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Decision 99-10-005 October 7, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Sereno Del Mar Water Company
doing business as Sereno del Mar Water
Company to Sell and Russian River Utility, a
California Corporation to Buy the Water System
in Sonoma County.

ORIGINAL

Application 98-07-046
(Filed July 27, 1998)

John D. Flitner, Attorney at Law, Hal Wood and
James Dutton, for Sereno Del Mar Water Company
and Russian River Utility, applicant.

Janet Boehm and Gayle Goldstone, for
concerned citizens of Sereno Del Mar, interested
party.

Bruce Burton and David A. Zensius, for California
Department of Health Services, interested party.

Christopher Alario, for Dominguez
Water Company, interested party.

Peter Fairchild, Attorney at Law, and David R. Paige,
Ratepayer Representation Branch, Water Division,
protestant.

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O P I N I O N

Statement of Facts

Background History

Sereno Del Mar Water Company (Sereno) was granted a certificate of public convenience and necessity by Decision (D.) 76460 issued November 25, 1969 (to become effective January 3, 1970), to serve a 50 lot subdivision 3-½ miles north of Bodega Bay in Sonoma County. Because of the system's limited quantity of proven water supply (from two wells and a proposed diversion from Scotty Creek), further system expansion was conditioned upon Commission authorization which would be dependant upon augmentation of the water supply. At the time of certification, Ocean Investments, a limited partnership, was the owner of both the subdivision and the system.

Subsequently, additional water supply sources were developed, and by later Commission decisions, several additional contiguous subdivision areas developed by Ocean Investments were authorized to be added to Sereno's service area (see D.78848 and D.79946). Finally, in 1976 the 30 lot Gleason Beach Assessment District contiguous to Sereno's service area, lacking its own water supply, was authorized service from Sereno, and Sereno, by a deviation from its filled tariff, was authorized to accept the Gleason Beach facilities together with a storage tank to meet fire flow requirements, and pressure reducing valves, as a contribution in aid of construction. (See D.84946 and D.86088.) These acquisitions brought the number of lots the utility was committed to serve to 197.

In 1981, Ocean Investments sold and transferred the 2,945 shares of stock of Sereno to Charles A. Hamilton (C.A. Hamilton) (D.82-06-009). Hamilton operated the system until 1994, when, in failing health, he transferred the stock to

the Charles A. Hamilton Revocable Trust (Trust) with himself as trustee, and his son, Charles H. Hamilton (C.H. Hamilton) as successor trustee. Early in 1989, C.A. Hamilton advised both the Commission and the Department of Health Services (DHS) that he could no longer operate the system. DHS petitioned the Sonoma Superior Court to appoint a receiver. On June 21, 1985, on DHS's recommendation, Superior Court appointed Russian River Utility (RRU) as Receiver.¹ By Resolution W-4079 issued November 19, 1987, the Commission concurred. Since mid-1995, RRU has operated and managed Sereno.

In August of 1995, C.A. Hamilton died, and C.H. Hamilton became the trustee of the Trust. In early 1997, C.H. Hamilton caused preparation of documentation to sell, assign, and transfer the 2,945 shares of Sereno stock held by the Trust to RRU, with Attorney Zeigler of the Santa Rosa, California law firm of Anderson, Zeigler, Disharon, Gallagher & Gray as the transfer agent. Since February 1998, that agent has held the stock and documents pending an application for Commission approval of the transfer of ownership.²

¹ RRU, incorporated in California in 1983 for the principal purpose of managing, operating, and improving deteriorated publicly owned water district systems and mutuels, provides various services for a fee to approximately 20 systems. It also has provided service as Court appointed receiver to several investor owned public utilities. RRU's stock is $\frac{3}{4}$ owned by Hal Wood, a sanitary hydraulic engineering graduate of the University of California, and a registered civil engineer with a Grade III water Treatment Plant Operations certificate. The remaining $\frac{1}{4}$ of RRU stock is owned by James E. Dunton who holds a Grade II Water Treatment Plant Operator Certificate. Both have extensive experience in managing and operating water systems.

² And by a letter dated April 28, 1998, Receiver Hal Wood of RRU wrote Fred Curry, Chief of the Small Water Branch, requesting current application forms for formal ownership transfer, stating he would prepare them for submission to get approval before commencing with actual transfer of ownership. He further advised of intentions to improve a well and augment storage at Sereno.

Before July of 1993, the Sonoma County Environmental Health Department had regulatory oversight over Sereno. To obtain a building permit, evidence of the applicant lot's ability to provide appropriate percolation to support a septic tank leach field, and evidence of a water connection, had to be supplied. Some lots cannot meet the "perking" requirements. Because of the then limited water supply situation, the County Health agency had imposed a new connection moratorium on RRU. Under a new state law in 1993, the County Health Agency could retain jurisdictional oversight over systems of less than 200 connections, or give this jurisdiction up to DHS. The County yielded its jurisdiction to the State. Since then DHS has continued the moratorium; it being understood that it would not be lifted until Sereno would be able to augment its water supply sources.

In the Fall of 1995, after DHS nominated RRU to the Superior Court and the Court appointed RRU as a receiver, RRU advanced \$15,300 to replace pumps and to install a 3-inch line from the treatment plant to the storage tank, and also advanced another \$14,600 to reconstruct a well. The \$15,300 was reimbursed to RRU from current revenues, but the \$14,600 apparently remains unrepaid.

The present supply source as stated in the application consists of two wells drilled into adjacent creekside hills and a water collector imbedded in

Finally, by a letter dated May 6, 1999, Attorney Zeigler affirmed to Administrative Law Judge (ALJ) John B. Weiss, that the Zeigler law firm continues to hold the stock and documents awaiting approval from the Commission before it effects the transfer.

Scotty Creek.³ After treatment, water from these sources is pumped to and stored in two storage tanks of 40,000 and 50,000 gallons capacity to be distributed through 10,300 feet of mains to the present 108 connected and metered customers. The distribution system is in good condition.

The Genesis of the Special Facilities Contribution Issue

While there were 197 lots in the three subdivisions that comprise the Sereno service territory, only 108 had water connections. With additional requests for service being denied under the long standing successive moratoriums of the health departments, the frustrations of the have-nots had grown over the years, as they could not build homes, and their property values were merely speculative. After RRU was named Receiver by the Court, some of these individuals led by Julia Fox-Thomas, held meetings with Wood to explore what might be done to meet DHS' requirements to lift the moratorium. These meetings resulted in Wood, working with DHS, devising plans to construct another water collector in Scotty Creek and to add additional storage tank capacity.

But as Sereno had no financial resources, was already in debt and under receivership, how could those required special facilities be paid for? Even had Sereno been able to make an equity investment, it would go to rate base and substantially increase the rates paid by the existing 108 served customers. The existing customers were satisfied with the status quo and would resist any rate increase which primarily would benefit only those without, but wanting, service

³ As of March 23,1999, only one hillside well and the Scotty Creek Water collector are in service. The production is stated to be 20 gpm in the application.

(the underlying animosity between the halves and those wanting to have was well indicated in letters sent to the ALJ).

Accordingly, the concept of requiring the stranded waterless lot owners who would most benefit from added special facilities to contribute the necessary funds was explored. Initial and on going discussions with the Chief of the Commission's Small Water Branch provided encouragement. As individual contributions did not fit Rule 15's Main Extension provisions (Form 4), Wood had an amended Form 4 prepared entitled "Main Extension Contract-Individuals Special Facilities." This essentially provided that each individual lot owner would advance a non-refundable contribution of \$10,000 to be deposited in a trust account by Sereno with Sereno to be obligated to start construction of a well collector and storage tank, etc. in an effort to find and produce additional water. Sereno agreed to process service applications when DHS lifted its moratorium, provided at least \$120,000 was contributed.

A copy of this amended Form 4 with various supporting information was sent in letter form on October 14, 1998⁴ to the Chief of the Small Water Branch. The error was that this submission should have been in Advice Letter form.

Receiving no response, Wood implemented the contribution project, receiving \$190,000 from 19 contributors by the end of 1998, and Sereno started construction of the new well collector and a 200,000 gallon storage tank so as to meet a DHS imposed schedule for competition. Shortly thereafter, \$28,500 of this was refunded, \$1,500 per contributor, as being in excess of the amount needed to

⁴ This October 15, 1998 letter also stated Wood's intention, with agreement of the Bodega Bay Fire Protection District Chief, to have a 1-inch meter service to each proposed new contribution derived service.

fund the special facilities. Using its own water availability assessment, DHS lifted its moratorium (on an interim basis pending evaluation of the augmented water system upon completion when a new water permit will be issued). Sereno thereupon issued connection permits to the 19 contributors.

Winter rains and the flow in Scotty Creek forced temporary cessation of work on the well collector. DHS indicates it is willing to extend its completion time limits. A coastal permit for the storage tank has been applied for to Sonoma County and the fees paid.

The Application to Sell and Buy Sereno

Earlier in 1998, Wood had determined that he would pursue a sale and transfer of Sereno to RRU, as contemplated between the Hamilton Trust and RRU previously. Accordingly, in April of 1998, Wood wrote the Chief of the Small Water Branch asking that he be provided with appropriate Commission application forms. Wood stated his intention to seek formal Commission approval of a transfer to RRU. On July 27, 1998, RRU filed the present application seeking authorization to acquire the Sereno common stock under provisions of Pub. Util. Code § 854.

Ratepayer Representation Branch Protest

On August 17, 1998, the Ratepayer Representation Branch of the Water Division (Branch) filed the present protest to the application, expressing Branch's concern over the possible effect a sale and transfer under the proposed application terms would have with respect to a resulting rate base.

Rule 6.1 Aspects

As relevant to proceedings filed on or after January 1, 1998, Rule 6.1 of the Commission's Rules of Practice and Procedure requires the Commission to

preliminarily determine the category of the proceeding and whether or not a hearing is indicated.

By Resolution ALJ 176-2998 dated August 6, 1998, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that a hearing was not necessary. However, the protest filed by Branch on August 17, 1998, raised questions indicating that a public hearing would be desirable.⁵

The March 25, 1999 Prehearing Conference (PHC)

Following the issuance and circulation of a March 19, 1999, Branch report in the application strongly opposing the application,⁶ and a March 23, 1999 RRU detailed response to the Branch report,⁷ a noticed PHC was held in San Francisco

⁵ The Application included certain representation labeled "original costs," "depreciation reserve," and "net book value;" interpretations of Pub. Util. Code §§ 2718-2720 that appeared to call for clarification.

⁶ Branch's report stated that RRU had violated Pub. Util. Code § 854 by acquiring the Sereno stock without prior Commission approval; that RRU while acquiring the stock at no cost, was appraising the acquisition (based on reproduction costs new less depreciation) at \$445,646; that RRU in violation of Sereno's tariffs had improperly collected \$161,500 (\$190,000 less refunds of \$28,500) in contribution from 19 contributors as contributions for special facilities, and had also over charged these contributors \$3,000 each for a 1-inch meter where a 5/8-inch meter would suffice; and that RRU proposes no future investment in Sereno if acquired, but would rely upon qualification for a loan from DHS's State Revolving Fund for further improvements.

Branch's recommendation was that the Commission void the asserted stock transfer; set the valuation of Sereno at \$1; prohibit all new connections until the special facilities additions are completed; require Sereno to refund the \$161,500 received as contributions; and require a refund of the \$5,000 connection fees. Branch would dismiss the RRU application because of these violations; for lack of the financial ability of RRU to make necessary improvements and lack of competence to operate.

⁷ The RRU response pointed out that RRU had not acquired the Sereno stock as yet; that it was in trust with a law firm pending a decision on its application. RRU stated it had no intention to base future rates on the application appraisal value which had been

Footnote continued on next page

on March 25, 1999 before Assigned Commissioners Henry M. Duque and ALJ Weiss.

Well attended, supporters and opponents of the applicant also presented their views at the PHC. In addition, numbers of residents wrote of their views, some seeking delay.

For RRU, Wood stated that he wanted the issue over the validity of the contributions for special facilities resolved as quickly as possible so as not to delay completion of the work already in progress.⁸ Wood stated that he had not understood that his proposed agreement with the individuals should have been submitted as an advice letter rather than was done by letter and attachments to the Chief of the Small Water Branch. Having consistently received encouragement to go the contribution route to get the facilities, both from Small Water and DHS, Wood stated he assumed he was proceeding correctly. When he received no response from his October 1998 letter, he proceeded to have contracts executed by the escrow agent, and as contributions were transferred to the

done for insurance purposes. Noting that Sereno has virtually no rate base, RRU stated its preference to operate under the Operating Ratio method rather than focusing on return on net investment. RRU stated that the special facilities agreements it used to obtain the \$161,500 contributions would be beneficial to everyone – the present ratepayers, the 19 new ratepayers to be, and the utility, and asks that they be approved as a variance. RRU also asks approval to proceed using those funds to complete the well collector and storage tank already started and thus satisfy the DHS requirement. RRU further stated its belief that use of State Revolving Fund loans at 2-½-3% interest for the future filtration plant would be more feasible and less expensive for ratepayers than requiring the utility to obtain the money elsewhere. It states that RRU has some financial resources it could invest if necessary, and in 1975 had already loaned Sereno money still unpaid. Supporting its statements, RRU included eight exhibits.

⁸ Wood referred to the earlier Gleason Beach extension in the 1980's as a precedent, where the Commission in similar circumstances had allowed a contribution in aid of construction for that extension of special facilities as a variance to Sereno's tariff.

Construction Fund by that agent, some of the money was used to pay construction bills. The escrow agent released water connection permits after DHS lifted the moratorium.

Branch's position was that contributions in aid of construction from individuals were completely contrary to Commission policy and Rule 15 provisions of Sereno's Tariff. Branch asserted that the basic problem with RRU's application lies in the applicant's lack of financial resources; that quite possibly, better financed operators who are prepared to live with the Commission's rules would be available to take over Sereno. Branch stressed that it is the responsibility of a utility company to provide the financing needed for its system facilities, not for the customers to provide the finances. In response to Branch's query whether or not, in view of Branch's report, Wood (as Sereno's receiver) intended to make immediate refunds as Branch recommended, Wood replied "No, I don't." Wood went on to state that the balance of the Construction Fund monies would be retained in the Bank of the West pending Commission resolution.

Janet Boehm, representing concerned citizens of Sereno Del Mar (concerned citizens), expressed her group's concerns over adequacy of the water supply to support additional connections.⁹ The Branch report also led to concern over asserted tariff violations. Her position was to deny the application. The representative of another group argued that the contributions be allowed; that the money be used to complete the well collector and storage tank, and that the

⁹ The concerned citizens had circulated a petition to residents asking if the residents were concerned and wanted more information. 32 of 36 responses assertedly supported further investigation before the Commission acted.

contributors be allowed to connect. Then he would assess the system to ascertain if it could support still additional connections.

Dominguez Water Company's (Dominguez) regulatory affairs manager stated that his company would be interested in Sereno if the RRU application was either withdrawn or denied.

There were a number of suggestions to delay the proceeding so that the ratepayers might determine whether they might prefer to form a mutual or organize a district. The ALJ ruled there would be no delay, noting the time it would take and the need for an acquisition through eminent domain or purchase, as well as the fact that this proceeding is a Senate Bill 960 matter with an 18 months maximum lifespan. Offered the opportunity to withdraw or proceed, RRU elected to proceed.

DHS's engineer representative stated DHS's satisfaction that the second well collector and 200,000 gallon tank will support additional connections and make the system reliable. Specifically, he rejected the Branch report statement that the Sereno system would not be reliable without a source producing 100 gallons a minute, and asserted that DHS's analysis showed reliability with less. He also stated that from DHS's public health perspective, RRU is competent to operate the Sereno system. While unable to guarantee a State Revolving Fund loan that was applied for to finance the forthcoming filtration plant, the engineer stated that it would likely be forthcoming within the next two years; that the category Sereno is in is nearing funding. (RRU planned to use this 2-½% interest loan to finance the approximate \$130,000 cost of the filtration plant that soon will be required.)

Wood also touched on ongoing discussions with the Board of the contiguous Carmet By the Sea Water System, a 62-member mutual system that RRU manages under contract. The concept is that if agreement can be reached,

Carmet could avoid having to invest in its own filtration plant by using Sereno's when built. In exchange Sereno could acquire surplus water from Carmet's two productive springs.

The Resulting Scoping Memo

Based upon the number of issues surfacing during the PHC, Commissioner Duque and ALJ Weiss concluded that an Evidentiary Hearing (EH) was necessary. Accordingly, on April 6, 1999, the Commissioner issued a Scoping Memo and Ruling which set the scope and hearing schedule. The EH was to address:

"Whether or not the Commission can be reasonably assured that Russian River Utility has the financial means and the operating ability to acquire and operate the Sereno Del Mar System so as to provide adequate service at reasonable rates? To what extent should the service situation which led to the 19 main extension agreements influence the Commission's decision? Should these agreements be shown to have violated Tariff Rule 15, should the Commission grant a variance nunc pro tunc to validate them, or should the agreements be voided, and refunds be ordered? In the latter instance, how should the additional water collector and storage facility mandated by the Department of Health Services for completion in 1999 be financed, considering that funding from the State Drinking Water Revolving Fund is a year distant and assuming approval of a loan? What is the feasibility of a cooperative agreement with Carmet Water Company (a mutual) for water exchanges? In that the bulk of existing plant today reflects contributed plant from developers or a public assessment district, should the utility, if a sale and transfer is authorized, be directed as a condition for the sale and transfer to file an application to adopt an operating ratio basis upon which to structure its rates and charges for the future?

The Evidentiary Hearing

Pursuant to the Assigned Commissioner's Scoping Memo and Ruling, an EH was held before ALJ Weiss in Santa Rosa on May 10, 1999, and concluded in San Francisco on May 19, 1999. Both hearings were well attended by interested customers of Sereno.

RRU provided its evidence through five witnesses: Hal Wood, president and principal shareholder of RRU; James Daugherty, a registered civil engineer and owner of Brelje & Race, consulting firm to publicly owned Sonoma County water districts; Robert Bos, president of Carmet Mutual Water Company; Bruce Burton, DHS district engineer of the DHS Santa Rosa District Office; and Jack Gibbons, retired assistant director of the CPUC Finance Division.

The concerned citizens provided its evidence through Charles Trimback, retired engineer with experience in the petroleum and nuclear fields; Gayle Goldstone, a self-employed quantitative analyst who also teaches at Santa Rosa Junior College; Chuck Meli, a local resident; and David A. Zensius, a DHS Sanitary Engineer with regulatory supervision over Sereno.

Branch provided its evidence through Daniel R. Paige, a program and project supervisor of the Ratepayer Representation Branch of the Commission's Water Division.

Dominguez's position and interest in the proceeding was provided by Christopher Alario, its regulatory affairs manager.

DHS, while an interested party, provided no evidence on its own behalf, but did participate in cross-examination.

There were 28 exhibits introduced into evidence, including two Branch reports.

Upon completion of the hearing and the filing of briefs, the proceeding was submitted for decision on June 23, 1999.

The Evidence Introduced

The evidence is that RRU is not a public utility operation within the purview of this Commission, and itself owns no utility system. It is a small management corporation which on a fee basis contracts with and has successfully managed, operated, or rehabilitated numerous small mutual water systems and water district systems in northern California. In addition, it is the court appointed receiver for two public utility water systems (one being Sereno).

RRU's unaudited financial statement for year 1998 (Exh. 7) pertains solely to its management for a fee business operations, not to the finances of the systems it contract to operate, and reflects the nature of the small corporate organization created solely for the benefit and livelihood of its sole two owners (Wood and Dunton), providing reasonable incomes and benefits to them.

While RRU does have a substantial line of credit available, and access to increased credit, the evidence is that RRU has very limited capital resources available for investment. While acquisition of Sereno would cost RRU nothing (the Estate will give it to RRU), RRU lacks capital funds to invest to pay for the immediate \$161,500 cost of the DHS mandated well collector and storage tank, or for the forthcoming \$130,000 cost of a filtration plant that DHS will shortly require for compliance with the Safe Drinking Water Act provisions. However, Sereno by filing Advice Letter 21 on June 28, 1999, asked for Commission authorization for its 19 individuals special facilities contribution agreements as a variance from its Tariff Rule 15, Form No. 4.¹⁰ This approval would serve to

¹⁰ On March 31, 1999, immediately after the PHC on March 25, 1999, Wood wrote each of the 19 contributors who had each contributed \$8,500 in 1998 to cover the cost of the Special facilities. He stated therein that as Branch had objected to the forms of his Amended Form 4, he was requesting each sign a "simple retroactive agreement letter." The new form entitled "Contribution to Sereno Del Mar Water Company" states that

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obviate any need for RRU to have investment capital for those improvements. Further, Sereno would at the appropriate time also seek authorization from the Commission to borrow State Revolving Fund monies at 2-½%-3% interest when the \$130,000 filtration plant must be added. This loan would be paid for through a surcharge on rates, a procedure and method not uncommon to small water companies in California. As the Sereno distribution system, less than 30 years old, is in good condition, there are no additional large capital requirements anticipated.

Because of depreciation and the past Gleason Beach addition of substantial contributed plant, today Sereno has only a \$49,650 rate base. While the Application stated that as determined under Pub. Util. Code §§ 2718-2720, the original cost was \$732,000 (assertedly current reproduction cost) with a depreciation reserve of \$300,000 (assertedly a weighted average of improvements constructed from 1970 to 1993), for a net book cost of \$432,000, no evidence was advanced to support these statements. Instead, RRU in its response to the initial Branch report (Exh. 1) stated that as the facilities had been contributed, there was

the contribution will not be used to increase Sereno's rate base. It states that the contribution was deposited in North Bay Title Company with the \$10,000 contribution allocated as follows:

Admin. fee of title company	\$ 100.00
Refund to contributor of excess in Dec. 1998	\$1,500.00
1-inch meter connection fee with fire service	\$5,000.00
Net Contribution	\$3,400.00

It further states that both the net contribution of \$3,400 and the connection fee of \$1,500 were earmarked to pay for the second well collector, electric controls, monitoring and telemetry, and a storage tank with solar power and radio transmission telemetry. The new forms, signed by all 19 contributors, state they void the earlier 1998 "Main Extension Contract-Individual."

Wood's transmission letter, his explanation letter, and the 19 signed contribution forms were entered as Exhibit 14.

no intent to determine future rate requests on those appraisals, rather that they would be used for insurance purposes and to calculate replacement reserves. Subsequently, both Branch and the Applicant used original cost \$131,790, accumulated depreciation \$82,110, and rate base of \$49,690 in their disputations. Sereno loses \$15,000 a year on its operations, and still has not repaid the \$14,600 owed RRU on the latter's 1995 loan. If authorized by the Commission to acquire Sereno, RRU intends to file an advice letter seeking approval to establish its operations of Sereno on an Operating Ratio method rather than on the Rate Base method to provide for a return.¹¹

RRU contends that given Sereno's lack of any appreciable rate base and its urgent need of special facilities, allowing it to accept contributions for these facilities, and to borrow from the State for the filtration plant would be the most beneficial solution for the ratepayers. The contention is that the 19 contributors are willing and satisfied as then they will have water connections and value for their properties; the existing ratepayers will pay nothing for these special facilities which will enhance their supply and storage for the future, and some additional future connections will be possible. The State loan surcharge is estimated at \$6 per month per ratepayer over 20 years. If invested money must be provided to cover the \$161,500 plus \$130,000 costs, it goes into rate base and the investor must be provided with a return which the ratepayers must produce in increased rates.

Branch objection to RRU acquisition of Sereno derives from Branch's belief that the system would be able to provide better service at more reasonable rates were a Class A water utility to acquire Sereno. Branch's position is that RRU

¹¹ The Operating Ratio method of ratemaking calculates a margin over operating and maintenance expense rather than focusing on return on net investment.

demonstrably is incapable of owning and operating Sereno¹² as demonstrated by RRU's actions in proceeding to accept contributions for special facilities from the 19 contributors without prior Commission authorization, and its forcing of 1-inch meters on the 19, whether through ignorance, lack of resources, or willful intransigence. In an attempt to demonstrate that a Class A utility would be able to provide cheaper service, branch prepared and distributed a revision to its March 19, 1999 Report, using Dominguez as a proxy.¹³ The end result of the Branch analysis purported to show that under Dominguez ownership the

¹² Branch points out that under Sereno's tariff's Rule 15, Sereno may collect special facilities contributions only from developers, and that none of the 19 contributors is a developer. Branch therefore asserts that all of the \$161,500 thus collected must be refunded with none used for the facilities.

¹³ Just prior to the first day of EH (May 10, 1999), Branch distributed a revised version of its March 19, 1999 Report. This revised version (Exh. 26), apart from some minor substantive changes, added a Section 6 which purported to compare RRU results of operations for years 2000 and 2004 with those for Dominguez ownership. For this analysis Branch used expense estimates derived from a RRU submission to DHS under provisions of Section 116 540(a) of the California Health and Safety Code pertaining to qualifications for a change of system ownership, without any explanation of how they got them, to arrive at distortions of rate base, operating and maintenance expense, depreciation, and loan payments, etc. to the detriment of RRU. But the Branch comparison was disputed by RRU's expert financial witness Gibbons, who after a scathing analysis submitted his analysis (Exh. 16).

On May 16, 1999, when RRU sought to have the second report admitted as an exhibit, Branch objected and sought to withdraw it. Branch stated that the second report's portion dealing with the comparison between revenues and expenses that would assertedly apply to RRU and Dominguez were not accurate in the sense that Branch had relied upon certain assumptions that Branch conceded were shown by RRU witness testimony not to be correct.

In that both reports had enjoyed wide dissemination, with ratepayer concerns expressed based upon the conclusions of the reports, and in view of extensive testimony and exhibits in rebuttal to the new section included in the second report, ALJ Weiss ruled that the second report could be admitted as Exhibit 26.

average customer bill would be \$31 less in year 2000 and \$15 less in year 2004 than under RRU.

But these Branch figures and assumptions could not stand up when disputed by RRU's expert financial witness Gibbons. Gibbons pointed up that under RRU ownership none of the cost of the well and tank (being contributed) and of the filtration plant (paid for by a low cost State loan) would go into rate base,¹⁴ whereas under Dominguez these costs would go into rate base. Thus, RRU's rate base would be \$46,680, while Dominguez's rate base would increase to \$339,650. RRU's return on equity would stay at \$6,800, while Dominguez's return would go to \$32,950. The filter plant 20-year loan would add \$9,750 annually to RRU's revenue requirement. Using Branch's O&M and A&G expense figures, a 3% depreciation on original plant for RRU and on original plant, plus additions for Dominguez, the loan amortization for RRU, and the proper taxes, Gibbons in Exhibit 16 produced a more accurate gross revenue requirement estimate applicable to RRU or Dominguez ownership as follows under 3 scenarios:

	<u>RRU</u>	<u>Dominguez</u>
1) Under present condition	\$50,730	\$50,175
2) After well and storage	50,730	82,000
3) After well and storage, and filter	50,730	108,500

Then, in Exhibit 28, Gibbons refined these estimates, correcting certain Branch assumptions, to contrast with Branch's Exhibit 26. In Exhibit 28, Gibbons set forth Results of Operations, Rate Base, and average monthly bill for year 2000

¹⁴ In addition, Sereno under RRU would receive no depreciation expense on the contributed well collector and storage tank, nor on the State loan financed filtration plant.

and year 2004 (as used by Branch in exhibit 26). The end result of this corrected analysis shows that the ratepayers would pay considerably more in the average monthly bill under Dominguez ownership.¹⁵ Branch did not contest Gibbon's exhibits or testimony, and conceded the inaccuracy of Section 6 of its Exhibit 26.

And as RRU points out, with addition of the well collector and storage tank, and later addition of the filtration plant, there are no remaining known capital expense items open. Capital needs for the immediate future would be limited to services, motors and pump replacements which RRU could finance.

Branch's cross examination of Wood developed the fact that each of the 19 contributors is receiving a 1-inch meter connection with fire service (for which the Tariff fee is \$5,000),¹⁶ but was not informed he could have a 5/8-inch meter instead (the 5/8-inch meter is in general use in the Sereno territory). While the \$5,000 charge was included in the \$10,000 contribution package and was not a separate additional charge,¹⁷ the fact remains that each of the 19 would pay the higher monthly service charge that applies to the larger meter service in the future.

The Branch cross examination also raised questions as to whether Sereno will obtain a State Revolving Fund loan as Wood is counting on. Wood has not as yet done more than a pre-application and while the utility is a "D" priority (and funding is only part way through that category), it had not yet been

¹⁵ Average Monthly Bill

	<u>RRU</u>	<u>Dominguez</u>
Year 2000	44.65	62.10
Year 2004	46.35	72.20

¹⁶ While the local fire chief is stated to concur with the decision to offer only 1-inch meter connections, there is no local ordinance requiring that size meter.

¹⁷ See footnote 10.

"invited" to formally file (until funds are available a utility is not "invited" to formally file an application). (The Commission is informed that as of June 1, 1999, Sereno was "invited" to file.) Wood estimated that financing the loan when granted would involve a surcharge of approximately \$6 per month per customer for 20 years.

While only in early negotiations, the evidence presented indicated that were Sereno and Carmet to share a filtration plant, there would be benefit to both utilities. A small plant could handle the requirements of both. The concept appears to be that Sereno would build and operate the facility, and treat Carmet water in possible exchange of Carmet's excess water supplies.

The evidence introduced by concerned citizens, representing to some degree approximately one-quarter of the residents, made clear the organization's opposition to RRU acquisition of Sereno, and its concerns whether the current source can support additional connections.

Concerned citizens' financial witness, an MBA business quantitative analyst and teacher, from her analysis of RRU's financial statements, concluded that under standard small business practice, the debt to equity ratio of 1.17 to 1, the liquidity ratio of 1.69 to 1, and its net income percentage of 3.98%, would serve to make RRU an unqualified buyer; that is poor liquidity could relate to cash flow problems and that it was overburdened with debt. Concerned citizens, taking its cue from Branch's March 19, 1999 Report, was also concerned over RRU's use of contributions, and the proposed future State Fund loan funding for the treatment plant rather than use of RRU resources to make special facilities improvements, as well as RRU's charges for 1-inch meters to the 19 contributors.

The water availability witness for concerned citizens introduced hearsay examples of two new owners who purportedly will use more water per day than the previous residents, and presented usage data from selected other water

systems in Sonoma County which he stated exceed Sereno's recorded 137 gpd average usage. Accordingly, he sought to have the Commission use a 260 gpd per connection measure rather than the system's recorded usage in determining whether water was available for further connections. Reportedly, he obtained that 260 gpd usage from DHS as one typically applicable to month of August consumption. Against a backdrop of University of California of Davis data setting forth the year 1997-98 inches of rainfall for Bodega Bay at an all time high, he presented hearsay statements of the views of three hydrologists who question whether the capacity of the Scotty Creek well collector can be projected for average or dry years based upon the August and September 1998 tests done by RRU. He also is concerned because DHS cannot give him assurance that Sereno's system will not again run out of water.

As to the adequacy of the water supply evidence introduced at the hearing reveals the following:

Sereno's annual report for year 1997 (filed June 1, 1998) showed that the system pumped an approximate total 6,000,000 gallons for the report year, an average of 16,438 gallons per day (gpd). Allowing for an unaccounted for loss of 10%, leaves 14,794 gpd presumably consumed in customer use, or 137 gpd per connection.

Wood's Progress Report Water Well Yield to DHS (Exh. 21) reported yield results of tests on August 10, 1998 and September 11, 1998. These tests respectively were of four and five hours duration. Each day produced 24 gallons per minute (gpm); the first with surface flow in Scotty Creek and the second with no surface flow in the creek. Dropping this 24 gpm to 22 gpm to allow for recharge, shows 31,680 gpd to be available. With the same unaccounted for water loss of 10%, it appears that 28,512 gpd would be available. Wood projected future demand at 130 gpd per connection.

Branch's March 1999 Report (Exh. 1), while giving no source or back up material for its figure, stated that the Sereno system produces 16 gpm, or 23,040 gpd. Allowing the same 10% unaccounted for water loss, this would indicate that 20,736 gpd would be available.

Therefore, using the 16 gpm production stated by Branch and the 137 gpd per connection usage of record (from the 1997 Annual Report), we obtain the following projections of the number of connections that the system should be capable of supporting before addition of the second collector and storage.

<u>Source</u>	<u>Water Supply gpd</u>	<u>Indicated Connections</u>	<u>Actual Connections</u>	<u>Open</u>
RRU	28.512	208	108	100
Branch	20.736	151	108	45

Using the Application's stated 20 gpm production, with the same water loss adjustment, and same 137 gpd per connection use, the system's connection capacity would be 189 connections. Using the September 1998 test production of 22 gpm, with the same water loss adjustment, and the same 137 gpd per connection use, would indicate a possible 208 connection capability.

Discussion

In private investor sales and transfer of public utilities, the function of the Commission is to protect and safeguard the interests of the public. The concern is to prevent impairment of the public service by the transfer of utility property and functions into the hands of parties incapable of performing an adequate service at reasonable rates, or upon terms which could bring about the same undesirable results (So. Cal. Mountain Water Co. (1912) 1 CRC 520). The Commission wants to be assured that the purchaser is financially capable of the acquisition, and that after the acquisition he will be able to provide a satisfactory operation.

In the present proposed sale and transfer, the evidence does not provide any basis for concern over the ability of RRU to provide a satisfactory service. While RRU's management and operation of water systems stretching back many years has largely been confined to numerous county water districts, mutuals, and other public owned water entities, RRU has also satisfactorily performed as receiver for public utility water systems. The public owned systems range in size up to 1,020 services, and the periods of service for the six largest range from four to ten years. RRU has satisfactorily managed and operated Sereno since the Superior Court appointed it as receiver in 1995. There have been no reports of unsatisfactory service on file at the Commission. And it is interesting to note, contrasting with before RRU's receivership, that despite all the questions raised over adequacy of the water supply at present, there have been no water outages since RRU took over in mid-1995.

The principal objection to RRU acquisition of Sereno rests in Branch's charges in its reports of improper RRU conduct in accepting without prior Commission approval, contributions of \$10,000 each from 19 individuals in the form of special facilities fees. These Sereno service area property owners had been unable to obtain water service because of the DHS moratorium imposed because DHS considered Sereno to be lacking adequate production facilities for additional connections. The funds contributed were placed in a special trust fund reserved to finance the additional well collector and storage tank special facilities proposed by RRU, and accepted by DHS as a condition for lifting its moratorium. In exchange, each of the 19 contributors would receive a water connection permit, a prerequisite for obtaining a County building permit.

Historically, the Commission's decision in City of Alameda vs. Southern Pacific Company (1915) 8 CRRC 372 (Rule 17), laid down the general principal that the utility itself should own the instrumentalities by means of which it

tenders service, and thereafter under general orders the Commission provided that each utility must provide every part of its property at its own cost (Jane Barnett (1919) 16 CRRC 438, McBueney v. Claremont Domestic Water Co. (1923) 23 CRRC 800). Prior to 1990, except for rare deviations, Commission rules did not allow facilities fees to be imposed on individual customers, following the general principle that investor owned utilities should themselves be responsible for raising the capital required to finance their provision of service. However, the difficulties incurred by small investor owned water utilities in obtaining capital to pay for additional production facilities has forced reconsideration, and in Re General Order 103 and Water Tariff Rules 15 and 16 (1990) 38 CPUC2d 384, and Re Revision of General Order 103 and Water Tariff Rules 15 and 16 (1991) 39 CPUC2d 594, the Commission proposed and adopted changes allowing smaller investor owned water utilities under limited circumstances, to assess facilities fees from new customers. The Commission viewed the primary objective of a facilities fee to be to provide smaller water utilities with another source of capital needed by many for additional production facilities required because of customer growth.

But the Commission held that the utility seeking to impose a facilities fee would first have to show that in order to make these new customer connections, the utility would have to add facilities or refurbish existing facilities. The conclusion was that charging such a facilities fee would be a benefit both to the investor owned public utility and also to the existing ratepayers, because under such a policy current ratepayers would not be obliged to pay through rate increases for additional plant facilities required in order to provide service to new customers. The concept was that it is reasonable that those seeking service should contribute to facilities costs incurred in order to be able to provide them the service they sought.

In Re Revision (supra), the Commission further concluded that a facilities fee should be utility specific, with calculation of the fee to be dependent on the circumstances of the utility in question, and authorized on a case-by-case basis. Accordingly, the Commission stated that the utility contemplating such a fee must:

- 1) determine whether prospective new connections would require additional or replacement plant;
- 2) determine the estimated cost of the new facilities required to serve the new connections, and
- 3) propose an appropriate utilities fee.

In its Ordering Paragraph 2 to the decision, the Commission stated:

"A Class C or Class D utility, or a Class A or B utility district or subsidiary serving 2,000 or fewer connections, may accept from individual customers amounts in contribution as a facilities fee pursuant to tariffs approved by the Commission."

Subsequently, in Re Financial and Operating Risks of Commission Regulated Water Utilities (1994) 55 CPUC2d, 158, at 199, footnote 11, the Commission summarized the procedure by which facilities fees were to be calculated and approved. The Commission stated:

"Under the procedure, a water company seeking a facilities fee submits a request to the Water Utilities Branch, supporting it with a showing of the additional operating facilities needed for actual or projected growth. Once approved by Branch and by the Commission (through an advice letter filing) the facilities fee collected by the utility is to be kept in a segregated bank account and credited to contributions in aid of construction at the time the fees are spent for additional plant." (Emphasis added.)

In the present matter Sereno has dedicated itself to serve the 197 lots within its three subdivisions. At present only 108 enjoy service to their lots. Others wanted service but under the DHS moratorium could not obtain

connections until Sereno obtained additional source and storage facilities to accommodate them. A public utility is in a different position from a private operator; it may not discriminate (Pub. Util. Code § 453), and is legally obligated to furnish adequate water service to the public when it is reasonably possible to secure and deliver sufficient water to meet demands. (Thousand Oaks Water Company (1931) 36 CRRC 73.) And this obligation extends to all of the public within its dedicated service area, not merely to those first to have been connected. This is not a "I've got mine, too bad for you" situation. Where increased demand for service renders existing facilities inadequate, it is the duty of the utility to provide necessary additional facilities, or to increase the capacity of existing facilities to meet that demand Engel v. Henry (1962) 54 CPUC 457. And this is exactly what RRU undertook to do.

Given Sereno's lack of any financial resources, an insignificant rate base, existing debt, and revenues not sufficient to meet expenses, the Receiver did not have an investment option to obtain the funds for the required special facilities. In addition, the presently served 108 customers base was not disposed to accept the significantly higher rates that further investment would require in order to accommodate service to additional customers.¹⁸ Accordingly, after discussions with the Chief of the Small Water Branch following the offer of some of the waterless lot owners to contribute the funds, the Receiver proceeded to work up a contributions solution in order to serve the unserved at no expense to the served.

¹⁸ There obviously is division in the community, as expressed in some customer mail, over any expansion of the customer base, and this has created significant bitterness among the different adherents.

After consultation with DHS, the Receiver determined what special additional facilities (the well collector and storage tank) would be required before DHS would remove the moratorium. He ascertained the approximate \$160,000 cost, and he apportioned that cost pro rata , initially at \$10,000 (but refunds were made later when more contributors came in). These procedures are those required by Re Revisions, supra. But apparently unaware of the advice letter procedure to be followed (as set forth in Re Financial, supra, and also detailed in Section X of General Order No. 96-A), he mailed a copy of his proposed deviation contract and details of what he was doing to the Chief of the Small Water branch. Receiving no acknowledgement or response, he proceeded with the plan, accepted contributions which were placed in a title company construction fund from which a portion was spent on the special facilities before winter rains called a halt.

Except for failure to have used the advice letter procedure, his actions were in accord with Re Revisions (supra) and Re Financial (supra), although there is no evidence that Wood was even aware of these 1991 and 1994 Commission decisions. Wood's experience basically is in the public entity area, not the public utility area. But later he learned of his error in having used a letter rather than an advice letter to seek the deviation from Rule 15's Form 4, and on March 24, 1999 he filed Advice Letter 20 (later on instructions from Small Water Branch revised and on June 28, 1999 refiled as Advice Letter 21) to comply. And copies of the final revised 19 contribution contracts were entered as Exhibit 14 in this application proceeding (see footnote 10).

The question thus arises, does Wood's failure to have followed the advice letter procedure under these circumstances serve to render RRU demonstrably incapable of owning and operating Sereno as Branch contends?

The Commission has considerable discretion in its dealings with the utilities it regulates. The question posed by Branch and before the Commission in Advice Letter 21 is addressed to that discretion. Other applications for authority to deviate from Tariffs have been considered and granted in light of special circumstances shown (for example, the Sereno 1976 Gleason Beach Assessment District deviation -D.86088).

Here we have the progressing construction of the well collector and storage tank planned and designed not only to enable Sereno to extend service to the remaining unserved lots in its dedicated service area, but also to add reliability for the present 108 served customers. The Small Water Branch was informed as the facilities plans were developed, and it encouraged Wood to use a special facilities contribution plan to pay for the additions, although Wood's contribution plan was put into effect, contributions were accepted, and construction was well advanced before the appropriate formal advice letter authorization for the rule deviation involved was filed.

As a result of the construction start, DHS reconsidered its evaluation of the existing supply, decided the system could in the interim support additional connections, and lifted the restriction to the existing 108 connections temporarily (pending re-evaluation after completion of the added facilities), thus allowing Sereno to have issued water connection permits to the 19 contributors.

In situations such as present here, Commission discretion should be exercised with due regard to the probable consequences in the event of either a grant or a denial of the deviation.

If we deny a deviation, and as Branch recommends, require Sereno to refund the \$161,500 contribution fund received, Sereno will have to somewhere obtain that part of the fund already dispensed to pay for construction to date. But Sereno has no financial resources, cannot realistically borrow the amount,

and cannot look to RRU for it. (As the Receiver's Superior Court appointment order states, in accordance with Health and Welfare Code § 4035, no personal liability shall be borne by the receiver in connection with its operation of the Sereno Water System.) Wood's efforts were good faith efforts to resolve a festering problem of the Sereno system, and to comply with DHS's demands that additional water supplies be obtained. These efforts were also in accord with the thrust of Thousand Oaks, supra, where the Commission stated in regard to a similar situation:

"They have willingly assumed the duties and obligations of furnishing adequate water service to the public as a public utility and, as such, are legally obligated so to do when it is reasonably possible to secure and deliver sufficient water to meet the fair and proper demands of their consumers."

Wood at least did something and in good faith; his limited exposure to and knowledge of past Commission decisions and General Order provisions does not change that conclusion.

The net result, if the Commission denies the requested deviation, would at the least be that to do as Branch requests and order payback of the \$161,500, would result in the existing 108 connected customers having to pay through a surcharge for the approximate \$30,000 already expended on the collector and tank. The balance would come from the trust funds. As DHS, on July 7, 1998, issued a new water supply permit to Sereno which limits connections to 133, presumably the 19 contributors would get back their contributions and also be allowed connections. But this was done by DHS in anticipation that these special facilities were in progress of construction and would be completed by November 1, 1998. If these special facilities are required by DHS regardless of the outcome of the contribution issue, then all ratepayers up to a total of 133 would have to incur a surcharge to pay the \$160,000 cost of the facilities.

On the other hand, if the deviation sought by Advice Letter 21 were granted, it is difficult to see who would be injured, or in what way the public interest would be adversely affected. The 108 present connected customers would not be required to pay a surcharge applicable to cover the already expended approximate \$30,000 on the well collector and tank – an obligation of Sereno, not the receiver. And at no cost to themselves, the 108 would receive a very enhanced capability and reliability in the Sereno system. And the unserved, at least to a total of 25 including the 19 contributors, would be able at long last to connect and receive water service.

However, we see no reason why the deviation authority should extend beyond the 19 contributors. The latter would receive what they willingly bargained for – service which will enhance the value of their properties. Any collection of contributions beyond the 19 would be a windfall for the utility. But those beyond the 19 do not get in free – they must pay the Tariff meter connection fee. Applicants beyond the 19 contributors, but only to the limit set by DHS's water permit to Sereno, (at present six additional) should be granted connection permits to the extent of available system capacity at the time of each's application and be required to construct a residence within a reasonable period or forfeit their permit. Hoarding of unused connection permits should not be condoned.

Next, we turn to the meter connection fee issue. The 19 contributors and all future applicants must be allowed opportunity to choose the 5/8-inch service connection meter rather than the 1-inch meter dictated to them to date to reduce their monthly service charge. As footnote 10 clarifies, the \$5,000 attributed to a 1-inch meter was really part of the \$10,000 contribution to the special facilities fund, and not a separate, distinct, and additional charges as assumed by many

during the hearing. And it was earmarked specifically to pay for the special facilities. It should not be refunded or reduced.

Our determination then should be to grant the deviation sought by Advice Letter 21 as applicable and restricted to the 19 contributors listed in the advice letter. And we should not conclude that RRU's actions with regard to the events leading up to filing of the advice letter serve to render RRU demonstrably incapable of owing and operating Sereno.

Further, we cannot find that RRU would lack the financial resources to acquire and provide an adequate service at reasonable rates. As the Hamilton Trust has agreed to give the Sereno system to RRU at no cost, there is no purchase price to meet. And apart from the additional special facilities which Commission approval of Advice Letter 21 providing contributed funds would cover, the Sereno system is in good condition and requires no additional present capital investment. When the filtration plant that DHS will require to be added in the future is finally determined upon – with or without Carmet participation – the \$130,000 cost can be financed at least cost to the rate payers through a low cost State Revolving Fund 20-year loan with a surcharge. As Gibbon's Exhibit 28 pointed up, an alternative capital investment of that amount would go to rate base with depreciation, taxes, and return on the added equity serving to push up the gross revenue requirement with the result of higher monthly ratepayer bills, which would exceed a loan surcharge. Thus RRU has no need for substantial capital to acquire and operate Sereno. Its access to its substantial line of credit would suffice to meet the very small capital needs involved in its acquisition and future operation of Sereno.

But, as stated during the hearing, if authorized to acquire Sereno, it would be RRU's intention to promptly file advice letter proceedings for authorization to convert the Sereno operation to an Operating Ratio Method for its return rather

than to continue, considering Sereno's miniscule rate base, to operate on a Rate Base Method of Return.¹⁹

Finally, while concerned citizens argued that the present system cannot accommodate more than the existing 108 active connections, the evidence does not support their view. Based upon Sereno's 1997 actual 137 gpd per connection recorded usage, and even applying Branch's 16 gpm production figure, adjusted to allow for unaccounted water loss, the evidence is that it would at least produce 20,736 gpd. Thus, before addition of the special facilities under construction, indications are that there would be, at 137 gpd per connection, sufficient water to serve a possible total 151 connections.

These production figures, and the recorded 137 gpd consumption, serve to probably explain why the DHS witness called by concerned citizens, while declining to speculate regarding the ultimate number of connections that might be authorized under the new permit that will issue after the special facilities are completed and evaluated, testified that in his opinion the present system had sufficient water for the 132 connections proposed in the question, even if per connection usage was 260 gpd. As another DHS representative had stated in the March 25, 1999 PHC, DHS uses different source production assessment procedures than the Commission.

However, imposition or lifting of a building permit moratorium, or building permit limitations on connections, are matters under DHS jurisdiction,

¹⁹ In Re Financial (supra), the Commission determined that at least some utilities with small rate bases would benefit from adoption of an Operating Ratio Method as an alternative to the Rate Base Method, and the Commission authorized the Small Water Branch to calculate returns under both methods for Class C and D water utilities requesting new rates, and to recommend to the Commission the method that produces the higher result.

as defined in our current Memorandum of Understanding with DHS, and the Commission is content here to defer to DHS's determination.

Conclusion

The general policy followed by the Commission, in accord with the thrust of the Public Water System Investment and Consolidation Act of 1997 (Pub. Util. Code §§ 2718 et seq.), is to encourage and facilitate the acquisition of small distressed and 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.

In the present situation we have RRU with well tested managerial and technical expertise in the management and operation of small water systems. While RRU has only limited financial resources, with the contribution of special facilities under construction there would be no requirement for any significant capital infusion since the distribution system is in good condition. With the addition of these facilities, the result will be an adequate utility system. And of great importance to the ratepayers, these facilities will cost them nothing, whereas were the system to be acquired by a larger utility, the facilities would be paid for by a capital infusion that would result in a large rate base increase and higher rates.

Similarly, RRU would use the low cost State loan to fund the soon to be required filtration plant, resulting in less cost to the ratepayers than would a capital investment by a larger utility, even allowing for the 20-year payback under a surcharge. And it appears that Sereno, as RRU proposes, may well be one of those small water utilities that would benefit under an operating ratio method of return.

The application should therefore be granted as set forth in the order that follows, authorizing a sale and transfer of Sereno's stock to RRU. In addition, the deviation sought by Advice Letter No. 21 should be granted to permit the special facilities contributions from the 19 contributors. Determination of future operating status for RRU's operation of Sereno should be resolved in a future advice letter submission, thereby enabling our staff to test the claimed operating expenses, etc., applicable for that method of return. Similarly, when the filtration plant is ultimately required, whether in association with Carmet or not, when Sereno is ready to enter into a State loan, Sereno must apply for authorization to do so, and for authorization for a surcharge to apply to amortize such loan and its interest requirement.

Finally, pursuant to provisions of Section 116525(a) of the California Health and Safety Code, any person or entity operating a public water system must have a permit to do so from DHS, and a change in ownership of a public water system requires the prospective new owner to apply to and satisfy DHS's 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 RRU acquisition of the Sereno system, RRU must also apply to DHS for reissuance of Sereno's existing permit.

Comments on the Proposed Decision of the ALJ

In accordance with the provisions of Pub. Util. Code § 311 and Rule 77.1 of the Commission's Rules of Practice and Procedure, the proposed decision (PD) of ALJ Weiss was issued on September 1, 1999, and the parties were afforded opportunity to comment on the PD. Both Dominquez and Branch filed comments as provided for in Rule 77.2.

Dominquez commented on the PD's reliance upon what Dominquez states appears to be incorrect assumptions made by witness Gibbons relative to how Dominquez would fund future system improvements. Exhibit 26, circulated by Branch, introduced the concept of Dominquez as a proxy Class A, and postulated differences between RRU and the proxy as to results, differences based upon the exhibit's content that Gibbons showed to be incorrect.

We recognize that Dominquez was not responsible for the content of the exhibit, but at hearing its representative did not object to admission of either Exhibit 26 or Exhibit 16 (the 3 scenarios presented by Gibbons). Apart from stating Dominquez's interest in Sereno, he stated that Dominquez would seek immediate rate relief for the supply and storage improvements mandated by DHS (whereas RRU would finance the \$160,000 cost through its 19 contributors with no rate base impact). He also stated that if possible to qualify, Dominquez would also seek a \$130,000 SDWBA loan to finance a future treatment plant. These facts could narrow the difference, but do not change our decision.

We assure Dominquez that in appropriate cases we fully intend to follow our previously stated policy and the thrust of the Public Water System Investment and Consolidation Act of 1997 to encourage and facilitate the acquisition of small water utilities by large Class A water companies.

Branch's comment again asserts that RRU lacks the resources to acquire and operate Sereno. As the PD stated, the acquisition to RRU will cost RRU nothing (a piece to another is unknown). RRU will finance the supply storage improvements with the \$160,000 contributions in aid of construction already received (and at no rate base costs to current customers), and will finance the future treatment plant with an SDWBA loan, for which it has been invited to apply. (It appears from Dominquez's comments that Dominquez would do the same.) As Branch's report stated, otherwise the system is in good shape. Thus

RRU's present \$86,000 line of credit (with more available) is more than adequate to operate this small system.

The PD noted on page 25 of the Commission's two General Order 103 cases that revised previous policy to permit (as an additional source of capital) on a case-by-case basis, small water utilities to assess a special facilities fee on new customers to pay for additional facilities required to serve them. The PD discussion adequately answers Branch's comments. With most of its extensive public water service experience in the public sector, RRU concededly has through ignorance or misunderstanding of Commission rules, failed to always comply. But it also has worked with the Small Water Branch to adjust, and as Court Appointed Receiver of Sereno, RRU has diligently worked with DHS to quickly remedy the problems it inherited, and has provided good service during the four years of its receivership.

Findings of Fact

1. Sereno is a private investor owned water public utility as defined in Pub. Util. Code § 241, and has been subject to the jurisdiction of the Commission since its certification in 1969.

2. Initially, Sereno was established as a weekend or summer second home purveyor, but the demographics slowly are changing, with more full time residential demand today.

3. In view of its part time demand characteristics, the historical per connection consumption has been very low.

4. From inception the Sereno system has had water supply problems derived from its dependence upon the Scotty Creek watershed area.

5. Following successive augmentations to supply sources, in 1976 the Commission authorized Sereno a deviation from its Tariff to permit the

contiguous but water deficient Gleason Beach Assessment District to contribute its facilities in exchange for extension of Sereno service to the District.

6. As a long term consequence of the Gleason Beach addition and the effect of depreciation, today the Sereno rate base is a meager \$49,690.

7. Sereno's water supply problems led the County Health Department to impose a new connection moratorium years ago; which moratorium was continued when in 1993, DHS took over regulatory oversight from the County.

8. In 1994, the owner-operator of Sereno, Charles A. Hamilton, placed all 2,945 outstanding shares of Sereno's common stock into a Trust.

9. In mid-1995, following Hamilton's incapacity and subsequent death, and in the absence of any active participation by the Trust in the operation of Sereno, DHS petitioned the Sonoma County Superior Court to fill the void, and the Court appointed DHS's nominee RRU as receiver to manage and operate the Sereno system.

10. RRU, a private investor owned management corporation headed by a well experienced licensed civil engineer, for many years has successfully contracted to manage and/or operate numerous district and mutual water systems, several of which serve up to 1,000 connections.

11. Following appointment as receiver, RRU advanced an emergency loan of \$29,600 to Sereno to replace pumps and to reconstruct a well. After advising the Commission in September 1997 of its reimbursement of \$15,300 from current revenues, RRU has received no further reimbursement, leaving a \$14,300 balance unpaid.

12. The Commission by Resolution No. W-4079 in 1997, also recognized RRU as receiver for Sereno.

13. Before the 1995 RRU receivership, there were many water outages, but there have been none since.

14. With only 108 of the 197 lots in Sereno's service area served, owners of a number of unserved lots unable for years to obtain a water connection because of the moratorium, pressured the receiver to fulfill Sereno's obligation to serve by devising a way to augment the supply, and also offered to contribute the funds to finance any additional special facilities needed to supply them.

15. In fulfillment of Sereno's service obligation, the receiver determined what special facilities had to be added to meet DHS's requirements, and following conversations with and encouragement from Small Water Branch, designed a tariff deviation scheme providing for unserved lot owners to equally contribute the costs of these required special facilities.

16. Through either unfamiliarity or ignorance of Commission General Order advice letter procedures applicable for tariff deviations, instead of filing an advice letter, on October 15, 1998, the receiver mailed to the Small Water Branch Chief a copy of its proposed initial deviation main extension agreement, and advised that when sufficient contributions were received in its escrow account for the project, it would apply to DHS and commence construction.

17. Nineteen contributors each provided a net \$8,500; DHS approved the special facilities proposed; and not hearing from Small Water Branch, the receiver started construction using a portion of the \$161,500 received.

18. Because of winter rains, work on the special facilities had to be temporarily suspended; nonetheless, re-evaluating the existing supply capability, DHS temporarily lifted the moratorium, allowing the 19 contributors to obtain water connection permits.

19. Back in late 1996 and early 1997, the Hamilton Trust and RRU had agreed to a transfer of Sereno ownership to RRU, and the Trust's Trustee had forwarded documentation to effect such a transfer which early in 1998 was delivered by

RRU to its corporate attorney pending Commission approval before proceeding to effect the transfer.

20. On April 28, 1998, RRU requested current transfer forms from Small Water Branch, as well as instructions on how to proceed.

21. On July 27, 1998, RRU filed the present application for Commission authorization to acquire Sereno, but as the application contained an ambiguous set of cost and depreciation estimates, it was duly protested by Branch.

22. A Branch report of March 19, 1999, Exh. 1, widely distributed, contained sharp criticisms of RRU, centering upon the special facilities scheme and RRU's financial status, as well as subsequently disproved charges of RRU having improperly acquired Sereno's stock in violation of Pub. Util. Code § 854, and Branch recommended dismissal of the application.

23. Subsequently, Branch distributed Exh. 26, an updated May 6, 1999 version of its March 19, 1999 report, which added Section 6 which purported to show that operation of Sereno by a Class A Water Utility (specifically Dominguez) would produce lower rates.

24. Gibbon's Exh. 16 and Exh. 28 disproved Branch's Exh. 26, showing that operations as requested by RRU, using the special facilities contributions and a later State low cost loan (rather than Dominquez's capital injections to pay for the special facilities and filtration plant with their resultant ballooning of rate base and depreciation) result in substantially lower rates under RRU.

25. Branch sought to delete Exh. 26 (submitted by RRU) conceding that Section 6 was based on assumptions dispelled by Gibbons, but as it had been widely distributed, the ALJ ruled for its admission.

26. The receiver's actions to resolve the water supply deficiency were in accordance with case law and good faith; however, its use of a letter notice rather than adherence to the prescribed advice letter procedure was in error.

27. The receiver's assignment of 1-inch meter connections as part of the contribution package to the 19 contributors for special facilities was arbitrary and unjust.

28. The receiver has operating and managerial experience with the Sereno system, as well as extensive experience with numerous other small public water systems and with public permitting agencies and DHS, all of which would be beneficial in operations as owner of Sereno.

29. It appears that a transfer from the Rate Base Method to the Operating Ratio Method would be beneficial in the long term in view of Sereno's present financial structure if RRU is authorized to acquire Sereno.

30. Were Sereno to finance the special facilities and the forthcoming filtration plant by contributions and a low cost State loan, in view of the good condition of the distribution system, future capital requirements would be minimal.

31. While RRU does not possess substantial capital reserves, it does enjoy access to bank lines of credit that are more than adequate for both its private management corporation needs and Sereno's minimal capital needs.

32. A transfer of ownership of Sereno to RRU would not be adverse to the public interest.

33. The plans of RRU, at such time as DHS mandates addition of a filtration plant, to finance such plant through a State low cost loan rather than through equity financing, are in the public interest, and should be pursued at the time by requesting Commission authorization pursuant to Pub. Util. Code § 818.

34. Should ongoing negotiations produce a workable plan for Sereno and Carmet to share a filtration plant with benefits to both entity's ratepayers, it would be in the public interest for Sereno to pursue Commission authorization for any such contractual arrangement.

35. It can be seen with reasonable certainty that acquisition by RRU of Sereno would present no significant impact on the environment.

Conclusions of Law

1. The sale and transfer of Sereno to RRU should be authorized as set forth in the order that follows.

2. The variance from Sereno's filed tariff sought to authorize contributions from each of the named 19 contributors listed in Advice Letter No. 21, and containing the provisions as set forth in the identical contribution statements in Exhibit 14 in this proceeding, should be authorized for the specific purposes stated in the statements.

3. The 19 contributors should expeditiously be offered the choice of either a 5/8-inch or a 1-inch meter connection at no further cost for replacement or installation.

4. A transfer should be conditioned upon the receiver acting for Sereno paying to the Commission the Public Utilities Reimbursement Fees collected up to the date the transfer is consummated.

5. Before assuming operation of Sereno following a transfer, RRU is required to comply with the provisions of Section 116525(a) of the California Health and Safety Code which require a prospective new owner operating a public water system also to apply to and satisfy DHS's 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.)

6. Should RRU acquire ownership of Sereno, the receivership should be terminated through petition to the Superior Court.

7. Upon completion of the sale and transfer and payment to the Commission of the Public Utilities Reimbursement Fees, the Hamilton Trust should be

relieved of its public utility water service obligations in the Sereno service territory.

8. Because the public interest would best be served by resolution of the ownership through having a transfer take place expeditiously, the ensuing order should be made effective on the date of issuance.

9. The receivership over Sereno should be terminated as expeditiously as possible in association with the sale and transfer.

O R D E R

IT IS ORDERED that:

1. Within three months after the effective date of this order, the Charles A. Hamilton Trust (the Trust), owners of record of the 2,945 shares of the capital stock of Sereno Del Mar Water Company (Sereno), is authorized to transfer, and Russian River Utility (RRU), is authorized to receive, these shares for no cash consideration.

2. Within 10 days of the actual transfer of the shares stated in Paragraph One, RRU shall notify the Commission in writing of the date on which the transfer was effected, and shall attach to the written notification a true copy of the instrument effecting the transfer.

3. As court appointed receiver of Sereno, RRU shall for the Trust, make remittance to the Commission of the Public Utilities Commission Reimbursement Fees collected to the date that the transfer of ownership to Sereno is accomplished.

4. Upon completion of the transfer as authorized by this Commission Order, and upon remittance to the Commission of the fees set forth in Paragraph 3 of this order, the Trust shall stand relieved of its public utility water obligations in the Sereno service area.

5. Sereno's Advice Letter No. 21 seeking a deviation from the utility's Tariff Rule 15's Form 4, to permit Sereno to receive a Special Facilities Contribution in the net amount of \$8,500 from each of the named 19 contributors for the specific purpose of constructing a second well collector in Scotty Creek, installing electrical controls, monitoring and telemetry equipment, and a 200,000 gallon storage tank with solar power and radio transmission telemetry, is approved.

6. The deviation authority set forth in Ordering Paragraph 5 is limited to the 19 contributors named in Advice Letter No. 21.

7. Within 30 days of the date of this order, the 19 contributors named in Advice Letter No. 21 shall be notified by letter that regardless of the fact that the 1-inch meter connection previously assigned to them may have already been installed, they may by mail notification to Sereno elect to receive their authorized water service through a 5/8-inch meter connection at no further charge for the connection or change. The Chief of the Commission's Small Water Branch is to be furnished a copy of Sereno's notice to each of the 19 contributors, and advised by Sereno of their final selection.

8. Should RRU proceed, as authorized in Ordering Paragraph 1, to acquire the Sereno shares and thereby obtain control of Sereno, RRU should consult with the Chief of the Commission's Small Water Branch for assistance in filing an Advice Letter to establish rates using an Operating Ratio Method, if RRU desires to seek authorization for the change.

9. Should RRU acquire ownership and control of Sereno, RRU should consult with the Chief of the Small Water Branch for assistance in filing an Advice Letter in order to recover through amortization the outstanding \$14,300 loan balance remaining from RRU's 1995 loan to Sereno.

10. Unless otherwise authorized by the Commission, after acquisition of Sereno's stock, RRU shall own and operate Sereno as a public utility water

system separate and distinct from RRU's management corporation activities and interests, and shall continue that separate operation using for the Sereno public utility operation the Commission's Uniform System of Accounts applicable to a Class D Water System.

11. Upon acquisition by RRU, the recorded cost of the existing plant of Sereno shall be \$131,790, the recorded accumulated depreciation shall be \$82,110, with a net plant of \$49,690 to apply for rate setting and all other related purposes.

12. Upon acquisition by RRU and notice of that acquisition to Department of Health Services (DHS), RRU should request DHS to petition the Sonoma County Superior Court for an order terminating the RRU receivership.

13. Application 98-07-046 is closed.

This order is effective today.

Dated October 7, 1999, at Los Angeles, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners