

Decision 00-05-027 May 4, 2000

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

Application of Country Estates Water Co., Inc. (U 286 W) for authority to sell and Del Oro Water Co., Inc. (U 61 W) for Authority to buy the Country Estates Water Co., Inc., in Kern County.

Application 99-11-031  
(Filed November 29, 1999)

**OPINION**

**Summary**

This decision grants Country Estates Water Co., Inc. (Country Estates) authority pursuant to Public Utilities Code Sections 851-854<sup>1</sup> to sell and transfer its water system and property to the Del Oro Water Company, Inc., (Del Oro) Chico, California. Del Oro is authorized to take over the water system which serves 89 customers in an area nine miles east of Bakersfield in Kern County.

**Procedural Status**

The application was filed on November 29, 1999, and notice of the filing appeared in the Commission's Daily Calendar on December 2, 1999. Pursuant to Resolution ALJ 176-3028, issued on December 2, 1999, the application was preliminarily categorized as a ratesetting matter for which no hearings would be required. No protests have been received. The Commission's Water Division has no objection. Given these developments, public hearing is not necessary, and it is not necessary to alter the preliminary determinations made in Resolution ALJ 176-3028.

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<sup>1</sup> All statutory references are to the Public Utilities Code unless otherwise stated.

**Statement of Facts**

Country Estates was granted a certificate of public convenience and necessity to operate as a public utility water company in D.59423, dated May 5, 1961.

The water system is comprised of three parcels of land, identified as APN 173-280-06-00-1, 173-280-05-00-8, and 173-313-08-00-6. The system includes these elements:

<u>Wells</u>	<u>Diameter</u>	<u>Depth</u>
Well #1	16"	700'
Well #2 (Standby)	14"	550'
<u>Pumping Equipment</u>	<u>Horsepower</u>	<u>Capacity</u>
Well #1	100	1,200 GPM (@300')
Well #2	40	

Reservoirs and Tanks: 3                                  Capacity: 47,000 (gallons)  
Water Mains: 7,240 feet  
Services: 89  
Meters: 89

Country Estates states that the original cost of the property being transferred is \$196,267, and the depreciation reserve applicable thereto as of December 31, 1998 is \$119,282, resulting in a net book cost of \$76,985. The basic selling price for the water system is \$90,000 plus (a) the cost of certain additions and betterments and (b) an agreed percentage of certain accounts identified as set forth in the Agreement to Purchase and Sell dated August 31, 1999 between the parties. Country Estates has no contributed plant and is not obligated to refund any advances for construction.

Del Oro states that it has the following experience which qualifies it to operate the system: Del Oro is a public utility water company that has been

providing water service to the general public in portions of the State of California since 1963 under the regulatory jurisdiction of the Commission. Del Oro presently provides water service to approximately 5,000 water customers in Butte County and, through wholly owned subsidiaries, it also serves approximately 1,300 customers in Nevada County, approximately 300 customers in Shasta County and approximately 700 customers in Humboldt County.

Del Oro proposes to adopt the presently filed tariffs of Country Estates. The financial statement of Del Oro, attached to the application as Exhibit D, shows that Del Oro has the necessary assets to operate Country Estates. Del Oro agrees to refund all customer deposits when due. According to the parties, the condition of the water system is good.

### **Discussion**

Country Estates desires to dispose of the water system because it wants to discontinue doing business as a regulated public utility. Del Oro desires to acquire the system because it can be profitably and efficiently consolidated with the regulated water systems Del Oro already owns and operates.

The Commission's obligation in considering the transfer of a public utility water system is, among other things, preventing impairment of public service and ensuring that the new operator will perform adequately and will impose reasonable rates. (*So. Cal. Mountain Water Co. (1912) 1 CRC 520.*)

Recently, the Legislature concluded that corporations should be provided with an incentive to purchase smaller public water systems. This policy is reflected in the Public Water System Investment and Consolidation Act of 1997, which added Sections 2718, 2719 and 2720. Briefly, Section 2718 simply codifies the name: "Public Water System Investment and Consolidation Act of 1997." Section 2719 codifies the Legislature's findings that (a) many public water

systems require replacement and upgrading to meet state and federal safe drinking water laws and regulations governing fire flow standards for public protection; (b) these infrastructure improvements require sizeable capital investment; (c) public water system operation is subject to scale economies; and (d) ratepayers will benefit if water corporations have an incentive to achieve scale economies. Section 2720 requires the Commission to use the standard of fair market value for any acquired system when establishing rate base for ratesetting. However, the Legislature left the Commission authority under Sections 851 and 852 to deny the application if the resulting rate impact is not "fair and reasonable."

Consistent with the Legislature's intent in promulgating Section 2718 *et seq.*, the general policy followed by the Commission is to facilitate the acquisition of small uneconomic water public utilities by large, well established water public utilities, so that the latter's managerial and technical expertise and financial resources can be combined with economies of scale to benefit the ratepayers of the former. However, not every proposed acquisition serves that purpose, and each situation must be examined with care.

Notwithstanding Del Oro's agreement to adopt the current rate schedules of Country Estates,<sup>2</sup> the potential for a future rate increase through application of the fair market value purchase price for rate base does exist. (Section 2718 *et seq.*) However, Del Oro and Country Estates agree that any changes in the utility's current rates should be deferred until the sale of the system is consummated. Following close of sale, Del Oro will submit a request to the Commission for an

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<sup>2</sup> Country Estates' current rates became effective on November 1, 1982.

adjustment in rates to reflect the operations of the utility as a separate district of Del Oro.

We are satisfied that Del Oro has the experience and the resources to provide good water service to the customers of Country Estates. Also, it is reasonable to conclude that any potential rate increase resulting from the sale will not result in an unfair or unreasonable increase in rates through the application of the fair market value purchase price as rate base. Accordingly, we conclude that the transfer of Country Estates to Del Oro would be in the public interest.

Upon payment to the Commission of the Public Utilities Reimbursement Fees collected to the date of the consummated sale and transfer, Country Estates can be relieved of further public utility obligations with regard to the system.

Finally, pursuant to provisions of California Health and Safety Code (CH&S) Section 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 Section 116540). Accordingly, apart from authorization from the Commission for Del Oro's acquisition of Country Estates, Del Oro must also apply to DHS for reissuance of the existing permits of Country Estates.

### **Findings of Fact**

1. Both Country Estates and Del Oro are private investor-owned water public utilities as defined in Section 241, and have been subject to the jurisdiction and regulation of the Commission.

2. Del Oro seeks authorization from the Commission to acquire Country Estates.
3. Del Oro has the resources and experience to competently operate the system.
4. The agreed-upon purchase price includes a premium over the net book cost of the system.
5. Notwithstanding that Del Oro agrees to adopt the current rate schedules of Country Estates, the potential for a future rate increase through application of the fair market value purchase price for rate base does exist. (Section 2718 et seq.)
6. Following close of sale, Del Oro will submit a request to the Commission for an adjustment in rates to reflect the operations of the utility as a separate district of Del Oro.
7. Application of the fair market value purchase price as rate base is not expected to result in a rate impact that is unfair or unreasonable.
8. Current ratepayers in the transferred system can reasonably expect to receive continued good service through Del Oro.
9. Notice of this application appeared in the Daily Calendar on December 1, 1999. No protests have been filed.
10. The Commission's Water Division has reviewed the proposed terms of sale of the water system and has no objection.

### **Conclusions of Law**

1. A hearing is not necessary.
2. Transfer of ownership of Country Estates to Del Oro would be in the public interest.

3. It can be seen with reasonable certainty that there are no adverse environmental issues associated with the proposed transfer of water service.

4. The application should be approved, and, after consummation of the transfer and payment to the Commission of reimbursement fees due pursuant to Section 401, *et seq.*, Country Estates should be relieved of its public utility responsibilities.

5. Del Oro should obtain permits to operate the system from the DHS pursuant to the requirements of CH&S Section 11650(a).

## **O R D E R**

### **IT IS ORDERED that:**

1. Within six months after the effective date of this order Country Estates Water Company (Country Estates) may sell and transfer to Del Oro Water Co., Inc. the water system set forth in the application.

2. Within 10 days of the actual transfer, Country Estates 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. Within 30 days of the actual transfer, Country Estates shall file an advice letter in accordance with General Order 96-A to modify its tariff book to reflect this sale.

4. Country Estates shall make remittance to the Commission of the Public Utilities Commission Reimbursement Fees collected to the date of the sale and transfer of the subject water system.

5. Upon completion of the sale and transfer authorized by this Commission order, and payment of the Public Utilities Commission Reimbursement Fees, Country Estates shall stand relieved of its public utility water service obligation.

6. Application 99-11-031 is closed.

This order is effective today.

Dated May 4, 2000, at San Francisco, California.

LORETTA M. LYNCH  
President

HENRY M. DUQUE

JOSIAH L. NEEPER

RICHARD A. BILAS

CARL W. WOOD

Commissioners

We will file a joint concurrence.

