

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



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In the Matter of the Updated and Corrected Application of GREAT OAKS WATER CO. (U162W) for an Order Authorizing an Increase in Rates Charged for Water Service, increasing the revenue requirement by \$1,846,100 or 14.94% in 2010, by \$254,425 or 1.79% in 2011, and by \$165,822 or 1.14% in 2012.

A.09-09-001  
(Filed September 3, 2009)

**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES  
ON THE DIVISION OF WATER AND AUDITS'  
FINANCIAL AND COMPLIANCE VERIFICATION OF  
GREAT OAKS WATER COMPANY**

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## I. INTRODUCTION

The Division of Ratepayer Advocates (“DRA”) respectfully submits these comments pursuant to the June 21, 2010 “Assigned Commissioner and Administrative Law Judge’s Ruling Addressing the Motion of DRA to Reopen the Record and Issue an Order to Show Cause,” Ordering Paragraph 4.

DRA appreciates the opportunity to comment on the Division of Water Audits’ (“DWA”) “Financial and Compliance Verification of Great Oaks Water Company” (hereinafter “DWA’s Report”). DRA supports most of DWA’s findings and recommendations. Most importantly, DRA believes that DWA’s Report correctly concludes that Great Oaks Water Company’s (“Great Oaks”) non-disclosure of its nonpayment of groundwater production expenses to the Santa Clara Valley Water District (“District”) demonstrates that Great Oaks is not in compliance with Public Utilities Code §§ 451 and 794, the Uniform System of Accounts for Class A water utilities, and Decision (“D.”) 04-06-018, which was updated in D.07-05-062.<sup>1</sup> In light of DWA’s findings, DRA urges the Commission to adopt DWA’s recommendations and consider DRA’s additional recommendations to ensure that Great Oaks understands the Commission will not tolerate anything less than accurate information and a complete explanation of the Company’s actual operating expenses and financial position.

DWA’s Report confirms DRA’s original contentions that Great Oaks deliberately omitted material information from its general rate case (“GRC”) application regarding the nonpayment of its groundwater production charges to the District and that Great Oaks’ actions have jeopardized DRA’s ability to fully examine Great Oaks’ true and actual operating expenses for ratemaking purposes. For these reasons, DRA respectfully requests that the Commission admit DWA’s Report into the record and order an additional hearing in this proceeding for the limited purpose of determining whether Great Oaks violated Rule 1.1 and therefore should be fined for misrepresenting its

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<sup>1</sup> Division of Water and Audits’ Financial & Compliance Verification of Great Oaks Water Company, August 20, 2010, (“DWA’s Audit Report”), at p. 1.

treatment of ratepayer-provided groundwater production funds, and whether Great Oaks' management team violated Section 2114 of the Public Utilities Code. If the Commission determines that a hearing is necessary, DRA submits that the Commission should examine the following questions:

1. Did Great Oaks violate Rule 1.1 by not disclosing to the Commission and DRA that it was not in fact paying groundwater production charges to the Santa Clara Valley Water District, even though it was including these charges as an expense in its GRC Application?
2. Did Great Oaks' management violate Section 2114 of the Public Utilities Code when it omitted material information regarding its withholding of groundwater production charges to the Santa Clara Valley Water District?
3. Did Great Oaks exercise prudent judgment in incurring interest and penalty charges for withholding payments to the Santa Clara Valley Water District?
4. Has Great Oaks exercised prudent judgment in depositing ratepayer-provided groundwater production funds in a money market account and been a good steward of the revenues received from its ratepayers?

If the Commission determines that an additional hearing is not necessary, DRA respectfully requests that the Commission admit DWA's Report into the record in this proceeding and issue a decision on the above-mentioned questions in this proceeding, not in a separate proceeding.

## **II. BACKGROUND**

On September 3, 2009, Great Oaks filed its GRC Application ("A.") 09-09-001, wherein it requested a \$1,846,100 increase in its revenue requirement.<sup>2</sup> In its GRC Application, Great Oaks estimated groundwater production charges levied by the District

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<sup>2</sup> See Assigned Commissioner and Administrative Law Judge's Ruling and Scoping Memo, *available at* <http://docs.cpuc.ca.gov/efile/RULC/110652.pdf>.

would cost \$4,497,610 for 2009.<sup>3</sup> Among the expenses that Great Oaks filed for recovery in the 2010-2012 rate cycle were its groundwater production charges. These expenses represent approximately 38% of Great Oaks' revenue requirement.

The Commission concluded Great Oaks' GRC evidentiary hearings on January 29, 2010. On or about March 15, 2010, DRA learned that on April 30, 2009, Great Oaks stopped paying the District for groundwater charges. In fact, four months before Great Oaks filed its application requesting that the Commission authorize its proposed rate increases in the 2010-2012 rate cycle, it had stopped paying an expense that accounted for 38% of its revenue requirement. However, Great Oaks did not disclose to DRA that it was not actually paying the District for groundwater production charges. Thus, on March 19, 2010 DRA filed a motion to reopen the GRC evidentiary record to admit information regarding Great Oaks' lack of payment of groundwater production charges to the District, and to request that the Commission issue an Order to Show Cause for Great Oaks' violation of Rule 1.1 and possible violation of Section 2114 of the Public Utilities Code ("DRA's Motion").

On June 21, 2010, the Assigned Commissioner and the Administrative Law Judge ("ALJ") issued a joint ruling addressing the motion of DRA and reopening the evidentiary record of Great Oak's GRC application.<sup>4</sup> The joint ruling directed DWA to verify four specific items outlined below:

Goal 1: Verify Great Oaks' assertion that its ratepayer-provided groundwater production funds are kept in a separate bank account.

Goal 2: Verify that Great Oaks' separate bank account has provisions which require approval from the Santa Clara Superior

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<sup>3</sup> See Motion of the Division of Ratepayer Advocates to Reopen the Record to Admit Great Oaks' Nondisclosure of Lack of Payment of Groundwater Charges and Request that the Commission Issue an Order to Show Cause ("DRA's Motion"), Attachment D, *available at* <http://docs.cpuc.ca.gov/EFILE/MOTION/115411.htm>.

<sup>4</sup> See Assigned Commissioner and Administrative Law Judge's Ruling Addressing the Motion of the Division of Ratepayer Advocates to Reopen the Record and Issue an Order to Show Cause, *available at* <http://docs.cpuc.ca.gov/efile/RULINGS/119462.pdf>.

Court for these funds to be dispensed to an entity other than the Santa Clara Valley Water District.

Goal 3: Verify that Great Oaks' accounting entries reflect its assertion that ratepayers are not liable for late payment interest and penalty charges related to the withholding of groundwater production charges.

Goal 4: Examine that Great Oaks' failure to inform DRA and the Commission of its actions of withholding the groundwater production charges from the Santa Clara Valley Water District did not violate any GAAP or the Commission's accounting or reporting requirements.<sup>5</sup>

DWA's Utility Audit, Finance and Compliance Branch ("UAFCB") investigation largely confirms the misconduct DRA alleged in its Motion to reopen the record. In the comments below, DRA addresses the joint ruling goals and UAFCB's findings and recommendations. Moreover, DRA provides additional recommendations to adequately protect Great Oaks' ratepayers from interest and penalty charges for the withholding of groundwater production charges and to ensure that Great Oaks knows that the Commission will not tolerate the deliberate omission of material information relevant to the ratemaking process.

### III. DISCUSSION

#### A. **Great Oaks' assertion that its ratepayers provided groundwater production funds are kept in a separate bank account is misleading**

In Great Oaks' response to DRA's Motion, Mr. John Roeder, Great Oaks' Chief Executive Officer, declared under penalty of perjury that ratepayer-provided groundwater production funds were being deposited and securely held in a "separate bank account."<sup>6</sup> However, in its verification of Goal 1, UAFCB established that Great Oaks did not open

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<sup>5</sup> DWA's Audit Report, at p. 3.

<sup>6</sup> See Declaration of John W.S. Roeder in Response to DRA Motion, at pp.1 to 2, *available at* <http://docs.cpuc.ca.gov/efile/RESP/116307.pdf> ("Declaration of John Roeder").

a “separate bank account” to deposit the withheld payments on groundwater production charges funded by its ratepayers.<sup>7</sup> Instead, UAFCB noted that Great Oaks claims it opened an “escrow-type account” with W&R, a financial service company.<sup>8</sup> DRA asserts, however, that this is yet another example of Great Oaks providing the Commission with misleading information.

Moreover, UAFCB noted that, according to W&R, Great Oaks’ account is a “money market mutual fund,” and UAFCB concluded that Great Oaks’ “escrow-type account” is similar to a money market mutual fund account.<sup>9</sup> However, DRA submits that it is unclear exactly what type of account Great Oaks opened to deposit ratepayer-provided groundwater production funds. In fact, UAFCB reported that the information Great Oaks provided “could not be used to verify that the money market account is in fact an escrow account in terms of how such accounts are normally structured.”<sup>10</sup> DRA notes that UAFCB’s description of Great Oaks’ account does not meet the definition and purpose of an escrow account. An escrow account is a mechanism where an independent trusted third-party holds money for two transacting parties, where the timing and direction of release of the money by the third-party is dependent on how certain pre-specified future events unfold.<sup>11</sup> Since it appears that Great Oaks is the only party that has full access to these ratepayer groundwater production funds, Great Oaks’ account is not an escrow-type account.<sup>12</sup> In addition, UAFCB was not able to verify whether Great Oaks provided any specific instructions to W&R for the safekeeping of these funds or for how these funds are to be distributed when a future event is triggered.<sup>13</sup> Therefore, if Great Oaks is the only party with full control over the ratepayer groundwater production

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<sup>7</sup> DWA’s Audit Report, at p. 4.

<sup>8</sup> *See id.*

<sup>9</sup> *See id.* (see also footnote 8).

<sup>10</sup> *Id.*

<sup>11</sup> *See* Black’s Law Dictionary, Ninth Edition, 2009 (“Escrow Account”).

<sup>12</sup> *See generally* Declaration of John Roeder.

<sup>13</sup> *See* DWA’s Audit Report at p. 4.

funds, it cannot be said that Great Oaks is securely holding these funds in an “escrow-type account.”

DWA’s Report further reveals that, even during the course of UAFCB’s investigation, Great Oaks failed to fully disclose the terms and conditions of its account with W&R. UAFCB indicated that due to this lack of disclosure, it could not develop an adequate understanding of the level of risk associated with this account, and even noted that W&R’s investment disclosure statement indicated that the investment products it offers are subject to the risk of possibly losing the principal invested.<sup>14</sup> Given that Great Oaks did not provide UAFCB with the terms of its account with W&R, DRA urges the Commission to adopt UAFCB’s recommendation that “Great Oaks should provide the Commission’s DRA with the conditions, requirements, agreements, instructions, etc. for the separate escrow-type account opened with W&R.”<sup>15</sup> DRA also agrees with UAFCB that Great Oaks should be required to transfer the entire balance in its W&R account into a secure and separate “bank escrow” account or to a regular standard bank account.<sup>16</sup> Additionally, DRA recommends that Great Oaks be required to provide DRA with the terms and conditions of the new account.

In its verification of Goal 1, UAFCB also noted that the funds Great Oaks deposited into the account with W&R were based on its Well Meters Reports rather than on funds actually collected from its customers.<sup>17</sup> Although Great Oaks’ Well Meters Reports supported the deposits, UAFCB was not able to reconcile the deposits in the W&R account with the amounts collected from Great Oaks’ customers.<sup>18</sup> DRA submits that there needs to be reconciliation between expenses being incurred for the groundwater production charges and the revenues collected from ratepayers to make sure the expenses

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<sup>14</sup> *See id.*

<sup>15</sup> *See id.*, at p. 11.

<sup>16</sup> *See id.*

<sup>17</sup> *Id.*, at p. 4.

<sup>18</sup> *Id.*

and revenues for the groundwater production charges match. As such, DRA agrees with UAFCB that “Great Oaks should propose as part of its next GRC rate design filing a method to separate out the total [groundwater production charges] component collected as revenue via surcharges, services charges, and quantity charges if the [groundwater production charges are] still an operating expenses.”<sup>19</sup>

Finally, UAFCB also reviewed whether Great Oaks made timely deposits into its W&R account. UAFCB stated that it selected a sample of Great Oaks’ documentation for certain months in 2009 and for the period of January to June 2010.<sup>20</sup> According to DWA’s Report, Great Oaks prepares a “Water Production Statement” to report to the District the amount of water pumped from its wells on a monthly basis, which Great Oaks must submit to the District on or before the 30<sup>th</sup> day following the end of the month.<sup>21</sup> Furthermore, upon submission of its Water Production Statement to the District, Great Oaks makes a deposit into its W&R account using the amount of the groundwater production charges indicated in the Water Production Statement.<sup>22</sup> Although UAFCB indicated that it analyzed the W&R statements, District’s invoices, and Great Oaks’ Well Meter Reports, it was silent as to whether Great Oaks was in fact making timely deposits into its W&R account.

DRA’s examination of Great Oaks’ Groundwater Account Charges through April 30, 2010 (Attachment A of Reply of DRA to the Response of Great Oaks to DRA’s Motion) shows that Great Oaks is required, at the end of each month, to report to the District the amount of water pumped the previous month.<sup>23</sup> Furthermore, Great Oaks’ Groundwater Account shows that the District bills Great Oaks on a monthly basis.<sup>24</sup> In

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<sup>19</sup> See *id.*, at 11.

<sup>20</sup> *Id.*, at p. 5.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Reply of the Division of Ratepayer Advocates to the Response of Great Oaks Water Company to DRA’s Motion (“DRA’s Reply Motion”), Attachment A, Great Oaks Groundwater Account, *available at* <http://docs.cpuc.ca.gov/efile/REP/117027.pdf>.

<sup>24</sup> See *id.*

light of this reporting pattern, DWA's Report's Appendix B reveals that Great Oaks has not deposited ratepayer groundwater production funds each month in 2010.<sup>25</sup> As such, DRA is not certain whether Great Oaks is in fact making timely deposits into its W&R account. Based on the above, DRA respectfully recommends that Great Oaks be required to make timely deposits in a Commission-authorized secure and separate "bank escrow" account or to a regular standard bank account. In addition, DRA urges the Commission to require Great Oaks to report quarterly to DRA the status of the account, including interest earned and the dates when it deposits ratepayer groundwater production funds into the account.

**B. Great Oaks' account does not include a provision which requires approval from the Santa Clara County Superior Court for these funds to be dispensed to an entity other than the Santa Clara Valley Water District**

In its assessment of Goal 2, UAFCB verified that Great Oaks has not made any withdrawals of groundwater production funds from its W&R account.<sup>26</sup> The amount of deposits plus interest earned in the W&R account through June 28, 2010 is \$5,363,124.<sup>27</sup> However, UAFCB was not able to verify that the W&R account has provisions that require approval by the Superior Court of the County of Santa Clara before any funds can be dispensed to an entity other than the District.<sup>28</sup> UAFCB stated that "according to Great Oaks' July 6, 2010 response to UAFCB's Data Request No.1, [t]he restrictions on the account are not provided by the account itself, but are instead based upon instructions from [Mr. Roeder] to Great Oaks' Chief Financial Officer, Vicki Mores, to open the account for the purpose of depositing and securely holding groundwater charges imposed by the [District] until a legal determination is made on the disposition of the funds."<sup>29</sup>

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<sup>25</sup> See DWA's Audit Report, Appendix B (January 2010 to June 2010).

<sup>26</sup> *Id.*, at p. 5.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*, at p. 6.

<sup>29</sup> *Id.*

As explained above, Great Oaks' W&R account is not likely an "escrow-type account" since Great Oaks has full control over the funds in this account and W&R is not subject to pre-specified instructions governing the release of these funds. As such, Great Oaks can easily withdraw these funds without the knowledge of the District or the Commission. In light of Great Oaks' past behavior regarding its non-disclosure of material information to the Commission, DRA submits that Great Oaks' "word" that the ratepayer-provided groundwater production funds will remain in its W&R account until a legal determination is made is not sufficient or adequate protection of ratepayer funds. DRA is also concerned that it may take several years for Great Oaks to get a final legal determination as to whether the District can continue to charge it for groundwater production (or to levy the so-called pump tax). Given that Great Oaks has failed to fully disclose the terms of its W&R account and the account does not have any restrictions regarding the withdrawal of funds to an entity other than the District, DRA calls into question whether Great Oaks has been a good steward of ratepayer-provided groundwater production funds.

For these reasons, DRA agrees with UAFCB's recommendation that "Great Oaks should be required to establish a specific withdrawal provision with W&R to ensure that any withdraws to entities other than the District must require approval of the Court or the Commission."<sup>30</sup> In addition, DRA recommends that when Great Oaks transfers the groundwater production funds into the new "bank escrow" account or regular standard bank account, Great Oaks should be required to establish the same withdrawal provision in the new account and must obtain the approval of the Commission for any withdrawals to entities other than the District.

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<sup>30</sup> See *id.*, at p. 11.

**C. Great Oaks' ratepayers are not adequately protected from liability for late payment interest and penalty charges related to the withholding of groundwater production charges**

In its evaluation of Goal 3, UAFCB stated that it reviewed the Profit and Loss Statement in Great Oaks' 2009 Annual Report and noted that the \$191,783 in interest and penalty charges accrued between March 2009 and December 2009 were recorded as non-utility interest/charges.<sup>31</sup> Furthermore, UAFCB stated that it verified that Great Oaks excluded non-utility items, including interest and penalty charges from the District, from its 2009 GRC Application.<sup>32</sup> Based on this verification, UAFCB concluded that Great Oaks' ratepayers have not been harmed by any interest and penalty charges resulting from its nonpayment of groundwater production charges to the District.<sup>33</sup> However, DRA believes that UAFCB's conclusion is premature because the Commission does not have the ability to verify that Great Oaks' ratepayers will not be liable for interest and penalty charges in Great Oaks' future GRCs.

DRA notes that Great Oaks could make adjustments to its operating and maintenance recorded expenses to include these interest and penalty charges in its next or future GRCs. As of June 30, 2010, Great Oaks has accrued a total of \$489,216 in late payment interests and penalty charges for withholding groundwater production charges.<sup>34</sup> DRA does not have the ability to ensure that Great Oaks' shareholder will be liable for these non-utility charges, rather than ratepayers, and there is no mechanism in place to ensure that these interest and penalty charges will in fact be kept out of Great Oaks' operating expenses in future GRCs. For these reasons, DRA does not believe that Great Oaks' ratepayers are adequately protected from being liable for interest and penalty charges for nonpayment of groundwater production charges to the District. As such,

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<sup>31</sup> *Id.* at p. 6.

<sup>32</sup> *Id.* at p. 7.

<sup>33</sup> *Id.*

<sup>34</sup> *See id.*, Appendix C.

DRA urges the Commission to issue an order that Great Oaks' shareholders will be responsible for all interest, penalties, and legal expenses associated with the nonpayment of groundwater production charges.

Moreover, DWA's Report did not include in its scope how other components of Great Oaks' GRC were impacted by the nonpayment of groundwater production charges. Under prospective ratemaking, utilities are allowed to earn a rate of return on working capital. The purpose for working capital is to compensate investors for funds provided by them which are permanently committed to the business for the purpose of paying operating expenses in advance of receipt of offsetting revenues from its customers and in order to maintain minimum bank balances. For test year 2010-2011, Great Oaks estimated a total of \$1,551,960 for working capital, which includes as a component of its calculation the groundwater production charges expense of \$5,242,307.<sup>35</sup> Since Great Oaks is not paying this expense, it should be excluded from the working capital calculation, otherwise the amount included in rate base for working capital will be overstated. Therefore, the Commission should reduce Great Oaks' working capital estimate.

**D. Great Oaks' failure to inform DRA and the Commission of its action of withholding the groundwater production charges violated Commission accounting and reporting requirements**

In its assessment of Goal 4, UAFCB concluded that although Great Oaks was in compliance with Generally Accepted Accounting Principles ("GAAP"), it is not in compliance with Public Utilities Code ("PUC") §§ 451 and 794, the Uniform System of Accounts ("USOA") for Class A water utilities, and D.04-06-018.<sup>36</sup> DRA submits that Great Oaks' lack of compliance with Commission directives regarding accounting and reporting requirements hindered DRA's ability to fully review Great Oaks' actual operating expenses for ratemaking purposes. As noted by UAFCB, Great Oaks had

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<sup>35</sup> See Great Oaks Updated and Corrected Exhibit GO-3, tab A-10 and 9.

<sup>36</sup> DWA's Audit Report, at p. 7.

ample opportunities to properly account and report its decision to withhold groundwater production charges prior to DRA's March 2, 2010 Motion seeking to reopen the record in this proceeding.<sup>37</sup> DWA's Report supports DRA's contention that Great Oaks deliberately omitted material information from its GRC application. Great Oaks' attempt to mislead DRA and the ALJ in this proceeding with information that did not reveal that it was not actually paying the District for what amounts to 38% percent of its revenue requirement is a violation of Rule 1.1 and a possible violation of § 2114 of the PUC.

**1. Great Oaks' compliance with GAAP does not absolve it from compliance with other Commission disclosure requirements**

UAFCB reported that Great Oaks used Financial Accounting Standard ("FAS") No. 5 to support its assertions that the collected groundwater charges were recorded in accordance with GAAP and disclosed in its financial statements.<sup>38</sup> While DRA agrees that Great Oaks is in compliance with GAAP, in that FAS No. 5 requires that losses from a contingency be accrued in the company's financial statements, DRA submits that this does not absolve Great Oaks from complying with Commission's directives regarding full disclosure and reporting of information that is material to the ratemaking process. Great Oaks' financial accounting follows from Commission decisions, but accounting guidelines do not normally formulate Commission ratemaking treatment and do not dictate disclosure of information for determining just and reasonable rates. As such, Great Oaks' compliance with GAAP is not a demonstration of compliance with other Commission accounting and reporting requirements.

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<sup>37</sup> *Id.* at p. 9.

<sup>38</sup> *Id.*, at p. 7.

## 2. Great Oaks is not in compliance with the Commission's Uniform System of Accounts

In DWA's Report, UAFCB concluded that Great Oaks' accounting of groundwater production charges is not in compliance with the USOA<sup>39</sup> cost definition.<sup>40</sup>

The USOA defines "cost" as follows:

"the amount of money actually paid for property or services or the cash value at the time of the transaction of any consideration other than money." (Emphasis added).<sup>41</sup>

As UAFCB noted, "[a]lthough Great Oaks has collected [groundwater production charges] representing approximately 38% of an average residential bill from its ratepayers as pass-through operating expense for ratemaking purposes, it has withheld making those payments to the [District] since April 2009."<sup>42</sup> DRA submits that Great Oaks' failure to disclose that it did not actually pay groundwater production charges, which it included as an expense in its GRC application is not consistent with the "cost" definition of the USOA. As such, DRA agrees with UAFCB's conclusion that Great Oaks is not in compliance with this accounting requirement.<sup>43</sup>

In addition, UAFCB found that Great Oaks did not comply with the records disclosure procedure in the USOA.<sup>44</sup> Pursuant to the USOA,

"2. Records.

A. Each utility shall so keep its books of account, and other such books, records, and memoranda which support, or are necessary to an understanding of the entries in such

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<sup>39</sup> Pursuant to PUC §794 and D.50185, the Commission exercised its authority to establish and adopt USOA for Class A water utilities on June 29, 1954. The USOA for Class A water utilities was incorporated into DWA's Standard Practice U-38-W on January 1, 1955.

<sup>40</sup> See DWA's Audit Report, at p. 9.

<sup>41</sup> Uniform Statement of Accounts for Class A Water Utilities ("USOA"), January 1, 1955, Definitions, at p. 6.

<sup>42</sup> DWA's Audit Report, at pp. 9-10.

<sup>43</sup> See *id.*, at p. 10.

<sup>44</sup> See *id.*, at p. 9.

books of account, so as to be able to furnish readily full information as to any item included in any account...

- B. The books and records referred to herein include not only accounting records in a limited technical sense but all other records such as minute books, stock books, reports, correspondence, memoranda, and the like, which may be useful in developing the history of or facts regarding any transaction.”<sup>45</sup>

As shown in the instructions quoted above, Class A water utilities are required to disclose not only their accounting records in a limited technical sense, but also all other relevant information to permit the verification of all the facts.<sup>46</sup> As noted by the UAFCB, Great Oaks’ recording of groundwater production charges as operating expenses while withholding payments to the District is relevant information that needed to be disclosed in order to allow the Commission to consider whether the recorded groundwater production expenses are reasonable.<sup>47</sup>

DRA notes that Great Oaks’ lack of disclosure hindered DRA’s ability to determine whether Great Oaks’ recording of groundwater production charges as an expense was reasonable, given that the treatment of these funds as an expense has an effect on other expenses included in rates. As previously explained in Section C, in this GRC, Great Oaks’ working capital request of \$1,551,960 is overstated because it includes the groundwater production charges for which the Company is not paying. By overstating the working capital calculation, ratepayers will be paying a return on a higher level of working capital than is reasonable. For these reasons, DRA agrees with UAFCB that Great Oaks’ nondisclosure has affected the Commission’s ability to determine whether Great Oaks’ recovery of groundwater production charges as expenses and the appropriate level for working capital is reasonable.

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<sup>45</sup> USOA, at pp. 8-9.

<sup>46</sup> *Id.*

<sup>47</sup> DWA’s Audit Report, at p. 10.

Finally, UAFCB determined that Great Oaks failed to comply with the USOA requirement to submit questions of doubtful interpretation to the Commission.<sup>48</sup> USOA states that “[t]o maintain uniformity of accounting, utilities shall submit questions of doubtful interpretation to the Commission for consideration and decision.”<sup>49</sup> The UAFCB found that Great Oaks’ recording of the groundwater production charges as expenses “while withholding payments and placing the collected monies into an escrow-type money market account is an unusual regulatory accounting event that meets the doubtful interpretation requirement and should have been brought before the Commission for review and approval.”<sup>50</sup> DRA agrees with this finding in DWA’s Report and asserts that there is no justification for Great Oaks’ failure to disclose all of the relevant facts necessary for the Commission to learn that these charges were not actually being paid to the District.

For these reasons, DRA respectfully requests that the Commission adopt UAFCB’s recommendation that “Great Oaks should be required to submit to DWA a written proposal for its accounting of groundwater production revenues, cash, receivables, and payables in compliance with the USOA.”<sup>51</sup> DRA respectfully requests that the Commission require Great Oaks to also provide DRA with its written proposal.

### **3. Great Oaks is not in compliance with D.07-05-062**

In its assessment of Goal 4, UAFCB also concluded that Great Oaks is not in compliance with the Commission’s GRC reporting of forecast and contentious issues set forth in D.04-06-018.<sup>52</sup> DRA notes that the Commission revised this decision in D.07-05-062, even though the requirements for reporting of forecast and contentious issues remain the same. D.07-05-062 requires a utility to “list the major controversial

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<sup>48</sup> *See id.*, at p. 9.

<sup>49</sup> USOA, at p. 9.

<sup>50</sup> DWA’s Audit Report, at p. 10.

<sup>51</sup> *See id.*, 12.

<sup>52</sup> *Id.*

issues included in the GRC filing.”<sup>53</sup> Furthermore, a utility is required to “include the dollar impact of these issues, and a brief summary of the utility’s rationale on this subject.”<sup>54</sup> In its GRC Application, Great Oaks did not list its nonpayment of groundwater production charges as a controversial issue. In fact, despite having several opportunities to disclose that it was withholding these payments, Great Oaks never disclosed this information to DRA and the Administrative Law Judge during hearings.

UAFCB noted that Great Oaks’ failure to report its withholding of groundwater production charges in its GRC precludes the Commission from taking into consideration all facts in authorizing a fair and reasonable test year and escalation years for its groundwater production expenses.<sup>55</sup> DRA asserts that Great Oaks should have included in its GRC application its rationale for withholding payment of groundwater production expenses to the District while it continues to collect these expenses in customer rates. Furthermore, as discussed above, Great Oaks’ reporting of groundwater production charges as actual expenses in its GRC has resulted in the Company being provided with a working cash level higher than it should have received.

In addition, Great Oaks’ management decision to incur interest and penalty charges for withholding groundwater production payment to the District is a controversial issue in its GRC application. Great Oaks should have disclosed in its GRC that it is incurring interest and penalty charges due to its nonpayment of groundwater production charges. Thus far, Great Oaks has incurred close to half a million dollars in interest and penalty charges and these charges will continue to increase until a final determination is made on the legality of its groundwater production charges. In the meantime, Great Oaks’ management may be undermining the utility’s financial position by incurring significant liability in the form of interest and penalty charges. Although DWA’s Report concludes that at this point, Great Oaks’ shareholders appear to have assumed interest

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<sup>53</sup> D.07-05-062, Opinion Adopting Revised Rate Case Plan for Class A Water Utilities, May 24, 2007, at p. A-22.

<sup>54</sup> *Id.*

and penalty charges for nonpayment in 2009, Great Oaks’ decision to incur these charges calls into question the prudence of its management decisions, especially since these funds could be better used as a source of capital to reinvest in utility infrastructure. Moreover, DRA does not have the ability to make certain that Great Oaks’ ratepayers are in fact protected from liability for the nonpayment of these charges. As such, DRA agrees with UAFCB that Great Oaks is not in compliance with the contentious issue reporting requirement set forth in D.04-06-018 and D.07-05-062.<sup>56</sup>

For these reasons, DRA respectfully requests that the Commission adopt UAFCB’s recommendation that “Great Oaks should be required to advise the Commission with information relating to any new accounting approaches, unusual accounting treatments or items, relevant procedures and records especially involving significant amounts.”<sup>57</sup>

#### **4. Great Oaks is not in compliance with PUC §451**

UAFCB also determined that PUC §451 is relevant to the groundwater production charges issue.<sup>58</sup> PUC §451 requires that “all charges demanded or received by any public utility” for any product or commodity furnished or any service rendered “shall be just and reasonable.”<sup>59</sup> “Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.”<sup>60</sup> DRA notes that Great Oaks is withholding payment for expenses that represent 38% of its revenue requirement in its GRC and DRA does not know for how long Great Oaks will continue to withhold these payments. Furthermore, as explained above, Great Oaks’ nondisclosure of its nonpayment of groundwater production charges also has an effect on its recovery of other expenses in customer rates. Based on these facts, DRA submits that the Commission cannot conclude that Great Oaks’ rate

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<sup>55</sup> DWA’s Audit Report, at p. 11.

<sup>56</sup> *See id.*

<sup>57</sup> *See id.*, at p. 12.

<sup>58</sup> *Id.*, at p. 8.

<sup>59</sup> PUC § 451.

<sup>60</sup> *Id.*

increase requests as reported in its GRC application are just or reasonable. Thus, DRA agrees with UAFCB that “Great Oaks is not in compliance with [PUC §451] because it withheld information necessary for the Commission to establish fair and reasonable recovery of [groundwater production] operating expenses.”<sup>61</sup>

#### IV. CONCLUSION

In conclusion, DRA respectfully requests the Commission admit DWA’s Report into the record of this proceeding. Moreover, DRA urges the Commission to adopt DWA’s recommendations and DRA’s additional recommendations to ensure that Great Oaks discloses all information necessary for ratemaking purposes. In addition, DRA respectfully requests that the Commission order a hearing in this proceeding for the limited purpose of determining whether Great Oaks violated Rule 1.1 and therefore should be fined for misrepresenting its treatment of ratepayer-provided groundwater production funds, and whether Great Oaks’ management violated Section 2114 of the PUC.

Respectfully submitted,

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August 30, 2010

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<sup>61</sup> See DWA’s Audit Report, at. p. 11.

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of “**COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES ON THE DIVISION OF WATER AND AUDITS’ FINANCIAL AND COMPLIANCE VERIFICATION OF GREAT OAKS WATER COMPANY**” to the official service list in **A.09-09-001** by using the following service:

**E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

**U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on **August 30, 2010** at San Francisco, California.

/s/ NELLY SARMIENTO

Nelly Sarmiento

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