

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting an Investigation on Whether Great Oaks Water Company's Failure to Inform the Commission and its Staff of its Treatment of Pump Tax Revenues Collected from Customers Violated the Commission's Rule of Practice and Procedure 1.1, the Uniform System of Accounts for Class A Water Companies, the Rate Case Plan, or Public Utilities Code Sections 451 and 794.

**FILED**  
**PUBLIC UTILITIES COMMISSION**  
**APRIL 19, 2012**  
**SAN FRANCISCO**  
**I.12-04-011**

**ORDER INSTITUTING INVESTIGATION INTO**  
**GREAT OAKS WATER COMPANY’S FAILURE TO INFORM**  
**THE COMMISSION & ITS STAFF REGARDING**  
**ITS NON-PAYMENT OF PUMP TAX REVENUES TO**  
**SANTA CLARA VALLEY WATER DISTRICT**

**I. SUMMARY**

On November 19, 2010, the California Public Utilities Commission (“Commission”) issued Decision (“D.”) 10-11-034 in Application (“A.”) 09-09-001, the Great Oaks Water Company (“Great Oaks”) general rate case (“GRC”) proceeding. In the Decision, the Commission ordered, among other matters, that the Consumer Protection and Safety Division (“CPSD”) prepare an Order Instituting Investigation (“OII”) to further review whether Great Oaks’ failure to inform the Commission and its staff that it had withheld its payment to the Santa Clara Valley Water District (“SCVWD”) of the pump tax revenues collected from its customers violated any of the following: 1) the Commission’s Rules of Practice & Procedure, Rule 1.1; 2) the

Uniform System of Accounts (“USOA”) for Class A Water Companies; 3) the Rate Case Plan; 4) Public Utilities (“PU”) Code Section 451; or 5) PU Code Section 794.<sup>1</sup>

Based on a review of the Commission’s Division of Water and Audits’ (“DWA’s”) Financial and Compliance Verification Report and the parties’ comments in A.09-09-001, the Commission determined good cause existed to further investigate Great Oaks’ conduct and determine whether fines should be imposed.<sup>2</sup>

CPSD’s investigation determined:

- Great Oaks appears to have violated the Commission’s USOA for Class A Water Companies and Public Utilities Code Section 794.
- Great Oaks may have violated the Commission’s Rate Case Plan for Class A Water Utilities (D.07-05-062).
- Great Oaks may have violated Public Utilities Code Section 451.
- Great Oaks does not appear to have violated Rule 1.1.

## II. BACKGROUND

In April 2009, Great Oaks stopped paying pump taxes that SCVWD had levied against it. On September 3, 2009, Great Oaks filed its General Rate Case (“GRC”) Application requesting the Commission authorize rate increases for the 2010-2012 rate cycle. Great Oaks’ application included what it perceived to be the required data pursuant to D.07-05-062, Appendix A, Rate Case Plan and Minimum Data Requirements for Class A Water Utilities General Rate Applications. In its GRC Application, Great Oaks recorded actual groundwater production charges (or pump tax) as operating expenses as of August 2009 and forecasted the amounts it would be required to pay in pump taxes for the remainder of 2009 and for 2010 through 2012.

Pump tax is treated as a pass-through operating expense for ratemaking purposes and Great Oaks collects the revenues from its customers to cover its pump tax

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<sup>1</sup> Decision 10-11-034, Ordering Paragraph 12.

<sup>2</sup> Decision 10-11-034, pp. 67-68.

payments. Great Oaks included its pump tax expenses in its application to calculate its revenue requirement. However, it did not disclose in its application that it had stopped paying the pump taxes to SCVWD and instead was holding the funds in a money market account.

On October 19, 2009, Great Oaks updated its GRC Application and corrected its workpapers. During the evidentiary hearings on January 21-22, 2010, Timothy Guster, General Counsel for Great Oaks, provided testimony on Great Oaks' various legal claims against SCVWD. According to Mr. Guster's testimony, SCVWD was illegally collecting this pump tax. On January 23, 2010, Great Oaks again updated its workpapers. These updates afforded Great Oaks at least two opportunities to disclose that it had stopped paying the pump taxes and was holding the funds in a money market account.

In March 2010, SCVWD informed DRA that Great Oaks had been refusing to pay the pump tax since April 2009.<sup>3</sup> Great Oaks' unpaid taxes as of March 2010 totaled \$4,856,030.<sup>4</sup> These pump tax payments are due monthly and based on SCVWD's terms, include a 1% monthly interest charge on the delinquent amount.<sup>5</sup> Great Oaks claims that it was withholding payments because of a series of lawsuits it filed in Santa Clara County Superior Court regarding the pump tax charges SCVWD levied.<sup>6</sup> The court ruled against SCVWD on the pump tax charges levied on Great Oaks in the 2005-2006 fiscal year. However, this matter is unresolved because SCVWD appealed the court's decision.<sup>7</sup> As of April 10, 2012, the court had not yet ruled on SCVWD's appeal

On March 19, 2010, DRA filed a motion to reopen the evidentiary record in A.09-09-001 to admit information demonstrating that Great Oaks had not disclosed to the

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<sup>3</sup> CPSD Report. This was a phone call from SCVWD to DRA.

<sup>4</sup> CPSD Report. Motion of the DRA 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 for violation of Rule 1.1 and possible violation of Section 2114, filed March 19, 2010, p 2.

<sup>5</sup> CPSD Report. Letter from SCVWD to Great Oaks dated August 13, 2010. Attachment A.

<sup>6</sup> CPSD Report. Letter from Great Oaks to SCVWD dated August 19, 2010. Attachment B.

<sup>7</sup> CPSD Report. Letter from Great Oaks to SCVWD dated September 23, 2010. Attachment C.

Commission that it was withholding payment of pump tax charges and to request that the Commission issue an order to show cause for an alleged violation of Rule 1.1 and possible violation of Section 2114 of the Public Utilities Code.

On March 31, 2010, Great Oaks filed its Annual Report for calendar year 2009. Included were balance sheets showing an unusually large ending balance for accrued liabilities (Account 230) when compared to the beginning balance because of the large sum of recorded pump taxes payable during the year. Account 230 also had a line item for pump taxes interest due. This balance sheet is not normally included in the required GRC application filing.<sup>8</sup>

On June 21, 2010, the Assigned Commissioner and Administrative Law Judge issued a joint ruling reopening the evidentiary record in Great Oaks' GRC Application, A.09-09-001.<sup>9</sup> The Ruling directed the DWA to determine, among other things, whether Great Oaks' failure to inform DRA and the Commission of its actions in withholding funds from the SCVWD violated any Commission accounting or reporting requirement.<sup>10</sup>

On August 20, 2010, DWA submitted its Financial and Compliance Verification of Great Oaks ("Verification Report") for the period from March 1, 2009 to June 30, 2010. DWA's report found that Great Oaks was not in compliance with the USOA for Class A Water Utilities, D.04-06-018,<sup>11</sup> and Public Utilities Code Sections 451 and 794.<sup>12</sup> As of August 13, 2010, Great Oaks owed the SCVWD \$6,481,420 for groundwater charges, which included interest and penalties.<sup>13</sup>

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<sup>8</sup> D.07-05-062, Appendix A.

<sup>9</sup> See Assigned Commissioner and Administrative Law Judge's Ruling and Scoping Memo, at 9, available at <http://docs.cpuc.ca.gov/efile/RULINGS/119462.pdf>.

<sup>10</sup> Id. at 12.

<sup>11</sup> D.04-06-018 was superseded by D.07-05-062.

<sup>12</sup> D.10-11-034, Appendix D, pp. 9-11.

<sup>13</sup> CPSD Report. Letter from SCVWD to Great Oaks dated August 13, 2010. Attachment A.

On September 23, 2010, after DWA submitted its Verification Report, Great Oaks remitted, under protest, \$5,880,991 to SCVWD, the amount collected from its ratepayers plus the accrued interest in the money market account with Waddell & Reed Services and agreed to continue to make payments to the SCVWD when due.<sup>14</sup> Great Oaks asserts that the aforementioned payment represents payment of pump taxes for the period of time from March 2009 through June 2010 and that these amounts are not to be applied to interest.<sup>15</sup> SCVWD asserts that the balance still owed to SCVWD for the period March 2009 through June 2010, and calculated through April 30, 2012 is \$781,213.79.<sup>16</sup>

### **III. DISCUSSION- GREAT OAKS' VIOLATIONS AND THE POSSIBILITY/OPPORTUNITY FOR FINES**

#### **A. Public Utilities Code Section 794 & USOA**

The Commission prescribed the accounting requirements for Class A Water Companies in the Uniform System of Accounts (“USOA”) for Class A Water Companies adopted by the Commission effective January 1, 1955.<sup>17</sup> Great Oaks is required to maintain its accounting records in conformance with the adopted USOA for Class A Water Utilities.

The USOA Section 2.A states:

Each utility shall so keep its books of account, and such other books, records, and memoranda which support, or are necessary to an understanding of, the entries in such books of account, as to be able to furnish readily full information as to any item included in any account. Each entry shall be supported by such detailed information as will permit a ready identification, analysis, and verification of all of the facts relevant thereto.

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<sup>14</sup> CPSD Report. Copy of check dated September 15, 2010, Attachment D.

<sup>15</sup> CPSD Report. Letter to SCVWD dated September 23, 2010, Attachment C.

<sup>16</sup> CPSD Report. SCVWD’s reconciliation of the balance due for Great Oaks, Attachment E.

<sup>17</sup> Decision No. 50185 on June 29, 1954 and modified by Decision No. 57578 on November 10, 1958.

The USOA Section 2.B states:

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.

Great Oaks recorded the pump tax charges collected from its ratepayers in Groundwater Charges, Account 700. This Account used by Great Oaks is in Operating Expenses under the sub-category of Operating Expenses other than Payroll. The USOA provides a list of valid accounts for operating expenses.<sup>18</sup> Account 700 is not an account USOA prescribed for Class A Water Utilities. Great Oaks should have used an account prescribed by the USOA in the 700 series or created a sub-account within one of the 700 series accounts.

Although Great Oaks collected pump taxes and recorded them as operating expenses,<sup>19</sup> it did not pay these taxes to SCVWD and instead deposited the amounts collected from its ratepayers for the period March 2009 to June 2010 in a money market account.<sup>20</sup> Great Oaks has filed a series of lawsuits in Santa Clara County Superior Court regarding the pump tax charges SCVWD levied. The court ruled against SCVWD on these pump tax charges. However, SCVWD has appealed the court's decision. The Court of Appeals has not yet ruled on SCVWD's appeal as of April 10, 2012.

Despite Great Oaks' on-going litigation, it should have, as required by the USOA, disclosed that it was withholding payments, the reasoning behind its non-payment, the accounting treatment it was giving these pump tax charges, and it should have discussed the ruling on the court decision and the pending appeal in its Application. This information should have been disclosed in Great Oaks' GRC Application and/or its

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<sup>18</sup> USOA, pp. 90-91.

<sup>19</sup> A.09-09-001, pp. 3-7.

<sup>20</sup> CPSD Report. SCVWD letter to Great Oaks dated August 13, 2010, Attachment A.

updates to the Application so that the Commission and its staff could consider whether the recorded pump tax expenses are reasonable. Great Oaks' failure to disclose this information may have violated USOA Sections 2.A and 2.B.<sup>21</sup> By failing to adhere to the dictates of the USOA, Great Oaks may have violated PU Code Section 794.

PU Code Section 794 states:

The commission may, after notice, and hearing if requested within 15 days after receipt of notice, prescribe by order the accounts in which particular outlays and receipts shall be entered, charged, or credited. Where the commission has prescribed the forms of accounts, records, or memoranda to be kept by any public utility for any of its business, it is unlawful for such public utility to keep any accounts, records, or memoranda for such business other than those so prescribed, or those prescribed by or under the authority of any other state or of the United States, except such accounts, records, or memoranda as are explanatory of and supplemental to those prescribed by the commission.

When the Commission has determined the appropriate accounting to utilize, it is "unlawful" to utilize any other accounting formats. Great Oaks appears to have violated PU Code Section 794 by not following the USOA. Great Oaks should have used an account prescribed by the USOA in the 700 series or created a sub-account within one of the 700 series accounts.

#### **B. Rate Case Plan**

The Commission's Rate Case Plan for Class A Water Companies, D.07-05-062, requires a utility to list the major controversial issues included in its GRC filing.<sup>22</sup> The Rate Case Plan also requires the utility include the dollar impact of such controversial issues and a brief summary of the utility's rationale on this subject.<sup>23</sup>

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<sup>21</sup> D.10-11-034, Appendix D, p 10.

<sup>22</sup> D.07-05-062, Appendix A, p A-22.

<sup>23</sup> D.07-05-062, Appendix A, p A-22.

The Santa Clara County Superior Court has ruled that the pump taxes levied during the 2005-2006 fiscal year violated Proposition 218 by not securing proper voter approval. The court also ruled SCVWD violated the District Act by improperly calculating groundwater charges (pump taxes) and spending inappropriately. This litigation is a material fact involving a large sum of revenue collected from Great Oaks' customers. To illustrate, the subject pump tax charge in 2009 is \$4,609,320 and the total revenue is \$12,356,560. This accounts for approximately 37.3% (\$4,609,320/\$12,356,560) of the total revenue.

Total revenue is a component in the calculation of the Operational Cash Requirement in Rate Base. If Great Oaks prevails in its litigation against SCVWD, its customers stand to receive substantial refunds from Great Oaks. CPSD asserts that Great Oaks should have reported this matter as a important issue in its GRC filing pursuant to the Commission's Rate Case Plan.

By withholding pump tax payments from SCVWD, Great Oaks accrued interest at one percent (1%) per month and continued to accrue interest at a rate of one percent (1%) on the delinquent amount due each month.<sup>24</sup> The accumulation of interest on the unpaid balance due SCVWD could have resulted in increased costs to Great Oaks' ratepayers. Prior to DRA's motion to reopen the GRC evidentiary record and before D.10-11-034 was issued, the record did not have information to ensure that Great Oaks' ratepayers would not be charged for these interest and/or penalty charges. The lack of information about these expenses in Great Oaks' GRC application could have prevented the Commission from properly accounting for these costs and/or preventing them from becoming a ratepayer liability in this and future GRCs. D.10-11-034 requires that Great Oaks' shareholders be solely responsible for all interest, penalties, and legal expenses associated with the nonpayment of groundwater production charges.<sup>25</sup>

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<sup>24</sup> CPSD Report. Letter to Great Oaks from SCVWD dated August 13, 2010, Attachment A.

<sup>25</sup> Decision 10-11-034, p. 81.

Great Oaks appears to have violated the Rate Case Plan by failing to disclose its non-payment of pump taxes to SCVWD.

**C. Public Utilities Code Section 451**

All charges a utility levies against its ratepayers must be just and reasonable. Public Utilities Code Section 451 states that:

All charges demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

All rules made by public utility affecting or pertaining to its charges or service to the public shall be just and reasonable.

Great Oaks collected substantial amounts of pump taxes from its ratepayers and chose not to make the pass-through payments to SCVWD. The Commission has a mandate to ensure that charges any public utility imposes are just and reasonable based substantially on complete and truthful information from the public utility it regulates. It is unjust and unreasonable for Great Oaks to withhold such material and controversial information from the Commission when it requests rate increases in future years.

Great Oaks should have disclosed in its GRC Application that it was withholding these payments and listed the litigation as a controversial issue, as required in D.07-05-062. Great Oaks' withheld pump taxes incurred interest and penalty charges. Great Oaks' failure to report its withholding of pump tax payments in its GRC Application potentially undermined the Commission's ability to consider all facts in determining the reasonable test year and escalation years' expense for its pump taxes.<sup>26</sup> Therefore, Great Oaks appears to have violated PU Code Section 451.

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<sup>26</sup> D.10-11-034, Appendix D, p. 11.

**D. Rule 1.1**

Great Oaks apparently did not violate Rule 1.1 of the Commission's Rules of Practice and Procedure. Rule 1.1 states:

Any person who signs a pleading or brief, enters an appearance, offers testimony at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law.

As described earlier, Great Oaks' accounting for its ratepayer provided pump tax funds and its withholding of the pump tax payments to SCVWD may have violated the USOA for Class A Water Companies, the Rate Case Plan, and PU Code Sections 451 and 794.

Pursuant to D.07-05-062, Great Oaks submitted the required minimum data for Class A Water Utilities General Rate Applications. The balance sheet and/or income statement do not have to be submitted as part of the GRC application. A partial balance sheet for 2009 would have revealed Great Oaks had withheld pump tax payments to SCVWD. CPSD found no evidence that DRA requested this additional information in its initial review of the GRC. While Great Oaks' decision not to disclose the information relating to its withholding of the pump tax revenues is unreasonable and its use of Account 700 is incorrect, CPSD does not assert they rise to the level of a Rule 1.1 violation.

**E. The Commission has the authority to consider fines**

PU Code Section 2107 states:

Any public utility which violates or fails to comply with any provision of the Constitution of this state or of this part, or which fails or neglects to comply with any part or provision of any order, decision, decree, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to a penalty of not

less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense.<sup>27</sup>

PU Code Section 2108 states:

Every violation of the provisions of this part or any part of any order, decision, decree, rule, direction, demand, or requirement of the commission, by any corporation or person is a separate and distinct offense, and in the case of a continued violation, each day's continuance thereof shall be a separate and distinct offense.

Great Oaks' improper accounting for its ratepayer-provided pump tax funds and its withholding of those tax payments to SCVWD appears to have violated the USOA for Class A Water Companies, the Rate Case Plan (D.07-05-062), and PU Code Sections 794 and 451. Pursuant to D.10-11-034, Ordering Paragraph 12, CPSD recommends the Commission open an OII based on CPSD's findings and order Great Oaks to show cause why penalties should not be imposed for the alleged violations.

#### **IV. REMEDIES, PROCEEDING CATEGORY AND NEED FOR HEARING**

For any violations of the Public Utilities Code, the Commission's Rules of Practice & Procedure, Rate Case Plan, or the USOA, the Commission will consider fines and penalties or any other relief the Commission finds appropriate.

Rule 7.1(d) of the Commission's Rules specifies that an Order Instituting Investigation will preliminarily determine the category of the proceeding and the need for hearing. We determine that this proceeding is adjudicatory as defined in Rule 1.3(a), and evidentiary hearings may be necessary. At this point we are not able to predict whether evidentiary hearings will be needed.

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<sup>27</sup> The maximum statutory penalty for violations of section 2107 has been changed to \$50,000.00 however, the offences that were the subject of this OII happened when the statutory maximum was \$20,000.00.

**THEREFORE, IT IS ORDERED** that:

1. An investigation on the Commission's own motion as directed by D.10-11-034 is hereby instituted to determine whether Great Oaks Water Company ("Great Oaks") violated: 1) Public Utilities Code Section 794; 2) Public Utilities Code Section 451; 3) the Uniform System of Accounts for Class A Water Companies; or 4) the Commission's Rate Case Plan for Class A Water Utilities.

2. Great Oaks is hereby ordered to respond to these allegations and show cause why it should not be sanctioned for apparently violating Commission rules by withholding pertinent information from DRA during its GRC proceeding (A.09-09-001);

3. CPSD is hereby named as a party to this proceeding;

4. The Commission may adopt fines, penalties, and any remedial actions that will prevent Great Oaks from future violations or any other relief the Commission finds appropriate;

5. Pursuant to Rule 7.1(c), of the Commission's Rules of Practice and Procedure, this proceeding is categorized as adjudicatory, and deemed to require hearings. *Ex parte* communications are prohibited pursuant to Rule 8.2(b). The determination as to the category is appealable under Rule 7.6 of the Commission's Rules of Practice and Procedure;

6. A prehearing conference shall be convened before an Administrative Law Judge ("ALJ") to establish a schedule in this matter, including the dates, time and location for the possibility of an evidentiary hearing if it is necessary;

7. The Executive Director shall cause a copy of this Order to be served via overnight and electronic mail on Great Oaks:

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This order is effective today.

Dated April 19, 2012, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
TIMOTHY ALAN SIMON  
MICHEL PETER FLORIO  
CATHERINE J.K. SANDOVAL  
MARK FERRON  
Commissioners

[CPSD Staff Report re Great Oak Water Company with attachments](#)