/s/ LORETTA M. LYNCH  
Commissioner

/s/ CARL W. WOOD  
Commissioner



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**CONCURRING OPINION** of Commissioner Loretta M. Lynch and  
Commissioner Carl Wood:

This case involves a transfer of ownership of the facilities of the Country Estates Water Company to the Del Oro Water Company. The Commission has voted to approve the transfer, and we concur. This separate opinion sets forth our views on the inter-relationship of Sections 851 and 854 of the Public Utilities Code with The Public Water System Investment and Consolidation Act, sections 2718 through 2720 of the Public Utilities Code, added by SB 1268 (Kelley), 1997 Stats. Ch. 675.

Transfers of utility property are controlled by Article 6 of Chapter 4 of the Public Utilities Act, sections 851 through 856. Section 851 governs sales or other transfers of utility property. It provides in part:

851. No public utility other than a common carrier by railroad subject to Part I of the Interstate Commerce Act (Title 49, U.S.C.) shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its railroad, street railroad, line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or any right thereunder, nor by any means whatsoever, directly or indirectly, merge or consolidate its railroad, street railroad, line, plant, system, or other property, or franchises or permits or any part thereof, with any other public utility, without first having secured from the commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation made other than in accordance with the order of the commission authorizing it is void.

This provision requires that the Commission determine that the public interest is promoted before a transfer is approved. D. 71758, La Puente Cooperative Water Company, 66 PUC 614, 628 (1966); D. 70449, Plunkett Water Company, 65 PUC 313 (1966). As the California Supreme Court noted in the first case interpreting the predecessor of this section:

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The commission's power is to be exercised for the protection of the rights of the public interested in the service, and to that end alone. Hanlon v. Eshleman, 169 C. 200 at 202 (1915), emphasis added.

Since this clear enunciation of an intention to protect consumer/user/ratepayer rights, the public interest standard in water utility transfer cases has been consistently understood by the Commission to require that the ratepayers in fact benefit from a transfer. For example, in Plunkett Water Company, supra, the Commission rejected a proposed transfer of water utility assets because the possibility of a rate increase for customers served by the transferred assets outweighed the benefits of improved fire protection. 65 PUC 313-315-16. The basis for the result was declared by the Commission to be, in part, that "...[t]he 231 customers who would be concerned in this transfer have not consented to assume the burden which would be involved, nor were they advised of the possibility or contingency...." Ibid. at 315. Captive water customers, and the facilities used to serve them with water, ought not to be traded among investors unless the Commission determines that it is in their interest that the transfer take place. Compare, D. 70772, Anderson Water Company, 65 PUC 607 (1966), approving a sale to a municipal entity proposing to upgrade and interconnect water systems, despite an admittedly inflated ratebase.

In Corona City Water Company v. Public Utilities Commission, 54 C. 2d 834, 9 Cal Rptr. 245 (1960) the California Supreme Court upheld a rejection by the Commission of the sale of a valuable water well by a utility (Corona) to a related entity asserted to be exempt from CPUC regulation (Temescal). The effect of the sale would have been to deprive the Corona customers of a lower cost source of water - i.e., to raise their rates. The issue before the Court and the Commission was whether the Commission should exert its jurisdiction over entities that were arguably exempt from

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regulation. In the face of a strong legal argument that – due to anomalies in the water rights – the well could not be pumped at all by Corona, the transferring utility, the Supreme Court upheld the Commission:

...whether or not ...an infringement [of Corona's rights] has occurred, the intercorporate relationship is fraught with hazards to Corona and its customers. Thus the largely agricultural independent stockholders of Temescal are in a position to subsidize their water service at the expense of Corona and to prevent Corona's objecting by their control of it. It is the existence of such power, not merely its improper exercise, that violates the principles underlying the exemption [from regulation.]  
9 Cal Rptr. 245 at 248

The basis for the Commission's power to approve transfers of water utility property under section 851 is the need to protect captive ratepayers from exploitation or abuse, either actual or threatened. It is the essence of the Commission's exercise of that power that it determine that the captive ratepayers will benefit from the transfer.

Section 851 governs dispositions of utility property. Section 854(a) governs acquisitions of utility property. Enacted in 1971 and extensively amended in 1989, it provides:

854. (a) No person or corporation, whether or not organized under the laws of this state, shall merge, acquire, or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the commission. The commission may establish by order or rule the definitions of what constitute merger, acquisition, or control activities which are subject to this section. Any merger, acquisition, or control without that prior authorization shall be void and of no effect. No public utility organized and doing business under the laws of this state, and no subsidiary or affiliate of, or corporation holding a controlling interest in a public utility, shall aid or abet any violation of this section.

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This statute has also been consistently understood to require a finding that acquisition of control is in the public interest and will benefit the affected ratepayers, including appropriate conditions. Application of Benjamin and Lourdes Nepomuceno, D. 87781, 82 PUC 504, 505 (1977), citing Hempy v. PUC, 56 C.2d 214 (1961). In that case, the Commission went so far as to control rates charged consumers by a court-appointed receiver in order to assure ratepayer benefits. 82 PUC 504, 509, Ordering Paragraph 7.

