

Decision 00-01-018 January 6, 2000

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Gerald V. Wedel and Linda J. Wedel, doing business as Pine Mountain Water Company (U-258-W) for Authority to Sell and Del Oro Water, Co., Inc. (U-61-W) for Authority to Buy the Pine Mountain Water System in Tulare County.

Application 99-07-016
(Filed July 13, 1999)

Application of Pine Flat Water Company , a California Corporation (U-257-W) for Authority to Sell and Del Oro Water, Co., Inc. (U-61-W) for Authority to Buy the Pine Flat Water Company Water System in Tulare County.

Application 99-07-017
(Filed July 13, 1999)

OPINION

Statement of Facts

Pine Mountain Water Company

Pine Mountain Water Company (Pine Mt.) was granted a Certificate of Public Convenience and Necessity (CPCN) by Decision (D.) 70198 issued January 11, 1966 to operate a public utility water system to serve Pine Mountain, a mountain area approximately 45 miles from the Town of Porterville in Tulare County. By D.89266 issued August 22, 1978, the system's sale to Gerald V. Wedel was authorized. Today Pine Mt. serves 84 unmetered customers through 11,800 feet of four-and six-inch transite mains. Pine Mt. also sells water on a metered basis to adjacent Pine Flat Water Company (Pine Flat). Pine Mt. operates from four wells and a 64,000-gallon reservoir.

Commission Resolution W-4037 issued April 9, 1997 authorized Pine Mt. to file an advice letter incorporating the Summary of Earnings, \$21,079 Rate Base, and 13.25% Rate of Return set forth in the Resolution. Pine Mt. filed its Advice Letter (AL) No. 12 thereafter, and its last general rate increase became effective April 19, 1997.

Pine Flat Water Company

About 1911, the Meyers Land Company, as part of its land sales operations, constructed a water system at Pine Flat, an area approximately 45 miles southeast of the Town of Porterville in Tulare County. The intention, not implemented, was to eventually form a mutual. Meyer's daughter, Helen M. Curtis, by 1936 the owner of the system, donated it to the Pine Flat utility organized by K.H. Morse. In 1949, the company obtained a CPCN from the Commission by D.42920. In the 1970 period, Gerald V. Wedel, part owner, became president. Today, Pine Flat serves 206 metered customers through 27,200 feet of two-inch standard screw mains, obtaining its water from three wells, five springs, and purchases from Pine Mt. It has five steel storage tanks with a total capacity of 84,374 gallons.

Commission Resolution W-4039 issued May 21, 1997 authorized Pine Flat to file an advice letter incorporating the Summary of Earnings (set forth in that Resolution) and rate schedules (also set forth in the Resolution). While not explicitly so stated in the Resolution's Ordering Paragraphs, the latter schedules were derived from use of an Operating Ratio Method of Return adopted in view of the small \$2,116 rate base (the result of depreciating the aging plant). The "margin" (or rate of return) was set at a very generous 20% of the total expenses listed in the Summary of Earnings. Pine Flat subsequently filed AL No. 14, and its last general rate increase became effective December 24, 1997.

Del Oro Water Co., Inc.

Del Oro Water Co., Inc. (Del Oro), a California corporation since 1963, has provided public utility water services under the regulatory jurisdiction of the Commission, and presently directly serves approximately 5,000 customers in Butte County, and through wholly-owned subsidiaries serves another 1,300 customers in Shasta and Humboldt Counties.

The Present Situation

The Wedels desire to sell their two water systems because they want to discontinue doing business as regulated public utilities.

Del Oro is interested in acquisition of the Pine Mt. and Pine Flat systems because it believes they can be profitably and efficiently consolidated with the regulated systems Del Oro already owns and operates.

Accordingly, the captioned applications have been filed to effectuate a sale and transfer of both Pine Mt. And Pine Flat to Del Oro. The selling price for Pine Mt. is \$37,500. The original cost is stated as being \$54,833 with a depreciation reserve of \$34,205, resulting in a net book cost of \$20,628. The selling price for Pine Flat is \$27,500, with the original cost being \$67,439 with a depreciation reserve of \$65,858, resulting in a net book of \$1,581. In both proposed acquisitions Del Oro agrees to refund all customer deposits when due. No refundable main extension advances are overdue, and those falling due in the future will be paid. While both applications state that the condition of the systems is good, we note that in the instance of Pine Flat, the Commission's 1997 Resolution W-4039 found that the existing mains were over 70 years old and the Resolution provided that Pine Flat should replace 3,500 feet of 2-inch mains with 6-inch mains. This has not been done.

Pursuant to Rule 6.1(a) of the Commission's Rules of Practice and Procedure, by ALJ Resolution 176-3020 issued July 22, 1999, the Commission

preliminarily determined that the captioned applications are ratesetting matters that do not require a hearing.

On August 4, 1999, each application was timely protested by the Ratepayers Representation Branch of the Water Division (RRB), merely stating RRB's belief that a hearing might be necessary.

A duly noticed prehearing conference (PHC) was held on October 22, 1999 before assigned Commissioner Henry M. Duque and Administrative Law Judge (ALJ) John B. Weiss in San Francisco. The assigned Commissioner and the ALJ considered the applications, the RRB protests, and the response of Del Oro at the PHC. Noting Del Oro's past demonstrated capabilities in managing, operating, and maintaining the diverse water public utilities serving over 6,000 customers in various parts of California, the assigned Commissioner and the ALJ concluded no hearing was required regarding Del Oro's capabilities.

Applying the proposed purchase prices reflecting premiums to rate base as required pursuant to Pub. Util. Code § 2718 et seq., and substituting these in the respective Summaries of Earnings applied to Pine Mt. And Pine Flat in each's latest rate proceeding, the Commissioner and ALJ concluded that prospective resulting rate impacts were neither unfair nor unreasonable in view of the Legislature's intentions in promulgating Pub. Util. Code § 2718 et seq., and did not warrant further investment of Commission resources as would be necessitated by a hearing. By the Joint Ruling of the assigned Commissioner and the ALJ issued October 29, 1999, RRB's request for hearing was denied.

Discussion

With exceptions not relevant here, historically the Commission has applied the concept of original cost less depreciation in the determination of rate base value to be used in ratemaking. But by the provisions of the Public Water Systems Investment and Consolidation Act of 1997 (Pub. Util. Code §§ 2718 et

seq.), the Legislature has provided that henceforth the Commission "shall" use the standard of fair market value (as set forth in § 1263.320 of the Code of Civil Procedure¹) when establishing the rate base value for the distribution system of an acquired water corporation.

In promulgating the 1997 Act, the Legislature clearly was well aware that incentives, both financial and operational, would be necessary to induce larger, well established water corporations to take over smaller, less well-established water corporations facing needs to replace or upgrade their systems to meet the increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards. These incentives must ultimately be reflected in rates. The benefits of well run, well-financed water utilities to ratepayers do not come without cost. And unless the potentially resulting rate impact is clearly unfair and unreasonable, the intention under Pub. Util. Code §§ 2718, et seq. was that the Commission "shall" approve the proposed acquisitions. But if the resulting potential rate impact was unfair and unreasonable, the Legislature left the Commission authority under Pub. Util. Code §§ 851 and 852 to deny the applications. The Commission lacks discretion to condition approval of an acquisition upon valuation, below fair market value, of the resulting rate base of the distribution systems of an acquired system (see Interim Opinion Regarding Applicability of Pub. Util. Code § 2718 et seq. to the proposed merger

¹ The relevant portion of Section 1263.320 states:

- (a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to be a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

(D.99-09-030 issued September 2, 1999) in the Joint Application of Cal-Water Service Co. and Domingues Water Company et al. in Application (A.) 99-02-004).

When the prospective rate impact indicated from application of "fair market" value purchase price as the new rate base is not so great as to be clearly unfair or unreasonable to the ratepayers, considering the future benefits they will receive by virtue of being served by larger, well-managed utilities better able to meet the present and future requirements of federal and state laws and regulations, we see no reason to expend the Commission's limited resources on preparation of staff reports and hearings. To do so and thereby delay and increase the cost of desirable acquisitions for form's sake would only serve to discourage would be acquisitions, and ignore the clear intention of the Legislature when it enacted Pub. Util Code §§ 2718 et seq.

In these applications the proposed purchase prices in each instance meet the fair market value definition of Civil Procedure Code § 116275 for their designation as the new rate base value for prospective ratemaking in each proceeding. These purchase prices (or "fair market" values) clearly do not approach, much less exceed, the reproduction costs (as defined in Evidence Code § 820) for even that portion of each utility's distribution system represented by their existing water distribution pipes (as set forth in each utility's 1998 Annual Reports). This obviates any need to consider Pub. Util. Code § 2720(2)(b) issues.

After concluding that the agreed-upon sales price is the fair market value of the companies, we must now determine if the substitution of the fair market value ratebase instead of the current book value results in estimated rate increases that might be considered unfair or unreasonable. In the Pine Mt. instance, application of the "fair market" value purchase price as the new rate base in the 1977 Summary of Earnings set forth in Resolution W-4037, the utility's most recent rate proceeding, would produce an earnings requirement (using the

same 13.25% rate of return) only \$2,176 higher, so that the rates authorized by Pine Mt.'s AL No. 12 would increase approximately 13%. We find nothing inherently unfair or unreasonable in that.

Pine Flat, on the other hand, operates on the Operating Ratio Method of Return. Assuming it were to continue under that method, the proposed purchase price would have no impact at all on prospective rates. If the operator received Commission authorization to move back to the Rate Base Method of Return, the proposed purchase price would then become the new rate base. The effect of applying that new rate base to the 1997 Summary of Earnings set forth in Resolution W-4039, the utility's most recent rate proceeding, would produce an earnings requirement less than that under the Operating Ratio Method. Thus, the resulting rates would be slightly less than those authorized under Resolution W-4039 and AL No. 14 for Pine Flat.

Upon payment to the Commission of the Public Utilities Reimbursement Fees collected to the date of the consummated sales and transfers, the Wedels and Pine Flat can be relieved of further public utility obligations with regard to the Pine Mt. and Pine Flat systems.

Finally, pursuant to provisions of California Health and Safety Code (CH&S) § 116525(a), any person or entity operating a public water system must have a permit to operate that system from the Department of Health Services (DHS), and a change in ownership of a public health system requires the prospective new owner to apply to and satisfy DHS' requirement that the new owner "possesses adequate financial, managerial, and technical capability to assure the delivery of pure, wholesome, and potable drinking water" (CH&S Code § 116540). Accordingly, apart from authorization from the Commission for

Del Oro acquisition of Pine Mt. and Pine Flat, Del Oro must also apply to DHS for reissuance of the existing permits of Pine Mt. and Pine Flat.

Findings of Fact

1. Both Pine Mt. and Pine Flat are private investor-owned water public utilities as defined in Pub. Util. Code § 241, and have been subject to the jurisdiction and regulation of the Commission since certification.
2. Del Oro is a private investor-owned water public utility as defined in Pub. Util. Code § 241, subject to the jurisdiction and regulation of the Commission since 1963, and today Del Oro successfully itself or through wholly-owned subsidiaries serves over 6,000 customers in various counties in California.
3. By the captioned applications, Del Oro seeks authorization from the Commission to acquire Pine Mt. and Pine Flat, and the Wedels and Pine Flat seek authorization to sell the systems..
4. Del Oro is a willing buyer; the Wedels' and Pine Flat are willing sellers, and none of the parties are under any necessity to buy or sell.
5. The agreed upon purchase prices for Pine Mt. and Pine Flat each include a premium over the selling entities' rate bases as determined in each sellers' last general rate proceeding in 1997.
6. Given the extensive distribution mains of both the Pine Mt. and Pine Flat systems, the purchase prices, reflecting as they do the respective fair market values, do not exceed reproduction costs as determined in accordance with Evidence Code § 820, and there are therefore no additional purchase price amounts to be considered pursuant to Pub. Util. Code § 2720(b).
7. Application of the fair market value purchase prices as rate bases, and substituting these for the rate bases determined in the Summaries of Earnings for the last general rate proceedings of Pine Mt. and Pine Flat, could result in rate

impacts of approximately 13% for Pine Mountain and probably no increase for Pine Flat.

8. Despite the fact that by ALJ Resolution 176-3020 the Commission had preliminarily determined that no hearing was required for either captioned application, the Assigned Commissioner and the ALJ conducted a PHC to consider RRB's protest and Del Oro's response.

9. By a Joint ruling of the Assigned Commissioner and the ALJ issued after the PHC and consideration of the applications, protests, and response of Del Oro, RRB's request of hearings on the applications was denied; the Commissioner and the ALJ having concluded that as Del Oro by past performance had demonstrated its capability to manage, operate, and maintain the two systems, and as no unjust or unreasonable effect on the existing customers of the contracting parties would result from the acquisition, there was no necessity for a hearing.

10. Before Del Oro can operate the Pine Mt. and Pine Flat systems it is required to comply with CH&S § 116540.

11. Payment to the Commission of the Public Utilities Reimbursement Fees due to the date of closing and transfer must be made by the Wedels and Pine Flat before they can be relieved of their public utility obligations with regard to the respective water systems having sold.

12. Transfer of ownership of Pine Mt. and Pine Flat to Del Oro would be in the public interest.

Conclusions of Law

1. In promulgating Pub. Util. Code §§ 2718 et seq., the Legislature recognized the necessity for incentives to induce larger, well-established water corporations to acquire small, less well organized water corporations; one of these incentives is implicit in the legislative language that states that the Commission "shall" use the

standard of fair market value to value the rate base of the distribution system of an acquired public water system and that this standard "shall" be used for ratesetting, even though the result may be higher rates.

2. Nothing in Pub. Util Code §§ 2718 et seq. suggests that the Legislature intended discretionary, rather than mandatory, application of the fair market rate base valuation standard.

3. Pub. Util. Code §§ 2718 et seq. does not undermine or otherwise conflict with the Commission's obligation to review a water utility sale within our jurisdiction and to authorize that sale only if the Commission concludes authorization is in the public interest.

4. Were the Commission to conclude that application of Pub. Util. Code §§ 2718 et seq. would result in unfair or unreasonable increase in rates, while the Commission cannot require a lower rate base valuation or discriminatory rate of return as a condition of its approval, the Commission's authority to deny the sale remains undiminished.

5. Application of fair market value purchase prices as rate bases and substituting these for the Summary of Earnings rate base used in the last general rate proceeding for each utility does not result in impacts that are unfair or unreasonable.

6. Public hearing is not necessary.

7. The applications for sale and transfer of Pine Mt. and Pine Flat Water Systems to Del Oro should be authorized as set forth in the order that follows.

8. Upon consummation of the sales and transfers, and payment to the Commission of the Public Utilities Reimbursement Fees collected to the date of the sales and transfers, the Wedels and Pine Flat should be relieved of their public utility obligations with regard to the systems.

9. Before undertaking actual operation of either water system after the sales and transfers, Del Oro should obtain permits to operate the system from the DHS pursuant to the requirements of CH&S § 11650(a)

10. These proceedings should be closed.

O R D E R

IT IS ORDERED that:

1. Within six months after the effective date of this order, Gerald V. Wedel and Linda J. Wedel (the Wedels), doing business as Pine Mountain Water Company (Pine Mt.), and the Pine Flat Water Company (Pine Flat), are authorized to sell, and Del Oro Water Co., Inc. (Del Oro) is authorized to buy the Pine Mt. and the Pine Flat water systems in Tulare County.

2. Within ten days of the actual sales and transfers of the systems, Del Oro shall notify the Commission in writing of the date on which each sale and transfer was consummated, and shall attach on each written notification a true copy of the instrument effecting the sales and transfer.

3. The Wedels and Pine Flat shall make remittance to the Commission of the Public Utilities Reimbursement Fees collected to the date that each sale and transfer is consummated. Upon completion of the sales and transfers, and remittance of the reimbursement fees, the Wedels and Pine Flat shall stand relieved of their public utility water obligations with respect to the Pine Mt. and Pine Flat water systems.

A.99-07-016, A.99-07-017 ALJ/JBW/eap

4. Application (A.) 99-07-016 and A.99-07-017 are closed.

This order becomes effective 30 days from today.

Dated January 6, 2000, at San Francisco, California.

RICHARD A. BILAS

President

HENRY M. DUQUE

JOSIAH L. NEEPER

CARL W. WOOD

Commissioners

I abstain.

/s/ LORETTA M. LYNCH

Commissioner