

L/ngs*

MAIL DATE

11/24/98

Decision 98-11-070

November 19, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

John P. Duffy d/b/a Vintners Inn,

Complainant,

vs.

Larkfield Water Company,

Defendant.

ORIGINAL

Case 94-09-038

(Filed September 16, 1994)

**ORDER GRANTING LIMITED REHEARING, MODIFYING
DECISION (D.)98-03-078 AND DENYING REHEARING**

D.98-03-078 arises from a dispute over the installation of water backflow prevention devices (BFPDs) on the property of the complainant, John Duffy. In this decision, we ordered defendant Larkfield Water Company (Larkfield) to bear the \$16,500 installation costs for the BFPDs. We further precluded Larkfield from passing the installation costs onto its ratepayers.

An application for rehearing of D. 98-03-078 was filed by Larkfield. In its application, Larkfield alleged the following legal errors: (1) the Commission unlawfully waived or ignored Larkfield's tariff; (2) the Commission erroneously granted Mr. Duffy a preference in violation of Public Utilities Code section 453(a); (3) the Commission imposed a penalty without following the procedural safeguards afforded under Public

Utilities Code section 2100, et seq.; (4) the decision effects an unconstitutional taking; and (5) Findings of Fact Nos. 8 and 13(b) are not supported by the record.

We have reviewed this application for rehearing as well as the objection and request for legal assistance filed in response by Mr. Duffy. The Department of Health Services (DHS), intervenor herein, did not file a response to the application. We conclude that a limited rehearing should be granted. As set forth below, we modify D.98-03-078 in certain respects. We then deny rehearing on the modified decision. Based on the present record, the legal error can be corrected with modifications to the decision. No further hearing is required.

Larkfield first alleges that we erroneously waived or ignored its tariff. Because the tariff mirrors the DHS regulations, Larkfield argues that it carries the force of law. Larkfield cites Lertora v. Riley (1936) 6 Cal.2d 171, 180, in support of its argument that the tariff carries the force of law. Lertora held that rules promulgated under a statute carry the force of law and cannot be ignored. Larkfield adds that our deviation from the tariff was based on an erroneous legal premise. Specifically, Larkfield contends that it was erroneously criticized for not invoking DHS' jurisdiction. Larkfield characterizes this premise as a legal impossibility. Larkfield argues that the Commission retained its jurisdiction to enforce the DHS regulations and related tariffs until DHS issued its order. Larkfield thus claims that it was erroneously criticized for not bringing the MOU to the Commission's attention early on in the proceedings.

As an initial matter, Larkfield errs in its interpretation of the respective jurisdictions of the Commission and DHS. DHS admitted that the issue of who bears the BFPD installation costs rests with the Commission. (D.98-03-078, p. 22.) The Commission's responsibilities under the MOU also include "making recommendations on the financial and rate-setting aspects associated with implementing the necessary improvements identified by DHS. . . ." *Id.* By contrast, Larkfield cites no authority for its proposition that the Commission's jurisdiction ceased upon issuance of the DHS order.

Larkfield is similarly incorrect that we either waived or ignored its tariff. We did not actually deviate from the tariff. Rather, Larkfield's tariff is simply unclear in certain respects. Rule 16C3 is clear that the customer bears the installation costs when Larkfield has determined that BFPDs are, in fact, required by Rule 16C2. Rule 16C2, however, is ambiguous as to when installation of the BFPDs is required in the first place.

Rule 16C2 initially calls for Larkfield to exercise its discretion in determining whether the installation of BFPDs is required. For example, the tariff instructs Larkfield to "evaluate the degree of potential health hazard to the public water supply. . . ." Rule 16C2. This includes a consideration by Larkfield of "the probability of a backflow occurring." *Id.* The tariff thus can be reasonably construed to require BFPD installation with a well only if Larkfield finds a potential health hazard or a probability of backflow occurring. We concluded that Larkfield had failed to adequately evaluate the degree of the potential health hazard. (D.98-03-078, p. 21.) We found that the threat of contamination was actually non-existent. *Id.* at 18-19.

By contrast, Rule 16C2a goes on to state that Larkfield "will require" BFPDs where the fresh water supply is available from a well. *Id.* (Emphasis added.) The tariff's use of the word "will" suggests that Larkfield has no discretion in requiring the installation of BFPDs. The tariff thus can be reasonably construed to mandate installation of BFPDs with a well irrespective of the findings of a potential health hazard or a probability of backflow occurring. In other words, this construction of the tariff requires the installation of BFPDs with a well even if there is no health hazard whatsoever or a zero probability of backflow occurring. These two reasonable constructions of Larkfield's tariff create an ambiguity for a customer such as Mr. Duffy.

The Commission requires that "a utility's tariffs, or contract, with the public under which it holds out service, must be clear." Complaint of Ellickson v. Gen. Tel. Co. of Calif. (1981) 6 CPUC2d 432, 438. Where tariff provisions are unclear, the Commission has found that "[i]t is not fair" to apply them against a customer. *Id.* at 437. This is because a customer is not a party to the contract when the tariff is drawn. "To

bind him [the customer] with uncertain or unclear language that has considerable economic impact, and to which he was not a party to the making, is onerous and unjust." In Carlton Hills School v. SDG&E Co., 1982 Cal. PUC LEXIS 1259, *6. Hence "[i]t is well-established that ambiguous tariff provisions are to be construed strictly against a utility and any doubt resolved in favor of the customer." *Id.* at *5.

As applied here, the tariff must be strictly construed against Larkfield so as to give it discretion in requiring the installation of BFPDs. Any doubt as to whether the BFPDs were required must then be resolved in Mr. Duffy's favor so as not to require the payment of the installation costs by him. While the issue of whether Mr. Duffy must pay for the BFPD installation costs can be so resolved, the ambiguity in the tariff should not be allowed to remain. We therefore refer this matter to the Water Division for evaluation of an order instituting investigation (OII) to address the BFPD ambiguity present in the tariff of Larkfield and any other water company. We modify D.98-03-079 to adopt the above rationale, as more fully set forth below.

Contrary to Larkfield's application, the Commission possesses the authority to impose the BFPD installation costs on Larkfield as opposed to Mr. Duffy. Public Utilities Code¹ section 532 provides, in pertinent part: "The Commission may by rule or order establish such exceptions from the operation of this prohibition [against non-compliance with a tariff] as it may consider just and reasonable as to each public utility." However, we acted prematurely in addressing the issue of the pass through of the BFPD installation costs on Larkfield's shareholders versus the ratepayers.

Complaint cases such as instant case do not address cost allocation and pass through issues. Rather, a complaint case is strictly between the individual customer and the utility. There generally is no Commission staff member representing the interests of the ratepayers. The issue of the pass through of the BFPDs should be addressed in

¹ Unless otherwise indicated, all statutory references are to the Public Utilities Code.

Larkfield's next general ratesetting case. We therefore modify D.98-03-078 so as not to reach the issue of the pass through of the BFPD installation costs, as more fully set forth below. We authorize Larkfield to establish a memorandum account for recording expenses from the purchase, testing and installation of the BFPDs. We also authorize Larkfield to file for the recovery of reasonable expenses recorded in the memorandum in its next general ratesetting case.

Although we do not decide the ratemaking issue here, we note that the reasonableness of Larkfield's actions (e.g. failure to invoke DHS' jurisdiction) must be considered in making a determination of whether the costs associated with the purchase and installation of the BFPDs should be passed onto the ratepayers. The Commission may disallow from rates costs associated with unreasonable utility practices. The term reasonable has been construed by the Commission to mean "the practices, methods and acts engaged in by a utility follow[ing] the exercise of reasonable judgment in light of the facts known or which should have been known at the time the decision was made." Re Southern California Edison Company (1987) 24 CPUC2d 476, 486.

In the present case, our questions about the ratemaking/reasonableness issue are prompted by the record in this proceeding. For example, it appears that at some point Larkfield had the option of granting to Mr. Duffy a waiver of the BFPD requirement. (See March 2, 1994 letter to DHS where Larkfield states: "you [DHS] would not back LWC [Larkfield] in their request for backflow devices. Instead, LWC [Larkfield] was told they could waive the requirement for backflow devices.") Three years later, DHS issued to Larkfield a compliance order mandating the installation of the very same BFPD. A question is whether Larkfield acted reasonably when it did not resolve the issue more promptly, either by granting Mr. Duffy a BFPD waiver or by making it clear to Mr. Duffy (and making it clear to the Commission at the hearing), that by failing to require installation of the BFPD, it was in jeopardy of DHS citation in the form of a compliance

order.² By our discussion of the ratemaking/reasonableness issue herein, we do not intend to prejudge it. Rather, we include this discussion as guidance to help the parties frame the issue in Larkfield's next general rate case.

Larkfield next alleges that it was erroneously ordered to grant Mr. Duffy special treatment. Larkfield cites section 453(a), which prohibits a public utility from granting "any preference or advantage to any corporation or person. . . ." Larkfield asserts that there is no legal basis for treating Mr. Duffy differently from its other customers. Larkfield concludes that the Commission effectively imposed a penalty on it without the procedural safeguards afforded under section 2100, *et seq.*

Because Larkfield already installed the BFPDs with its own funds, Mr. Duffy disputes that a penalty was imposed by the Commission. Mr. Duffy characterizes the BFPD installation as a "bad business decision" on Larkfield's part.

Larkfield fails to show that Mr. Duffy is being afforded a preference in violation of section 453. To establish a preference, a comparison must be made between substantially similar situations. Sunland Refining Corp. v. Southern Tank Lines, Inc. (1976) 80 C.P.U.C. 806, 816. This includes taking into account all relevant circumstances and conditions. *Id.* We note that Larkfield's application is completely devoid of a reference to any situation, much less a situation comparable to that of Mr. Duffy's. Even if Mr. Duffy was afforded a preference, Larkfield also fails to show that it

² Mr. Duffy and representatives from DHS and Larkfield met as early as November, 1993 to discuss the installation of the BFPDs. Apparently, DHS advised Larkfield and Mr. Duffy that the BFPD requirement could be waived by Larkfield. A few weeks later, on December 14, 1993, Larkfield informed Mr. Duffy by letter that it would not "waive the need for a backflow device." In a March 2, 1994 letter, Larkfield states that "you [DHS] would back LWC in their request for backflow devices. Instead, LWC was told they could waive the requirement for backflow devices." Then, in that same letter, Larkfield requested that DHS "revisit" its position "that the water purveyor has the authority to waive the requirements of Title 17." In its March 4, 1994 letter, DHS responded stating: the "Department fully supports the efforts of Larkfield Water Company. . . including requiring the appropriate backflow prevention device at the Vintner Inn connection." In a March 9, 1994 letter, Larkfield informed Mr. Duffy that DHS "fully supports LWC in their efforts to require backflow devices. . ." It seems that Larkfield never followed through by clarifying to Mr. Duffy, (or subsequently to this Commission), that DHS "support" was tantamount to notice that the failure to pursue the BFPD installation in this case would result in the issuance of a DHS compliance order. Instead, Larkfield threatened to shut off Mr. Duffy's water service, and Mr. Duffy thereafter filed the instant complaint with the Commission. After two years of litigation, DHS issued a compliance order mandating the installation of the BFPD on Mr. Duffy's property.

was unjust or undue so as to violate section 453. *Id.* There is nothing unjust or undue about the purported deviation because the tariff is vague and ambiguous as to the BFPDs.

Larkfield is also incorrect that we imposed a penalty. The Commission's disagreement with Larkfield does not equate with a penalty. The Commission is simply regulating Larkfield. Assuming, *arguendo*, there was a deviation, the Commission possesses the authority to order the deviation from the tariff. Section 532 provides, in pertinent part: "The Commission may by rule or order establish such exceptions from the operation of this prohibition [against non-compliance with a tariff] as it may consider just and reasonable as to each public utility."

Additionally, Larkfield contends that the decision effects an unconstitutional taking. Larkfield argues that it is entitled to recover the capital costs of the BFPDs and earn a fair rate of return. In support, Larkfield cites Duquesne Light & Power Co. v. Barasch (1989) 488 U.S. 299, 307-308. Duquesne restates the general proposition that public utility rates cannot be set so low as to be confiscatory. Larkfield concludes that it should, at the very least, be permitted to pass on the installation costs to its ratepayers.

Larkfield fails to establish an unconstitutional taking, however. Larkfield fails to demonstrate a financial hardship of a constitutionally impermissible magnitude. There is no evidence whatsoever in the application of the financial impact on Larkfield. "It is not the theory but the impact of the rate order that counts." Duquesne, supra, 488 U.S. at p. 310. "Rates which enable [a] company to operate successfully, to maintain financial integrity, to attract capital, and to compensate investors for the risk assumed certainly cannot be condemned as invalid, even though they might produce a meager return. . . ." *Id.*

Larkfield then requests that Finding of Fact 8 be eliminated on rehearing. Larkfield argues that it is unsupported by the record and thus erroneous. Finding of Fact 8 states that Larkfield did not offer DHS' testimony earlier because it was unaware of its "relevance." Larkfield's motion to submit DHS' testimony stated that it was unaware of "the level of interest" of DHS. Larkfield argues that the Commission mischaracterized

the motion in Finding of Fact 8. Larkfield claims that correspondence in the record demonstrated DHS' recent interest and desire to participate in the proceedings, although none is cited.

Mr. Duffy responds that Finding of Fact 8 is supported by the record. Mr. Duffy references the Commission's 30-page opinion and the 56 pages of pre-hearing conference testimony. Mr. Duffy adds that Larkfield's ignorance of DHS' interest amounts to ignorance of DHS' relevance in these proceedings.

Larkfield is incorrect that the Commission's Finding of Fact 8 is unsupported by the record and erroneous. For all intents and purposes, Larkfield's ignorance of DHS' interest is tantamount to ignorance of the relevance of DHS' testimony. There is also no evidence cited of any sudden interest on DHS' part. No oral or written statements from DHS indicating such an interest were set forth in Larkfield's motion. Larkfield simply stated in its motion what it believed was DHS' sudden interest. Further, Larkfield was not ignorant of the nature of DHS' on-going interest in this matter. DHS, Larkfield and Mr. Duffy had met in November, 1993 to discuss installation of the BFPDs. (See Duffy Exhibit 1-J Chronology.) DHS even stated its position that BFPDs were required in a 1994 letter to Larkfield. (See Duffy Exhibit 1-II.)

Larkfield also disputes the Finding of Fact 13(b) statement that Mr. Duffy was not afforded due process by DHS. Larkfield argues that there is no such requirement. Larkfield analogizes this case to Freeman v. Contra Costa County Water Dist. (1971) 18 Cal.App.3d 404, 410. Freeman similarly involved a property owner's challenge to the installation of BFPDs. Among other things, the property owner contended that due process required notice and a hearing before the water district could demand installation or terminate service. The Court held that there is no requirement that "notice and hearing be given in each individual case before an agency can enforce a valid statute or regulation." *Id.* The Court explained that the requisite notice and hearing occurred when the regulation was adopted.

Larkfield is correct that DHS did not deny Mr. Duffy "due process." DHS provided all water utility customers, including Mr. Duffy, with the requisite notice and hearing when it originally adopted its regulations. *Freeman, supra*, 18 Cal.App.3d at p. 410. Yet *Freeman* is inapplicable to our construction of Larkfield's tariff. The Commission is not precluded from providing Mr. Duffy with notice and a hearing concerning Larkfield's tariff. The Commission, not DHS, determines whether a utility can terminate a customer's service and whether the customer, the utility or the ratepayers bear the installation costs for the BFPDs. We therefore modify D.98-03-078 only to reflect that DHS provided Mr. Duffy with due process, as set forth below.

Lastly, Mr. Duffy requests legal assistance from the Commission and further requests that the Rules of Practice and Procedure be modified to prohibit Larkfield from including legal fees in its rate base. The Legal Division cannot provide Mr. Duffy with legal assistance in any further proceedings. The role of the Legal Division is to defend the Commission's decision should either Larkfield or Mr. Duffy seek further relief in the Court of Appeal.

Mr. Duffy's request to modify Larkfield's rates to preclude it from passing attorney's fees onto the ratepayers must also be denied. This request is more appropriately addressed in Larkfield's next ratesetting case. In review of this application, the Commission's function is to address the alleged legal error.

No further discussion is required of Larkfield's allegations of error. Accordingly, upon review of each and every allegation of error raised by Larkfield, we conclude that sufficient grounds for a limited rehearing have been shown. D.98-03-078 is therefore modified, as set forth below. Rehearing is then denied on the decision as modified.

IT IS ORDERED that:

1. A limited rehearing of the Application filed by Larkfield is granted for purposes of modifying the decision, as discussed above.

2. D.98-03-078 is modified as follows:

- a. The following new paragraphs are added at the end of the section entitled "Questions Directed to be Answered, j. Are the Circumstances. . .":

Larkfield is incorrect that we either waived or ignored its tariff. We did not actually deviate from the tariff. Rather, Larkfield's tariff is simply unclear in certain respects. Rule 16C3 is clear that the customer bears the installation costs when Larkfield has determined that BFPDs are, in fact, required by Rule 16C2. Rule 16C2, however, is ambiguous as to when installation of the BFPDs is required in the first place.

Rule 16C2 initially calls for Larkfield to exercise its discretion in determining whether the installation of BFPDs is required. For example, the tariff instructs Larkfield to "evaluate the degree of potential health hazard to the public water supply. . ." Rule 16C2. This includes a consideration by Larkfield of "the probability of a backflow occurring." *Id.* The tariff thus can be reasonably construed to require BFPD installation with a well only if Larkfield finds a potential health hazard or a probability of backflow occurring. We concluded that the Larkfield had failed to adequately evaluate the degree of the potential health hazard. (D.98-03-078, p. 21.) We found that the threat of contamination was actually non-existent. *Id.* at p.18-19.

By contrast, Rule 16C2a goes on to state that Larkfield "will require" BFPDs where the fresh water supply is available from a well. *Id.* (Emphasis added.) The tariff's use of the word "will" suggests that Larkfield has no discretion in requiring the installation of BFPDs. The tariff thus can be reasonably construed to mandate installation of BFPDs with a well irrespective of the findings of a potential health hazard or a probability of backflow occurring. In other words, this construction of the tariff requires the installation of BFPDs with a well even if there is no health hazard whatsoever or a zero probability of backflow occurring. These two reasonable

constructions of Larkfield's tariff create an ambiguity for a customer such as Mr. Duffy:

The Commission requires that "a utility's tariffs, or contract, with the public under which it holds out service, must be clear." Complaint of Ellickson v. Gen. Tel. Co. of Calif. (1981) 6 CPUC2d 432, 438. Where tariff provisions are unclear, the Commission has found that "[i]t is not fair" to apply them against a customer. *Id.* at 437. This is because a customer is not a party to the contract when the tariff is drawn. "To bind him [the customer] with uncertain or unclear language that has considerable economic impact, and to which he was not a party to the making, is onerous and unjust." In Carlton Hills School v. SDG&E Co., 1982 Cal. PUC LEXIS 1259, *6. Hence "[i]t is well-established that ambiguous tariff provisions are to be construed strictly against a utility and any doubt resolved in favor of the customer." *Id.* at *5.

As applied here, the tariff must be strictly construed against Larkfield so as to give it discretion in requiring the installation of BFPDs. Any doubt as to whether the BFPDs were required must then be resolved in Mr. Duffy's favor so as not to require the payment of the installation costs by him. While the issue of whether Mr. Duffy must pay for the BFPD installation costs can be so resolved, the ambiguity in the tariff should not be allowed to remain. We therefore refer this matter to the Water Division for evaluation of an order institution investigation (OII) to address the BFPD ambiguity present in the tariff of Larkfield and any other water company.

Contrary to Larkfield's application, the Commission possesses the authority to impose the BFPD installation costs on Larkfield as opposed to Mr. Duffy. Public Utilities Code section 532 provides, in pertinent part: "The Commission may by rule or order establish such exceptions from the operation of this prohibition [against non-compliance with a tariff] as it may consider just and reasonable as to each public utility."

However, we acted prematurely in addressing the issue of the pass through of the BFPD installation costs on Larkfield's shareholders versus the ratepayers.

Complaint cases such as instant case do not address cost allocation and pass through issues. Rather, a complaint case is strictly between the individual customer and the utility. There generally is no Commission staff member representing the interests of the ratepayers. The issue of the pass through of the BFPDs should be addressed in Larkfield's next general ratesetting case. We therefore modify D.98-03-078 so as not to reach the issue of the pass through of the BFPD installation costs, as more fully set forth below. We authorize Larkfield to establish a memorandum account for recording expenses from the purchase and installation of the BFPDs. We also authorize Larkfield to file for the recovery of reasonable expenses recorded in the memorandum in its next general ratesetting case.

b. Under the heading "Imposition of Costs of Installing the BFPDs," we delete the last full paragraph on pages 22-23 and the first full paragraph on page 23. We insert there the following *new* paragraph:

As discussed above, the ambiguous tariff must be construed against Larkfield and in favor of Mr. Duffy so as not to require payment of the BFPD installation costs by him. The issue of the pass through of the BFPD installation costs onto the ratepayers as opposed to Larkfield's shareholders should be addressed in the next general ratesetting case.

c. We modify Conclusions of Law Nos. 5 and 6 as well as Findings of Fact Nos. 13(b), 13(j) and 14 as follows:

FINDINGS OF FACT

13b. Was due process afforded Duffy? We note that DHS provided the legally required notice and a hearing when it originally adopted its regulations.

- 13j. Are the circumstances surrounding the issuance of a valid DHS order of such a nature as to warrant having Duffy pay for the installation of a BFPD? Answer. No. Larkfield's tariff requires the customer to pay the installation costs only when BFPDs are, in fact, required by it. Larkfield's tariff is vague and ambiguous as to when the installation of the BFPDs is required, however. If not, do the circumstances warrant having either the shareholders or ratepayers pay for the installation or some portion thereof. Answer. This issue should be addressed in Larkfield's next general ratesetting case.
14. This matter should be referred to the Water Division for evaluation of an OII to clarify the ambiguity present in the tariff of Larkfield and any other water company.

CONCLUSIONS OF LAW

5. The issue of the pass through of the BFPD installation costs onto the ratepayers as opposed to Larkfield's shareholders should be addressed in the next general ratesetting case.
6. Larkfield's tariff is vague and ambiguous as to when the installation of the BFPDs is required. Accordingly, the tariff must be strictly construed against Larkfield. Any doubts as to the requirement for the BFPDs must then be resolved in Mr. Duffy's favor so as not to require the payment of the installation costs by him.
3. A referral is made to the Water Division for evaluation of an OII to clarify the BFPD ambiguity present in the tariff of Larkfield and any other water company.
4. Larkfield is authorized to establish a memorandum account for recording expenses resulting from the purchase, testing and installation of the BFPDs on Mr. Duffy's property. Larkfield is also hereby authorized to file for recovery of reasonable expenses recorded in the memorandum in its next general ratesetting case.

5. Rehearing of D.98-03-078, as modified above, is denied in all other respects.

This order is effective today.

Dated November 19, 1998, at San Francisco, California.

RICHARD A. BILAS

President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners