rates District should pay. As was made clear in *Durant v. City of Beverly Hills* (1940) 39 Cal.App.2d 133, 138, Banning must continue to supply water to District, but that obligation is only to supply it at a reasonable cost. District cannot lose its source of water supply.

Finally, we observe that this sale and transfer would be in accord with the Commission's long-term objective of integrating small Class D water systems into larger, more economically viable systems (see Resolution M-4708 (8/28/79)). The sale and transfer should be authorized, even though it invalidates further application of the Commission's rate setting role in determination of rates to District under Banning administration.

Comments on the Proposed Decision of the Administrative Law Judge

As provided by PU Code § 311, the Proposed Decision of ALJ Weiss was served on the parties to this proceeding. Banning and District submitted comment. Banning

urged the Commission to adopt and publish the Proposed Decision to provide guidance for forthcoming sales of public water utilities to municipalities. Banning further noted certain typographic errors which have been corrected. District's comment, apart from providing date corrections to footnote 7, which corrections have been made, would repeat at greater length and loquacity elsewhere in the Opinion the same information summarized in the footnote. As discussed in the Opinion, District's asserted reliance upon Banning's statements in no way prevented District's full participation at the hearing and on briefing. While beneficial to District, the provisions of the 1972 Agreement, constituting no perpetual rights, could remain valid only so long as the Commission chose to exercise its jurisdiction, and herein are terminated by the Commission's authorization of the sale and transfer which determine to be in the overall public interest. District retains a right to be supplied with water, but subject to Banning's future rate determinations.

Reply comment was filed by Banning. Its assertions to the point that Commission jurisdiction terminates with transfer of the system to a municipality are sufficiently addressed in the Opinion.

Findings of Fact

1. Mountain is a private investor owned water public utility under Commission jurisdiction providing water service to approximately 235 residential customers within and outside of Banning, and to District, all in Riverside County.

2. District, a customer of Mountain served via a master meter pursuant to a 1972 supply contract, is a California Water District serving approximately 200 customers located in a sprawling high elevation area adjacent to Mountain. With high bonded debt and a difficult system to maintain with no independent water source, District is a high cost system.

3. Banning, a California General Law municipal corporation, since 1963 has owned and operated a water system in and adjacent to the City serving approximately 24,000 customers.

4. Banning has long been interested in acquisition of Mountain, as acquisition would be beneficial to implementation of its master plan for development in its sphere of influence and to provide a better balanced water supply system.

5. The Dysart family desires to sell Mountain, and following an initial approach to both Banning and District, determined to offer Mountain to Banning, deeming a sale to the city to be the most beneficial both to the Dysart family and Mountain's customers.

6. Banning after investigation accepted the Dysart offered purchase price of $875,000.

7. The purchase price exceeding the Mountain rate base (as determined by Staff to be less than half the purchase price), Staff urged Banning to employ an outside appraiser before proceeding.

8. An independent professional appraisal firm, basically using as its guide the value of Mountain to the City, rather than the rate base value to Mountain, concluded on various methods including principally Capitalized Earnings but also Reconstruction Cost Less Depreciation, that the asset value to Banning, all things considered, would be $1,776,000.

9. On September 27, 1996, having had no general rate increase since March of 1992, and operating at loss, Mountain by Advice Letter sought an increase in revenues to provide a rate of return not to exceed 10%. After Staff investigation and a December 1996 public meeting, Mountain accepted Staff's summary of earnings and recommended rate schedules, and by Resolution W-4023 issued on February 5, 1997, the Commission authorized a 10% rate of return with a quantity rate applicable to all customers of $0.865 per Ccf.

10. On July 9, 1996, Banning and Mountain filed the captioned application seeking a Commission authorization for a sale and transfer of Mountain's water system to Banning.

11. Although there was public notice of Banning's intention in a local area newspaper, availability of the application in the City Clerk's office, and notice in the Commission's Daily Calendar of July 29, 1996, no protests or comments were received

during the formal protest period provided by the Commission's Rules of Practice and Procedure.

12. On October 25, 1996, District wrote to state its concerns that if Banning acquired Mountain, Banning might increase rates to District inconsistent with terms of the 1972 Mountain-District agreement.

13. Despite lack of any legal or procedural impediment to proceeding ex parte, with concurrence of Banning and Staff and after notice to all including District, the ALJ conducted a prehearing conference on February 13, 1997, to allow all to raise questions and present views, followed by opportunity for closing and reply briefing.

14. The purchase price that Banning has agreed to pay reflects a reasonable estimate of the value to Banning of an acquisition of the Mountain system.

15. The financing plans of Banning indicate that revenues to be collected at present rates will suffice, except for an initial small city subsidy, to cover operating expenses, pay the debt service on financing to acquire Mountain, and enable Banning to make some repairs.

16. The rate setting provisions of the 1972 Mountain-District water supply agreement cease upon a sale and transfer to Banning of the Mountain system, as the Commission will lose all regulatory jurisdiction over the provision of water to the service area and all customers of Mountain; after consummation of the sale and transfer, jurisdiction to determine all future rates and charges rests with the Banning City Council.

17. Banning assures that after acquisition of Mountain, it will apply the average of the City's present three tier rate structure, $0.865, as the quantity charge to Mountain customers, including the District through its master meter.

18. Banning assures that apart from any CPI increments, it will not increase rates above $0.865 for a three to five-year period.

19. Without any consideration as to the reasonableness of the purchase price to be paid, the Small Water Branch recommends that the sale and transfer be authorized on condition that the rates to be charged Mountain's erstwhile customers not exceed rates charged Banning's other customers.

20. Imposition of any rate conditions to Commission authorization is unnecessary as any City Council determined rates must be fair, just, and non-discriminatory by judicial determination, and imposition of any such condition could be counterproductive in that rather than accept them, Banning could merely abandon the application to the Commission and proceed in eminent domain to immediately take possession without any conditions or assurances.

21. The acquisition of Mountain by Banning is not adverse to the public interest.

22. Other concerns of District are not within the jurisdiction of the Commission.

Conclusions of Law

1. Banning has statutory capacity to acquire Mountain, either through a voluntary purchase subject to Commission authorization, or by eminent domain proceedings.

2. With a Commission authorized voluntary sale and transfer to a municipality, the Commission loses all jurisdiction over provision of water and rates with respect to the acquired public utility and its customers.

3. The erstwhile customers of the acquired public utility continue to be entitled to water service at rates which must be fair, just, and non-discriminatory, and have recourse to Superior Court.

4. There is no statutory authority which sanctions Commission power to exercise a bifurcated rate regulation leaving a city the power to fix water rates for its residents and delegating to the Commission the power to fix rates for non-residents.

5. The application should be approved as set forth in the order that follows, and upon consummation of the sale and transfer, the certificate of public convenience and necessity held by Mountain should be cancelled.

O R D E R

IT IS ORDERED that:

1. Within three months after the effective date of this order, the City of Banning (Banning) may purchase and acquire from Mountain Water Company (Mountain) the latter's water system.

2. Within 10 days of the actual transfer, Mountain shall notify the Commission in writing of the date on which the transfer was consummated. A true copy of the instrument effecting the sale and transfer shall be attached to the written notification.

3. Mountain shall make remittance to the Commission of the Public Utilities Reimbursement Fees collected to the date the sale and transfer is consummated.

4. Upon completion of the sale and transfer authorized by this Commission order, Mountain shall stand relieved of its public utility water service obligations, and its certificate of public convenience and necessity shall be cancelled.

5. Application 96-07-037 is closed.

This order is effective today.

Dated July 16, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners