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

In the Matter of the Application of Cypress Ridge Sewer Co. (U311S) for a Certificate of Public Convenience and Necessity to Provide Sewer Utility Service to the Cypress Ridge Development in San Luis Obispo County, California.

Application 15-08-025
(Filed August 25, 2015)

And Related Matter.

A.15-12-015

**CYPRESS RIDGE OWNERS' ASSOCIATION ANALYSIS
OF PROPRIETY OF INCLUDING GAIN ON SALE ISSUES
IN THIS CONSOLIDATED PROCEEDING**

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Dated: April 29, 2016

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In accordance with the April 15, 2016 ruling of Administrative Law Judge Lirag requesting additional information and analysis (“Ruling”), Cypress Ridge Owners’ Association (“CROA”) submits its analysis of the propriety of addressing, in this consolidated proceeding, issues arising from the gain on sale resulting from Rural Water Company’s sale of its water system to Golden State Water Company.¹ The Ruling requires this analysis to be submitted by April 29, 2016. It is timely filed.

Specifically, the Ruling asks that parties provide:

[A] detailed analysis explaining whether or not any gain on sale derived from the sale of Rural Water Company’s public utility water system to Golden State Water Company, should be included as one of the issues to be considered, and why determination of this issue is necessary in resolving either of the two proceedings.²

¹ The sale closed in mid-October of 2015.

² Ruling, p. 2. CROA does not understand the Ruling to ask for full briefing of all issues related to the gain on sale arising from the sale by Rural Water Company (“Rural”) of its water system to Golden State Water Company (“GSWC”) six months ago. We presume that would occur in the case in chief sometime in the future. Our purpose here is to outline the reasons why the question (1) must be addressed at some

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Cypress Ridge Sewer Company (“Cypress”) seeks a certificate of public convenience and necessity (“CPCN”) to serve the Cypress Ridge subdivision. If the Commission grants Cypress that authority, the present sole owner of the sewer system and sole Commission-certified operator of that system, Rural Water Company (“Rural”), will be relieved of its public utility obligations and presumably stand free of Commission regulation.

Before the Commission frees Rural from Commission authority, the Commission must first determine what obligations Rural still bears with respect to the proceeds of its sale of its water system last October. Any final decision that does not resolve the gain on sale issue will be missing material findings required by Public Utilities Code sections 1705 and 1757(a)(3). Rural has announced that its owner, Mr. Charles Baker (“Mr. Baker”) simply (and illegally) dissolved Rural³ and presumably kept the proceeds of the \$1.7 million sale of Rural’s water system for himself. He did so knowing that (1) CROA had already urged the Commission to make a determination whether those proceeds were subject to allocation pursuant to D.06-05-041 and (2) the Commission had not yet made a determination whether to do so. Fortunately, California law, if enforced, prohibits Mr. Baker’s act from being given any legal effect.

Permitting Rural to free itself (and the proceeds of its sale) from Commission regulation on a “self-help” basis would result in the final indignity to Rural’s ratepayers. California law retains Commission authority over the sale proceeds. The Commission should determine their disposition here; without imposing any significant burden on the evidentiary record of this proceeding, it offers the most appropriate forum for doing so.⁴

If the certification of Cypress means that Mr. Baker is free to “take the money and run” before the Commission has had the opportunity to determine whether he may do so, it is difficult to see how that outcome is one that can be properly characterized as one that is in the public interest.

II. BACKGROUND

Rural, Cypress, and their owner Mr. Baker have long and troubled regulatory histories at the Commission. The most recent chapter is Mr. Baker’s December 2015 dissolution

point and (2) is most efficiently addressed in this docket that is being conducted close in time to the sale and where all of the affected parties are already participants.

³ Prehearing Conference Transcript, 5 (lines 8–21) (Guzman/Cypress).

⁴ See discussion at pp. 8-9 *infra*.

of Rural, without Commission approval, so that he could transfer to himself the proceeds of Rural's sale of its water system. Since Rural (1) is still subject to Commission jurisdiction, (2) owns the sewer system in Cypress Ridge, and (3) is the only Commission-certified provider of sewer service in Cypress Ridge, Mr. Baker's dissolution of Rural can only be explained by his desire to place as much distance as possible between the \$1.7 million proceeds of the sale and the Commission.

His actions are easily explained by the past history of the three entities—Mr. Baker, Cypress, and Rural. For years Rural simply avoided filing rate cases, resulting in substantial over collections from its ratepayers.⁵ After the Commission discovered the over collections, Rural then ignored Commission orders to refund the over collections.⁶ Rural and Cypress have each displayed an inability to properly open memorandum accounts, implicating the rule against retroactive ratemaking and requiring the Commission to grant rehearing with respect to Cypress's excess labor costs.⁷ Rural violated Section 851 of the Public Utilities Code⁸ by transferring utility assets to Cypress without first obtaining Commission approval. Cypress violated Section 1001 by operating those assets as a sewer corporation without first obtaining a certificate of public convenience and necessity permitting it to do so.

Rural/Cypress/Mr. Baker are now attempting to prove that no bad deed goes unrewarded. Having treated their ratepayers and the regulatory process largely with indifference,⁹ Mr. Baker and Rural now seek to "cash out." They have done so in two steps.

First, six months ago, Rural sold its water system to GSWC at a substantial premium over rate base; that premium, amounting to over \$1,100,000¹⁰, is derived from the existence of Rural's customer base and revenues that base generates (not from any plant investment of Mr. Baker).

⁵ See Res W-4794 (November 20, 2009).

⁶ See Resolution No. W-4883 (August 18, 2011). At page 6 of Res W-4883 the Commission stated that: Rural should not have ignored our order in Res. W-4794 to refund over-collected revenues. Utilities should not neglect to implement direct orders of the Commission. Therefore, we place Rural on notice that if in the future it disregards or omits implementation of our direct orders, Rural may be subject to sanctions and fines by this Commission.

⁷ See Decision 14-08-059 (August 28, 2014).

⁸ All statutory references herein are to the California Public Utilities Code unless otherwise indicated.

⁹ See CROA Protest of A.15-08-025, pp. 5–11.

¹⁰ See Prepared Direct Testimony of Keith Switzer in A. 13-10-011 at page 11 confirming that purchase price of \$1.7 million is a premium over Rural's rate base of \$590,000.

Second, a few months later, even though Rural had not been relieved of its public utility sewer obligations (and remains the legal owner and operator of the Cypress Ridge Sewer System),¹¹ Mr. Baker simply (and illegally) dissolved Rural and transferred its assets to himself. He kept the assets of greatest interest to himself, the \$1.7 million sale price Rural received from GSWC, and apparently holds the remaining assets, Rural's sewer system at Cypress Ridge, "in trust" pending their ultimate transfer to Cypress Ridge Sewer Company.¹² Pursuant to Section 851, that system remains the property of Rural, the only lawful provider of sewer service in Cypress Ridge, until the Commission approves Rural's transfer of the assets to another entity.¹³ A transfer of property for which authority is required under section 851 is void (not merely voidable), if no authority from the Commission is first obtained.¹⁴ Rural has never sought or obtained such approval. It should not be provided until the Commission has determined the proper disposition of Rural's other asset, the proceeds from the sale of its water system.

III. THE PROPER DISPOSITION OF RURAL'S GAIN ON SALE SHOULD BE ADDRESSED BY THE COMMISSION AND BE ADDRESSED IN THIS CONSOLIDATED DOCKET.

The reasons the Commission should address the proper disposition Rural's gain on sale here follow:

A. Any Commission Decision in this Docket Not Addressing Gain On Sale Is Legally Deficient

The Commission must address and resolve the allocation of Rural's gain on sale of its water system—whatever that resolution ultimately is—in this proceeding. The gain on sale from the \$1.7 million transfer is a material issue in this docket because the beginning of Cypress's lawful provision of sewer service presumably marks Rural's exit from Commission

¹¹ As all parties, including Cypress/Rural/Baker are aware, any past transfer of assets by Rural to Cypress Ridge Sewer Corporation is void because Rural never sought and obtained Commission authority to transfer those assets. Similarly, all parties are aware that Cypress Ridge Sewer Company never sought or obtained authority to provide sewer service to Cypress Ridge. Finally, all are aware that Rural has never obtained any Commission order relieving Rural from the obligation to provide sewer service to Cypress Ridge.

¹² Prehearing Conference Transcript, 5 (lines 8–21) (Guzman/Cypress).

¹³ See Pub. Util. Code, § 851.

¹⁴ "Transactions that do not obtain the required review and approval of the Commission under Section 851 are void." (*Pacific Gas and Electric Company*, 2001 Cal. PUC LEXIS 520, p. *1.) "Section 851 of the Public Utilities Code provides that sales and encumbrances within the scope of Section 851 are void if made other than in accordance with an order of this Commission first having been secured." (*Radio Relay Corp.*, 1974 Cal. PUC LEXIS 1139, p. *1).

regulation as a public utility sewer company. Allowing this proceeding to close, and presumably allowing Rural to dissolve, without issuing findings and conclusions on the applicability of the Commission's gain on sale rules and proper allocation of the proceeds from Rural's sale would violate the requirements of Section 1705 and Section 1757(a)(3).

B. Rural Remains a Public Utility Regulated by This Commission

Notwithstanding Mr. Baker's announced (and void) dissolution of Rural at the end of 2015,¹⁵ Rural remains subject to the jurisdiction of the Commission.

As set forth in A.15-12-015,¹⁶ Mr. Baker's dissolution of Rural rests on his belief that D.15-06-049 relieved Rural "of its public utility obligations." Mr. Baker and Rural, however, are incorrect. D.15-06-049 only relieved Rural of its obligation to provide public utility *water* service.¹⁷ Rural is still obligated to provide utility *sewer* service, as D.15-06-049 acknowledged. Indeed, D.15-06-049 ordered Rural (not Cypress) to effect the necessary filings at the Commission to address "the provision of sewer service to the Cypress Ridge subdivision."¹⁸ Rural selected one of three alternatives to meet that requirement (resulting in Application 15-08-025) but Rural failed to satisfy the requirements set forth by the Commission because Rural failed to:

[F]ile a Section 851 application requesting California Public Utilities Commission (Commission) authorization to transfer all of Rural's sewer utility assets to Cypress Ridge Sewer Co. upon certification of Cypress Ridge Sewer Co.¹⁹

While Cypress promised that Rural would file such an application,²⁰ Rural never did so. Instead, after Mr. Baker dissolved Rural, he transferred its assets (principally the \$1.7 million paid by GSWC) to himself. He apparently holds the sewer assets personally "in trust" to be transferred

¹⁵ Prehearing Conference Transcript, 5 (lines 8–12) (Guzman/Cypress).

¹⁶ A.15-12-015, pp. 3–4.

¹⁷ D.15-06-049, p. 26, Ordering Paragraph No. 3.

¹⁸ D.15-06-049, p. 27, Ordering Paragraph No. 10.

¹⁹ *Id.*, Ordering Paragraph 10a.

²⁰ In A. 15-08-025, Cypress stated that:

Rural Water will shortly be filing a Section 851 application, or an advice letter pursuant to ALJ Resolution 268, to transfer any sewer utility facilities it still owns to Cypress upon the granting of this application. At this point, the only remaining sewer utility facility owned by Rural Water is the Shared Structure reference in Section II.A., above.

Never happened. A.15-12-015 only seeks authority to transfer the Shared Building from Rural to Cypress; the remainder of the sewer system assets Rural purportedly transferred to Cypress were not included in the application.

to Cypress at a later date. It does not appear, however, that the sale proceeds are also being held in trust.

To date, Rural has only sought authority to transfer the Shared Building, which Rural apparently believes is the only utility asset Rural still owns. Legally, however, Rural still owns the sewer system serving Cypress Ridge. Rural may not unilaterally dissolve and thereby disclaim its obligation to provide sewer service in Cypress Ridge.

The Commission has long held that “abandonment of a public utility obligation is a very serious matter requiring PUC authorization.”²¹ Accordingly, utilities are required to seek and obtain Commission approval pursuant to Section 851 before dissolving.²² The Settlement Agreement for the sale of Rural’s water system to GSWC asked the Commission to relieve Rural of its “obligation to provide public utility *water* service”;²³ at no time has Rural asked to be relieved of its obligation to provide public utility *sewer* service.

Neither Mr. Baker nor Rural ever sought Commission authority to dissolve Rural. A.15-12-015 simply informed the Commission that Rural intended to dissolve, which Rural did immediately after filing its application. Rural’s failure to observe the legal requirements with regard to its dissolution is standard practice for Rural, but it remains an act in violation of (and thus void under) the Public Utilities Code.

Rural remains subject to the jurisdiction of the Commission. It owns, and is the only entity certified to operate, the sewer system serving Cypress Ridge.

C. The Settlement in A.13-10-011 Did Not Address Gain On Sale

GSWC and Rural filed A.13-10-011 to allow GSWC to purchase Rural’s water system assets and to assume the responsibility of providing water service to Rural’s former customers. Rural and GSWC stated that the owner of Rural, Mr. Baker, was advancing in age

²¹ *Gale v. Teel* (1977) 81 CPUC 817 (1977 Cal. PUC LEXIS 1520), p. *13. (citing Section 851.)

²² See, e.g., *Application of Angora Water Company*, D.83-12-052 (1983 Cal. PUC LEXIS 769) (seeking authority under Section 854 to transfer all of the Water Company’s capital stock and its assets to the South Tahoe Public Utility District, and then to dissolve); *Application of Metrocall*, D.87-11-046 (1987 Cal. PUC LEXIS 371) (seeking authority under Section 851 to dissolve and distribute its assets); *Application of Matt Dillon Water Company*, D.08-02-025 (2008 Cal. PUC LEXIS 71) (approving transfer of ownership of water company and relieving its owners of public utility responsibility); *Application of Mar Vista Water Company*, D.08-05-005 (2008 Cal. PUC LEXIS 202) (authorizing transfer of ownership of water company and relieving its owner of public utility responsibility).

²³ D.15-06-049, Attachment A, Settlement Agreement, p. 7, ¶ 2.5 (emphasis added).

and was no longer capable of running the water system; the sale to GSWC was intended to provide Rural's customers with a reliable operator.²⁴

In D.15-06-049, the Commission approved a Settlement Agreement relating to the sale of Rural's water system to GSWC. Neither the Settlement Agreement nor D.15-06-049, however, addressed the allocation of the million-plus dollar gain Mr. Baker realized on the sale of Rural. Instead, the Settlement Agreement approved by D.15-06-049 preserved the parties' rights to pursue separately any factual or legal issues not disposed of by the settlement.²⁵

CROA now seeks to do in this consolidated docket.

D. D.06-05-041 Requires Allocation of Gain On Sale to Ratepayers; the Extent to Which D.06-05-041 Applies Here Should be Fully Briefed by the Parties

Cypress asserts that the gain on sale requirements do not apply when an entire system is sold.²⁶ CROA, however, believes that the policy underlying D.06-05-041, to allow ratepayers to share in the gain on sale of assets for which they have been at risk, does apply here.

Rural's water system is comprised of individual utility assets; Cypress's argument that gain on sale may be allocated to ratepayers when a single asset is sold, but not when a utility sells all of its assets, is counterintuitive. D.06-05-041 found that because ratepayers bear the risk associated with both depreciable and non-depreciable utility property, most of the gain on sale from utility assets must be allocated to the ratepayers²⁷; accordingly, one is hard pressed to explain why the ratepayers are not entitled to an allocation simply because a utility chooses to sell, at one time, all the assets for which ratepayers have borne the risk identified in D.06-05-041.

But this is not the pleading to argue the point. CROA understands the Ruling to ask whether the issue should be considered, not how it should be resolved.

It should be resolved. The resolution of this difference of views should be fully briefed by the parties and resolved by the full Commission. It is an important question and the Commission would be hard pressed to find a better factual template for its resolution than this proceeding.

As we note below, resolution of the legal and policy questions will not burden the evidentiary record

²⁴ A.13-10-011, pp. 8–9.

²⁵ See CROA Protest to A.15-08-025, p. 15 (citing Settlement Agreement, Section 1.4).

²⁶ Cypress Reply to CROA Protest of A.15-08-025, p. 9.

²⁷ D.06-05-041, pp. 16–17, 26–27, 36.

E. This Proceeding Presents the Most Opportune Forum for Resolution of the Extent to Which Rural Should Share the Gain On Sale with its Ratepayers

For several reasons, this consolidated docket represents the most appropriate forum in which to resolve whether Rural should share the gain on sale with its ratepayers.

First, resolution will not require extensive (if any) factual determination by the Commission. The amount of the gain is largely beyond dispute and is effectively described in Mr. Switzer's Prepared Testimony in A.13-10-01.

Second, the affected parties—Rural, Mr. Baker, and CROA—are all participating in this consolidated docket. All were parties in A.13-10-01 are very familiar with the sale and the history of Rural and Cypress.

Third, resolution now rather than in some future proceeding is appropriate from a temporal perspective. The sale producing the gain at issue occurred contemporaneously with the early stages of this consolidated proceeding. It took place seven weeks after the filing of A.15-08-025 on August 25, 2015. The putative dissolution of Rural took place just over three months before the April 4, 2016 prehearing conference. If the Commission believes that it should issue an order preserving the proceeds of the sale or otherwise addressing the unlawful dissolution of Rural, that order should be issued soon. As a practical matter, deferring consideration of the gain on sale issue or the status of Rural to some yet-to-be-initiated docket means that no Commission order will issued until at least a year after the sale and, most likely, a year after the unlawful dissolution of Rural. The parties to the new docket will be required to file entirely new pleadings advancing the same arguments they will advance here.

Whether the Commission ultimately agrees with CROA or Rural/Cypress/Mr. Baker, it is important that the gain on sale issue be addressed and resolved as soon as possible.

Finally, retaining the issue in this consolidated docket will permit the parties to propose a “global” resolution through alternate dispute resolution. It will permit the neutral to advise the parties with respect to the risk of a litigated outcome and hopefully achieve some compromise on all the issues presented in this proceeding, including gain on sale.

IV. CONCLUSION

For the foregoing reasons, the Commission should address the issue of allocating the gain on sale from Rural's sale of its water system to GSWC before Rural is relieved of its public utility obligations. This proceeding is the most appropriate forum in which to do so.

Respectfully submitted April 29, 2016 at San Francisco, California.

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