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Decision 97-12-011 December 3, 1997

**ORIGINAL**

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California Water Service Company (U 60 W), a corporation, for an order authorizing California Water Service Company to form a holding company structure.

Application 96-12-029  
(Filed December 13, 1996)

## O P I N I O N

### Summary

This order approves the settlement agreement between Commission's Water Division and California Water Service Company (Cal Water). The settlement agreement authorizes Cal Water to reorganize into a holding company structure subject to several conditions.

### Procedural Background

On December 13, 1996, Cal Water filed its application seeking Commission authorization to form a holding company structure. Cal Water stated that such a structure will permit the separation of regulated and non-regulated businesses, without diminishing the Commission's ability to regulate effectively the utility's operations and without any adverse effect to customers.

On September 23, 1997, the assigned Administrative Law Judge held a prehearing conference where the parties reported that they had reached a mutually acceptable settlement agreement. The parties filed a motion requesting that the Commission adopt the settlement agreement and the agreement itself on that same day.

Also at the prehearing conference, the California Water Utility Council intervened as an interested party. With the agreement of the other parties, the Council received a copy of the settlement agreement which the Council agreed to review expeditiously and forward any comments. On September 30, 1997, the Council filed its letter indicating that it supported the settlement agreement.

### **Description of the Settlement Agreement**

The major provisions of the settlement agreement are:

1. Cal Water will provide the Commission access to its directors, officers, and employees for Commission inquiry into utility operations. Cal Water will also provide the Commission access to its books and records. In addition, Cal Water will file an annual report summarizing all transactions between the regulated and unregulated portions of the holding company.
2. Cal Water will maintain a capital structure, including dividend policy, that is consistent with Commission decisions. The regulated utility shall issue only its own debt and shall not guarantee any debt of the unregulated companies.
3. Common costs shall be allocated in a manner consistent with Commission decisions.
4. Assets and goods transferred from the utility to any affiliate shall be priced at cost or fair market value, whichever is higher. Assets and goods transferred to the utility from an affiliate shall be at the lower of cost or market.

### **Discussion**

Commission Rule of Practice and Procedure 51(e) requires that settlement agreements be (1) reasonable in light of the whole record, (2) consistent with the law, and (3) in the public interest to be approved by the Commission.

#### ***a. Reasonable In Light of the Whole Record***

The record in this case reveals that Cal Water sought Commission authorization to restructure its corporate organization into a holding company with various subsidiaries, including the regulated water utility. The primary purpose of the settlement agreement was to set forth the business practices that would govern the transactions between the regulated utility and other members of the corporate family. To this end, the settlement agreement (1) specifies the procedures for prompt and fair compensation or reimbursement for all assets, goods, and services transferred between the water utility and its affiliates, (2) provides reasonable assurance that the utility will be able to maintain its financial strength so as to fulfill its public utility obligations, and (3) affords the Commission sufficient oversight to meet its regulatory responsibilities. The record, therefore, supports the finding that the settlement agreement imposes

reasonable conditions necessary to protect Cal Water's customers, while allowing Cal Water sufficient discretion in structuring its business.

**b. Consistent with the Law**

None of the actions required by the settlement agreement are in violation of any statute or Commission rule or regulation.

**c. In the Public Interest**

The Commission is responsible for ensuring that the public is protected from excessive or improper charges by monopoly service providers. As the detailed settlement agreement reveals, the Commission staff has undertaken an in depth issue-by-issue analysis of Cal Water's proposed corporate structure and has imposed conditions as needed to protect customers. At the same time, the proposed settlement agreement provides Cal Water with sufficient leeway to determine its own organizational structure.

For these reasons, the Commission finds that the settlement agreement is reasonable in light of the whole record, is consistent with the law, and is in the public interest. The agreement is approved pursuant to Rules 51 through 51.10 of the Commission's Rules of Practice and Procedure. (See also *San Diego Gas & Electric*, 46 CPUC 2d 538 (1992)(rules for all-party settlements).)

**Findings of Fact**

1. Cal Water filed this application on December 13, 1996.
2. A prehearing conference was held on September 23, 1997.
3. The parties filed a proposed settlement agreement on September 23, 1997, and the interested party filed its comments supporting the settlement agreement on September 30, 1997.
4. The settlement agreement provides for conditions on water utility's business relationships with its corporate affiliates.
5. The settlement agreement resolves all matters relating to this proceeding.

**Conclusions of Law**

1. The settlement agreement is reasonable in light of the whole record, is consistent with the law, and is in the public interest.
2. The settlement agreement should be approved.
3. The conditions on corporate structure and business relationships provided in the settlement agreement should be effective until further order of the Commission.

**O R D E R**

Therefore, **IT IS ORDERED** that:

1. The settlement agreement affixed hereto as Attachment A and made a part hereof is approved, and the parties are directed to comply with the terms set forth in the settlement agreement.
2. This proceeding shall be closed.

This order is effective today.

Dated December 3, 1997, at San Francisco, California.

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

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California Water Service Company (U 60 W), a corporation, for an order authorizing California Water Service Company to form a holding company structure.

Application A. 96-12-029  
(Filed December 12, 1996)

SETTLEMENT AGREEMENT

Mr. Francis S. Ferraro  
Vice President - Regulatory Affairs  
California Water Service Company  
1720 North First Street  
San Jose, California 95112-4598

William J. Newell, Esq.  
McCutchen, Doyle, Brown & Enersen, LLP  
One Embarcadero Place  
2100 Geng Road  
Palo Alto, California 94303  
Attorneys for Applicant

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The parties ("Parties") to this Settlement Agreement ("Settlement Agreement") before the California Public Utilities Commission ("Commission") are Applicant, California Water Service Company ("Utility"), and the Water Division of the Commission ("Water Division").

In addition, since this Settlement Agreement represents a compromise by them, the Parties have entered into the Settlement Agreement on the basis that its approval by the Commission not be construed as an admission or concession by any Party regarding any fact or matter of law in dispute in this proceeding.

This Settlement Agreement is subject to the approval by the Commission. Concurrent with the Settlement Agreement the Parties are filing a joint motion with the Commission requesting its approval. The Parties agree to provide, or to cooperate in providing, such additional information, documents and testimony that may be required by the assigned Administrative Law Judge or the Assigned Commissioner to obtain a grant of said motion and adoption of the Settlement Agreement.

The Parties further agree that by entering into this Settlement Agreement, they are not waiving any legal rights they may have against any other party to this Settlement Agreement in a proceeding that is now pending before this Commission, or which may be asserted in the future except to the extent that the assertion of such a claim conflicts with or would tend to undermine this Settlement Agreement.

The Parties agree that the California Public Utilities Commission shall have jurisdiction over this Settlement Agreement, and that any party seeking interpretation of this Settlement Agreement, enforcement of this Settlement Agreement, or the assertion of rights pursuant to this Settlement Agreement shall seek redress first from the California Public Utilities Commission.

The Parties agree that no signatory to this Settlement Agreement nor any member of the staff of the Commission nor any employee of the Utility assumes any personal liability as a result of this Settlement Agreement. The Parties agree that no legal action may be brought by any

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party in any state or federal court, or any other forum, against any individual signatory representing the interests of any of the Parties. All rights and remedies of the Parties with respect to this Settlement Agreement are limited to those available before the Commission.

This Settlement Agreement shall not establish, be interpreted as establishing, or be used by any party to establish or to represent their relationship as any form or agency, partnership or joint venture. No party shall have any authority to bind the other or to act as an agent for the other unless written authority, separate from this Settlement Agreement, is provided.

The Settlement Agreement shall be governed by and interpreted in accordance with the laws of the State of California and in accordance with the rules, regulations and General Orders of the California Public Utilities Commission.

All issues between the Parties have been resolved. The Parties have agreed that no issues remain to be resolved through litigation.

**I. Introduction**

The purpose of this Settlement Agreement is to set forth the business practices to be observed in the relationship between (a) the Utility, on the one hand, and (b) its holding company and its regulated and non-regulated affiliated companies, on the other hand. All transactions between these entities are to be guided by the policies and guidelines stated in this Settlement Agreement.

Additionally, the Settlement Agreement is intended to: (a) establish procedures for prompt and fair compensation or reimbursement for all assets, goods and services transferred between the Utility and its affiliates, including the Holding Company, (b) provide reasonable assurance that the Utility is able to maintain its financial strength so as to reasonably fulfill its public utility obligations, and (c) permit the Commission to fulfill its regulatory responsibilities.

**II. Access To Directors, Officers And Employees**

The Directors, Officers and Employees of the Utility and its affiliates, including the Holding Company, shall be available to appear and testify in Commission proceedings in

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connection with any proceeding involving the Utility. The Officers and Employees of the Utility and its affiliates, including the Holding Company, shall be available for staff consultations as necessary or required.

**III. Access To Books And Records**

The Utility and its affiliates, including the Holding Company, will provide the Commission, its staff, and its agents acting on its behalf with access to the books and records of the Holding Company, and each affiliate, in connection with the Commission's exercise of its regulatory responsibilities.

**IV. Annual Report**

On an annual basis the Utility will file with the Commission, prior to the last working day in May of each year, an annual report that will include:

A. The annual consolidated financial statements of the Holding Company as reported on Form 10K to the Securities and Exchange Commission. The Utility shall also provide workpapers that reconcile the Holding Company's Form 10K filing with the Holding Company's, the Utility's and each affiliate's general ledgers for the previous calendar year.

B. A summary statement of all affiliated transactions between the Utility and its affiliates, including Holding Company, for the previous calendar year. This summary statement shall include a description of the transaction(s) and an accounting of all costs associated with the transaction(s). However, the summary statement is not intended to identify each and every transaction where multiple transactions occur in the same account. These transactions shall include:

1. Services provided by the Utility to any affiliate, including the Holding Company.
2. Services provided by any affiliate, including the Holding Company, to the Utility.



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3. Assets transferred from the Utility to any affiliate, including the Holding Company.
4. Assets transferred from any affiliate, including the Holding Company, to the Utility.
5. Employees transferred from the Utility to any affiliate, including, the Holding Company.
6. Employees transferred from any affiliate, including the Holding Company, to the Utility.
7. Financing arrangements and transactions between the Utility and its affiliated companies, including the Holding Company.

C. A copy of all periodic reports filed with the Securities and Exchange Commission during the previous year.

**V. Capital Requirements**

The capital requirements of the Utility shall be given first priority by the Utility and the Holding Company's boards of directors.

**VI. Capital Structure Of The Utility**

The Utility shall maintain a balanced capital structure consistent with that determined to be reasonable by the Commission in its most recent decision on the Utility's capital structure and, to the extent the Commission determines that the Utility has not maintained a reasonable capital structure, the Holding Company shall provide or cause to be provided equity capital to restore such capital structure.

**VII. Issuance Of Debt By The Utility**

The Utility will continue to issue its own debt.

**VIII. Issuance Of Debt For Affiliates**

A. Holding Company debt and debt of other affiliates shall not be issued or guaranteed by the Utility without prior approval by the Commission.

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B. Commission approval is not required for the Holding Company debt issuances or debt issuances of other affiliates unless such debt is guaranteed by the Utility or secured by the Utility's assets.

C. Long-term loans to the Utility by the Holding Company or any other affiliate require prior approval by the Commission.

**IX. Dividend Policy**

The dividend policy of the Utility will continue to be established by the Utility's board of directors as though the Utility were a stand-alone utility company.

**X. Accounting Requirements**

The Utility and each of its affiliates, including the Holding Company, will maintain their accounting records in accordance with Generally Accepted Accounting Principles and, where appropriate, consistent with the Commission's Uniform System of Accounts.

**XI. Allocation Of Common Costs**

The Utility and each of its affiliates, including the Holding Company, shall allocate costs between them consistent with the Commission's allocation policy for water utilities. Historically, the Commission has authorized allocation methodologies on a case by case basis. While this has resulted in various authorized methodologies, the Commission's underlying philosophy has remained unchanged: ratepayers of the utility should not subsidize affiliates of the utility. Some examples of the Commission's authorized allocation methods are: (a) three factor allocation (customers, expenses, and revenues), (b) all revenues and expenses above the line and a management fee paid to shareholders, and (c) all non-utility revenues and expenses below the line. Generally, the Commission has found services that are direct charged and shared services that are allocated based on a cost causation factor to be reasonable for ratemaking purposes. As a result of Water Division sponsored workshops on cost allocation methodologies the Commission is expected to issue an Order Instituting Rulemaking this fall. Under consideration is a new

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allocation philosophy: maximization of utility resources to benefit both ratepayers and shareholders.

A description of the Utility's current allocation procedures is contained in the Utility's Application. The Utility states that its allocation procedures are in accordance with the Commission's current policies and will be maintained in accordance with the Commission's future policies. The Utility and Water Division acknowledge that the Utility's allocation procedures are, and will be, subject to review in general rate proceedings to ensure consistency with the Commission's water allocation policies.

**XII. Operations And Employee Transfer Policy**

A. Unregulated operations, including all pertinent contracts, that are performed by the Utility shall be transferred to the appropriate affiliate as soon as the requisite consents are obtained.

B. The Utility shall avoid a diversion of management talent that would adversely affect the Utility.

C. The Utility shall endeavor to transfer to its affiliates employees whose primary responsibility is to conduct unregulated operations. The timing of such transfer will take into consideration the Utility's employment obligations to such employees, its obligations under its Union contracts and the cost of providing comparable terms of employment.

**XIII. Transfer Of Assets And Goods From The Utility**

All transfers of assets and goods from the Utility to any affiliate shall be in compliance with the applicable provisions of the Public Utilities Code and Commission policies. Unless in conflict with the Public Utilities Code or Commission policies, assets transferred from the Utility to an affiliate shall be at cost or fair market value, whichever is higher. However, the Utility may seek prior Commission authorization by application or advice letter in determining the appropriate ratemaking value for an asset.

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**XIV. Transfer Of Intangible Assets And Goods From The Utility**

The Holding Company and its other affiliates shall pay the Utility the fair market value of all intangible assets and goods transferred from the Utility. "Intangible assets and goods" shall mean: all intellectual property of the Utility (whether such property constitutes patents, trademarks, service marks, copyrights or other intellectual property) and all other similar intangible assets or goods.

It will be the Utility's responsibility to develop a verifiable, independent, appraised fair market value for any intangible asset that is transferred to any affiliate. The Commission's staff will have access to all supporting documents used in the development of the fair market value. If sufficient support for the appraised fair market value does not exist to the Commission staff's reasonable satisfaction, the Utility will hire an independent consultant under the Commission staff's and the Utility's joint control to reappraise the fair market value for any intangible asset that is transferred to any affiliate. The fair market value may be a single cost price, a royalty on the intangible asset, or a combination of both.

**XV. Transfers Of Assets And Goods To The Utility**

All transfers of assets and goods to the Utility from any affiliate shall be in compliance with the applicable provisions of the Public Utilities Code and Commission policies. Unless in conflict with the Public Utilities Code or Commission policies, assets transferred from an affiliate to the Utility shall be at cost or fair market value, whichever is lower. However, the Utility may seek prior Commission authorization by application or advice letter in determining the appropriate ratemaking value for an asset.

**XVI. Cost Of Reorganization**

All costs arising from the Utility's formation of the Holding Company are and will be charged below the line, and will not be used to determine future revenue requirements.

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**XVII. Confidentiality**

All records or information of a confidential nature furnished to the Commission staff under the terms of or in accordance with this Settlement Agreement which are individually marked confidential are not to be treated as public records. The Commission staff may only open these records or information to public inspection in accordance with the Commission's General Order 66-C.

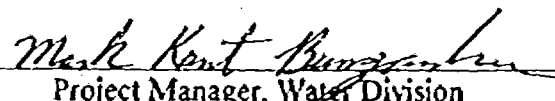
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IN WITNESS WHEREOF, the parties to this Settlement Agreement have executed this Settlement Agreement on and as of the dates set forth below.

DATED: September 23, 1997.

By:   
Vice President  
California Water Service Company

DATED: September 23, 1997.

By:   
Project Manager, Water Division  
California Public Utilities Commission

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PROOF OF SERVICE

I am over 18 years of age, not a party to this action and employed in San Francisco, California at Three Embarcadero Center, San Francisco, California 94111-4067. I am readily familiar with the practice of this office for collection and processing of correspondence for mailing with the United States Postal Service and correspondence is deposited with the United States Postal Service that same day in the ordinary course of business.

Today I served the attached:

Motion For Adoption of Settlement Agreement

by causing a true and correct copy of the above to be placed in the United States Mail at San Francisco, California in sealed envelope(s) with postage prepaid, addressed as follows:


Laura J. Tudisco  
Staff Counsel  
State of California  
Public Utilities Commission  
505 Van Ness Avenue  
San Francisco, CA 94102-3298

Mark Bumgardner  
Project Manager, Water Division  
State of California  
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John Pierino  
Vice President  
California Water Utility Council  
1546 Trevor Drive  
San Jose, CA 95118

Ida L. Huber  
California Water Utility Council  
1546 Trevor Drive  
San Jose, CA 95118

I declare under penalty of perjury that the foregoing is true and correct and that this declaration was executed on September 23, 1997.

  
\_\_\_\_\_  
Ruby J. Lee

(END OF ATTACHMENT A)