These authorities, stretching over more than 80 years of consistent interpretation, convince us that the public interest standard under sections 851 and 854 includes a requirement that the transaction result in ratepayer benefit, that there be a positive contribution to the well-being of the water users who obtain that essential service from the water utility or property being transferred. Ratepayer benefit, not ratepayer indifference is the essence of the public interest standard under section 851.

It was in this context that the Legislature enacted SB 1268 in 1997, the Public Water System Investment and Consolidation Act, Public Utilities Code sections 2718 through 2720. Significantly, in enacting the statute the Legislature specifically preserved to the Commission "all powers and responsibilities granted pursuant to Sections 851 and 852." Public Utilities Code section 2720(d). In making certain findings and declarations, the Legislature specifically reaffirmed the "ratepayer benefit" requirement of those sections:

2719. The Legislature finds and declares all of the following:

- (a) Public water systems are faced with the need to replace or upgrade the public water system infrastructure to meet increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards for public fire protection.

- (b) Increasing amounts of capital are required to finance the necessary investment in public water system infrastructure.
- (c) Scale economies are achievable in the operation of public water systems.
- (d) Providing water corporations with an incentive to achieve these scale economies will provide benefits to ratepayers. (emphasis added)

The statute lists types of items that might support a ratepayer benefit determination: "...whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable." Public Utilities Code section 2720(b).

The principal provision of SB 1268 is Public Utilities Code section 2720(a), which sets out a procedure for establishing rates following the completion and approval of an acquisition of a public water system by a regulated water utility. This section provides in pertinent part:

2720. (a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting. (1) For purposes of this section, "public water system" shall have the same meaning as set forth in Section 116275 of the Health and Safety Code. (2) For purposes of this section, "fair market value" shall have the same meaning as set forth in Section 1263.320 of the Code of Civil Procedure.<sup>1</sup>

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<sup>1</sup> CCP Section 1263.320 provides:

1263.320. (a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by 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

This provision establishes a post-transfer ratemaking methodology for transferred systems. Its existence becomes a consideration for the Commission when it is faced with an application for transfer, but of course has no bearing on the merits of the transfer itself or the standard to be utilized in approving the transfer. Indeed, to the extent that it purports to guarantee recovery of inflated sale prices through ratebase treatment for acquisition premiums, it may raise the bar for Commission approval because it may make more difficult a Commission determination of ratepayer benefit if a large rate increase would be required by the section. In fact the statute contains its own limitation on the extent to which purchase prices can be inflated - the definition of market value based on a "willing buyer" would be violated by a buyer who was relieved of all risk and restraint through guaranteed recovery of any level of investment. In any case, the existence of the statute heightens the scrutiny which we give to water utility transfers, to ascertain the ratepayer benefit that may justify ratebase treatment for an acquisition premium.

Following the enactment of SB 1268, the section 851 approval process requires a finding of ratepayer benefit that involves a balancing approach.<sup>2</sup> If ratepayers can see no perceptible improvement in service or service quality, then a rate decrease resulting from a sharing of operational improvements is probably required. On the other hand, an acquisition premium supporting an enhanced ratebase may be balanced by real operational or other improvements in service. These improvements need not be quantified, but they must be concrete, perceptible and real.

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available. (b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

<sup>2</sup> It is not necessary in this case to address the extent to which the public interest considerations listed in sections 854(b) and 854(c) may also weigh in the balance. These sections, which require the commission to make certain explicit findings, do not apply by their terms to water utilities. However, the itemization of issues may inform the commission's deliberations on how to strike the public interest balance, and parties seeking to justify a transfer which involves a rate increase may present how the transfer touches on the itemized issues.

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In this case, there is an acquisition premium, and potential ratebase write-up as a result of the sale price. However, following the logic of the Anderson Water Company case above, this premium is justified by operational improvements that result from Del Oro's acquisition of the Country Estates property. Del Oro can supply energetic professional management, improved access to capital needed to comply in the future with water quality requirements, more efficient operations due to economies of scale. On balance, the probable rate increase resulting from the modest write-up - an increase in ratebase of approximately \$150 per service connection over the book value of the utility assets - is far outweighed by the service quality and organizational improvements that result from this merger. Hence our vote of approval.

Loretta M. Lynch

Carl Wood

/s/

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**LORETTA M. LYNCH**  
Commissioner

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**CARL WOOD**  
Commissioner

Dated: May 12, 2000 at San Francisco, California