

Decision **PROPOSED DECISION OF ALJ PATRICK** (Mailed 5/8/2007)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application of California Water Service Company and Grand Oaks Water Company to Transfer Ownership of the Assets of Grand Oaks Water company to California Water Service Company Under Certain Terms and Conditions and to Transfer the Certificate of Public Convenience and Necessity to Provide Water Service to the Name of California Water Service Company. (U-60W)

Application 05-12-012
(Filed December 12, 2005)

OPINION ON JOINT APPLICATION TO TRANSFER THE ASSETS AND CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY OF GRAND OAKS WATER COMPANY TO CALIFORNIA WATER SERVICE COMPANY

1. Summary

The Commission adopts the Joint Settlement Agreement between the Division of Ratepayer Advocates (DRA) and California Water Service Company (CalWater) on the joint application of CalWater and Grand Oaks Water Company (Grand Oaks) requesting authorization to transfer the assets and certificate of public convenience and necessity (CPCN) of Grand Oaks to CalWater and CalWater’s request for ratemaking treatment beyond that historically provided by the Commission as an incentive for large water utilities to acquire small, poorly-run water utilities such as Grand Oaks. This proceeding is closed.

2. Procedural Summary

On March 2, 2006, applicant CalWater and the DRA, which is the sole protestant and the only other party to the proceeding besides the joint applicants, participated in a telephonic prehearing conference before the assigned Administrative Law Judge. The participants agreed that DRA would explore alternatives to the acquisition of Grand Oaks by CalWater.

On May 11, 2006, the Joint Ruling of Assigned Commissioner and Administrative Law Judge Responding to April 20, 2006 Status Update was issued. The ruling discusses DRA's efforts to find some other entity, other than CalWater, to acquire the Grand Oaks system.

On June 22, 2006, a public meeting was held, in Tehachapi, to: (1) discuss the rate impact of CalWater's application to acquire Grand Oaks; and (2) explore the alternative of Golden Hills Community Services District acquiring the system.

On April 27, 2007, after extensive negotiations and it had become clear there would be no other acquirer for Grand Oaks, CalWater and DRA filed a Joint Motion to Adopt Settlement.

On May 2, 2007, the assigned Administrative Law Judge issued a ruling stating that evidentiary hearings were not necessary and submitted the matter for decision.

3. Background

Grand Oaks is a Class D (500 or fewer service connections) water utility serving Grand Oaks Estates near Tehachapi. It is small even by Class D standards, currently with only 43 connections and a moratorium on new connections.

CalWater's involvement with Grand Oaks is described in Decision (D.) 05-08-007 and other decisions cited there. Stated briefly, CalWater has operated Grand Oaks for several years, but for all practical purposes Grand Oaks has had no owner and thus nowhere to turn for the resources necessary to lift the long-standing moratorium on new hook-ups. Before CalWater came to the aid of these customers the system was barely functioning; at times, there was not enough water to flush toilets. In D.05-08-007, the Commission ordered CalWater to file, jointly with Brit O. Smith, the nominal owner of Grand Oaks, an application to acquire Grand Oaks; the Commission also allowed CalWater to propose conditions for the acquisition. The Commission directed CalWater to continue to operate Grand Oaks until further order.

On December 12, 2005, as ordered by the Commission, CalWater and Smith filed the instant joint application requesting authorization to transfer the assets of Grand Oaks, including the CPCN to CalWater, under certain terms and conditions.

4. The System

The Grand Oaks system is poorly constructed and needs significant capital improvements. The main components of the system are a two-inch main, a six-inch main, one storage tank and three wells, of which only one is operational. The existing two-inch main should be replaced with a six-inch main to improve system operations, including fire flows. The existing six-inch main has a history of leaks; however, replacement may be deferred because of customer bill impact concerns. Currently, only one well is operational; therefore, a second well (Well #3) should be reworked to improve system reliability, fire flows and system pressure.

5. Public Meeting

On June 22, 2006, a public meeting was held in Tehachapi for the 43 customers of the Grand Oaks water system. Approximately 40 people, representing 17 customers, were in attendance. During the meeting and in correspondence to the Commission, customers expressed strong support for CalWater acquiring the Grand Oaks water system. They requested that CalWater: (1) limit proposed major capital additions to items absolutely necessary to maintain water service, (2) work collaboratively with customers before implementing major infrastructure upgrades, and (3) give customers the option of making an up-front, lump sum payment in lieu of higher monthly/bimonthly water rates for major upgrades.

CalWater provided customers with cost estimates and the bill impact figures for the needed major capital improvements. While customers are concerned about the affordability of rates, they generally supported the rehabilitation of a second well (Well #3) to improve reliability. After hearing customers' concerns, CalWater's representative agreed to limit immediate major capital improvements to rehabilitation of Well #3 at an estimated cost of \$15,000, work with customers on future system replacement needs, and provide customers an opportunity to make an up-front, lump sum payment in lieu of higher water rates for major upgrades.

6. Position of CalWater

As a condition precedent to accepting the assets and CPCN of Grand Oaks, CalWater requests rate making treatment beyond that historically provided by the Commission as an incentive for large water utilities to acquire small, poorly-run water utilities such as Grand Oaks.

In D.99-10-064, the Commission provided incentives for Class A water utilities to acquire small troubled water utilities. However, the incentives are for a period not to exceed seven years.

As discussed in its application, CalWater is willing to acquire Grand Oaks if the regulatory mechanisms for small water systems continued to apply to Grand Oaks after the acquisition is approved. CalWater argues that the seven year limitation is a substantial deterrent to acquiring Grand Oaks and requests the same ratemaking and regulatory mechanisms applicable to Class C and D water systems without a time limitation. CalWater points out that while it has a long history of acquiring small water systems and improving customer service, its acquisitions have been in close proximity to an existing CalWater system, which Grand Oaks is not.

7. Position of DRA

Although DRA did not oppose CalWater acquiring Grand Oaks, it did oppose CalWater's ratemaking proposal. As an alternative, DRA sought out other entities such as the City of Tehachapi and the adjacent Golden Hills Community Services District to acquire Grand Oaks. However, DRA's efforts were not successful and such an outcome is no longer feasible. After extensive negotiations and recognizing that there are no qualified willing takers for Grand Oaks, DRA joined CalWater in a settlement of the issues.

8. Joint Settlement Agreement

The Joint Settlement Agreement (Agreement), attached to this decision as Attachment 1, is summarized below:

- CalWater will operate Grand Oaks as a stand alone Class D water system and rates will not be subsidized, except for low income ratepayer assistance, by CalWater's rates in other districts.

- CalWater will defer major capital improvements until, in CalWater's best judgment, it determines an improvement is needed for health, safety or reliability. CalWater will consult Grand Oaks' customers prior to making any final decisions on capital improvements.
- CalWater will rehabilitate Well #3 at an estimated cost of \$15,000 within 12 months of acquiring Grand Oaks.
- When the total cost of a capital improvement project exceeds \$10,000, CalWater will provide customers the option of paying for such projects either in an up-front lump sum payment or through monthly/bimonthly rates.
- Up-front, customer lump sum payments will be treated as Contributions-in-Aid-of-Construction. Consistent with standard ratemaking practice, CalWater will not earn a rate of return on these contributions.
- CalWater will record any customer contribution with the customer address. That address will be exempt from surcharges or higher rates used to pay for the given capital improvement project.
- CalWater will include in rate base the portion of the approved cost of capital improvement projects not funded by customer contribution.
- CalWater will file an advice letter for each capital improvement project that exceeds \$10,000 and set forth the expiration date of each surcharge.
- CalWater will earn a 12.75% after tax rate of return on rate base consistent with Class C and D ratemaking treatment. This rate is subject to change based on the authorized return for Class C and D water companies.

9. Discussion

The issue in this proceeding is whether the seven year limitation on ratemaking incentives provided to Class A water companies for acquiring troubled small utilities should be waived so that CalWater Service may acquire

Grand Oaks. We conclude that in this instance there are special circumstances justifying such a departure from the ratemaking treatment set forth in D.99-10-064.

In this matter, CalWater is a reluctant acquirer. CalWater's facilities are some 50 miles away from Grand Oaks and CalWater has been operating Grand Oaks only as an accommodation to the stranded customers. Moreover, Grand Oaks is a troubled small water utility and there are no qualified takers for the system. The public interest requires that we find a solution, even if it requires a departure from standard ratemaking treatment. Accordingly, because of the extenuating circumstances present, we grant CalWater's request for special ratemaking treatment as modified by the Agreement. Grand Oaks will continue to be treated as a stand-alone Class D water utility, without any time limitation on such ratemaking treatment.

9.1 Joint Settlement Agreement

We now turn to the Agreement offered by CalWater and DRA. Where parties to a proceeding settle all disputed issues, the Commission applies criteria set forth in Rule 12.1(d) of the Commission's Rules of Practice and Procedure to evaluate the proposed settlement. This rule requires that the settlement be "reasonable in light of the whole record, consistent with law, and in the public interest."

Before we analyze these criteria, we note that the circumstances of the settlement, particularly its endorsement by all parties, generally supports its adoption. In particular, we note the troubled history of Grand Oaks as set forth in D.05-08-007 and other decisions cited there, which provide the background for today's decision.

The record shows that the Agreement was reached after significant give-and-take between the parties which occurred over a significant amount of time. This give-and-take is demonstrated by the positions initially taken by parties, and the final positions agreed upon in the Agreement.

The Agreement is also consistent with Commission decisions on settlements, which express the strong public policy favoring settlement of disputes if they are fair and reasonable in light of the whole record.¹ This policy supports many worthwhile goals, including reducing the expense of litigation, conserving scarce Commission resources, and allowing parties to reduce the risk that litigation will produce unacceptable results.²

As long as a settlement taken as a whole is reasonable in light of the record, consistent with law, and in the public interest, it may be adopted. We next analyze these criteria with specific reference to the Agreement.

9.2 The Joint Settlement Agreement is Reasonable in Light of the Record

The record shows that the parties conducted extensive negotiations, explored alternative solutions and held meetings with the customers to arrive at a mutually acceptable solution to the problems facing Grand Oaks. The record contains sufficient information for us to judge the reasonableness of the Agreement.

¹ See, e.g., D.88-12-083 (30 CPUC 2d 189, 221-23), D.91-05-029 (40 CPUC 2d 301, 326), and D.05-03-022, mimeo., p. 8.

² See D.92-12-019, 46 CPUC 2d 538, 553.

9.3 The Joint Settlement Agreement is Consistent with Law

The parties believe that the terms of the Agreement comply with all applicable statutes, including Pub. Util. Code § 851 governing the transfer of utility property. Further, nothing in the Agreement contravenes statute or prior Commission decisions. Indeed, the Commission's recent Water Action Plan promotes "the acquisition or the operation of small private water utilities by larger private or municipal water utilities." (Water Action Plan adopted December 15, 2005, at 5.) The issues resolved in the Agreement are clearly within the scope of the proceeding. Moreover, the Agreement, if adopted, would result in just and reasonable rates.

9.4 The Joint Settlement Agreement is in the Public Interest

The principal public interest affected by this proceeding is the delivery of safe, reliable water service at reasonable rates. The Agreement advances this interest for several reasons.

First, our approval of the Agreement avoids the cost of further litigation, and reduces the use of valuable resources of the Commission and the parties.

Second, Grand Oaks has lacked committed ownership since 1997, if not earlier. A moratorium on new hook-ups exists and may be stifling local development. Lifting the moratorium requires an owner with resources for planning and investment in the Grand Oaks system. As discussed above, the system needs major replacements requiring significant capital investment. CalWater has the resources to make these capital investments.

Third, CalWater has agreed to moderate potentially harsh bill impacts of needed system improvements by allowing the customers to get involved in the decision-making process and by providing customers with the option to make

up-front, lump sum payments to pay for major capital improvements in advance to avoid bill increases resulting from an increased rate base.

Finally, we note that the settling parties comprise all of the active parties in this proceeding, and we do not know of any parties who contest the Agreement. Thus, the Agreement commands the unanimous sponsorship of all active parties in this proceeding who fairly represent the interests affected by the Agreement. We find that the evidentiary record contains sufficient information for us to judge the reasonableness of the Agreement and for us to discharge any future regulatory obligations with respect to this matter. Thus, the proposed settlement is consistent with the criteria for all-party settlements set forth in D.92-12-019 (46 CPUC 2d 538).

For all these reasons, we approve the Agreement as proposed.

10. Reduction of Comment Period

Pursuant to Rule 14.6(b) of the Commission's Rules of Practice and Procedure, all parties stipulated to reduce the 30-day public review and comment period required by Section 311 of the Public Utilities Code to 10 days. Comments were received from one customer seeking clarification of the lump-sum payment option. Where necessary, we have made changes to the Administrative Law Judge's (ALJ) proposed decision for the sake of clarity.

11. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Bertram D. Patrick is the assigned ALJ in this proceeding.

Findings of Fact

1. Grand Oaks is a small, troubled water utility with no willing takers to acquire the system.

2. As ordered by the Commission in D.05-08-007, CalWater filed the instant application to acquire the assets and CPCN of Grand Oaks.

3. In D.99-10-064, the Commission provided incentives for Class A water utilities to acquire small troubled water utilities. However, the incentives are for a period not to exceed seven years.

4. As a condition precedent to accepting the CPCN, CalWater requests ratemaking treatment beyond that historically provided by the Commission as an incentive for large water utilities to acquire small, poorly-run water utilities such as Grand Oaks.

5. CalWater contends that the seven-year limitation on D.99-10-064 incentives is a substantial deterrent to its acquiring the Grand Oaks system.

6. CalWater is willing to acquire Grand Oaks if the ratemaking and regulatory mechanism applicable to Class C and D water systems will apply to Grand Oaks without a time limitation.

7. There are special circumstances in this instance which justify granting CalWater's request for special ratemaking treatment, including removing the seven-year time limitation, for Grand Oaks, if CalWater acquires the system.

8. On April 27, 2007, CalWater and DRA filed a motion requesting the Commission to adopt a settlement agreement entitled Joint Motion to Adopt Settlement.

9. Grand Oaks' customers strongly support CalWater acquiring the Grand Oaks system.

10. All issues in this proceeding are encompassed by, and resolved in, the Agreement.

Conclusions of Law

1. CalWater's application to acquire the assets and CPCN of Grand Oaks, should be granted as modified by the Agreement.
2. As modified by the Agreement, CalWater's request for special ratemaking treatment for Grand Oaks should be granted.
3. Grand Oaks should continue to be treated as a stand-alone Class D water utility without any time limitation on such ratemaking treatment, after CalWater acquires the system.
4. The special ratemaking treatment in the Agreement and authorized herein is the Commission's response to the dire circumstances facing Grand Oaks' customers. This does not constitute a modification to D.99-10-064 and does not set a precedent for other utilities to seek similar ratemaking treatment.
5. The Agreement fully resolves and settles all disputed issues among the parties concerning CalWater's application in this proceeding.
6. The Agreement is reasonable in light of the whole record, consistent with law, and in the public interest.
7. The Joint Motion to Adopt Settlement filed by DRA and CalWater should be granted and the Joint Settlement Agreement should be adopted.
8. This decision should be effective today so that the Agreement may be implemented expeditiously.
9. Based on the stipulation of all parties, the 30-day public review and comment period should be shortened to 10 days, pursuant to Rule 14.6(b).
10. A.05-12-012 should be closed.

O R D E R

IT IS ORDERED that:

1. California Water Service Company's (CalWater) application to acquire the assets and certificate of public convenience and necessity of Grand Oaks Water Company (Grand Oaks) is granted, as modified by the Agreement.

2. CalWater's request for special ratemaking treatment for Grand Oaks as modified by the Agreement is granted.

3. Grand Oaks shall continue to be treated as a stand-alone Class D water utility without any time limitation on such ratemaking treatment, after CalWater acquires the system.

4. The Joint Motion to Adopt Settlement Agreement, filed by Division of Ratepayer Advocates and CalWater, is granted.

5. The Joint Settlement Agreement, attached to this decision as Attachment 1, is adopted.

6. Within eight days of today's date, CalWater shall file an advice letter with tariff changes and new rates to implement this decision. The tariff changes and new rates shall become effective on or after the date filed, subject to Water Division's determination that they are in compliance with this decision.

7. Application 05-12-012 is closed.

This order is effective today.

Dated _____, at San Francisco, California.