

Decision 11-06-032 June 23, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application of Mountain Utilities, LLC
(U906E) and Kirkwood Meadows Public
Utility District for Transfer of Control of
Assets and Additional Requests Relating to
Proposed Transaction.

Application 11-02-020
(Filed February 25, 2011)

(See Appendix A for Appearances)

**DECISION APPROVING SALE AND TRANSFER OF CONTROL OF ASSETS AND
RELIEVING MOUNTAIN UTILITIES OF ITS OBLIGATION TO PROVIDE PUBLIC
UTILITY ELECTRICITY SERVICE**

Table of Contents

Title	Page
DECISION APPROVING SALE AND TRANSFER OF CONTROL OF ASSETS AND RELIEVING MOUNTAIN UTILITIES OF ITS OBLIGATION TO PROVIDE PUBLIC UTILITY ELECTRICITY SERVICE.....	2
1. Summary.....	2
2. Background.....	2
3. Identification of Parties.....	4
3.1. Mountain Utilities, LLC.....	4
3.2. Kirkwood Meadows Public Utilities District.....	5
3.3. Division of Ratepayer Advocates.....	6
4. Summary of Authority Sought.....	6
4.1. Reason for the Sale and Transfer.....	9
5. Standard of Review.....	11
5.1.1. Public Utilities Code § 851.....	12
5.1.2. Public Utilities Code § 854.....	13
6. The Transfer Application: Discussion.....	15
6.1. Impact on Rates.....	15
6.1.1. Sale Price.....	17
6.1.2. Reconstruction of the Powerhouse.....	18
6.1.2.1. Viability of KMPUD Financing.....	19
6.1.3. The Out-Valley Project.....	20
6.2. Impact on Quality of Service.....	21
6.3. Impact on Quality of Management.....	22
6.4. Impact on Mountain Utilities' Employees.....	22
6.5. Impact on Commission Jurisdiction.....	23
6.6. Conclusion.....	23
7. Allocation of Gains/Losses.....	24
8. Compliance with the California Environmental Quality Act (CEQA).....	26
9. Categorization and Need for Hearing.....	27
10. Comments on Proposed Decision.....	28
11. Assignment of Proceeding.....	28
Findings of Fact.....	28
Conclusions of Law.....	32
ORDER.....	34

Appendix A - Service List

**DECISION APPROVING SALE AND TRANSFER OF CONTROL OF ASSETS
AND RELIEVING MOUNTAIN UTILITIES OF ITS OBLIGATION TO PROVIDE
PUBLIC UTILITY ELECTRICITY SERVICE**

1. Summary

This decision approves the transfer and sale of Mountain Utilities, LLC's electric generation and distribution assets to Kirkwood Meadows Public Utility District. Mountain Utilities and Kirkwood Meadows Public Utility District have established that the sale and transfer is not adverse to the interests of ratepayers; in fact, certain service efficiencies are likely in both the near and long term. Although construction of the replacement powerhouse will result in rate increases, the increase is likely to be small, and Kirkwood Meadows Public Utility District is better positioned to mitigate the increase than Mountain Utilities.

Upon final closing of the transfer and sale to Kirkwood Meadows Public Utility District pursuant to the Asset Purchase Agreement, Mountain Utilities is relieved of its obligation to provide public utility electric service to customers within its service territory. This proceeding is closed.

2. Background

On February 25, 2011, Mountain Utilities (MU), LLC (U906E) and Kirkwood Meadows Public Utility District (KMPUD) (the Joint Applicants) filed an application seeking Commission approval for the transfer and sale of MU's

electric generation and distribution assets¹ to KMPUD (Application). The acquisition of the assets occurs pursuant to an Asset Purchase Agreement² (APA) executed by the Joint Applicants and results in KMPUD taking over all of MU's electric operations. As such, MU seeks to be relieved of its duty to provide public utility electric service to customers within its service territory.

No protests were filed in this application. On April 1, 2010, pursuant to Rule 1.4(b), the Division of Ratepayer Advocates (DRA) filed a Motion for Party Status in order to conduct discovery and undertake a comprehensive review of the application. On April 4, 2011, the motion was granted. In its April 27, 2011 Prehearing Conference (PHC) Statement, DRA stated that it had not found any "legal or factual issues that would warrant any further discovery, hearings, or comments/briefs."³ On April 8, 2011, 456 signatories representing 286 households in the Kirkwood community submitted a letter in support of the Application.

A PHC and concurrent evidentiary hearing were held on May 4, 2011. During the evidentiary hearing, the assigned Administrative Law Judge (ALJ) asked a number of questions of the Joint Applicants in order to further clarify and expand upon the extensive information contained in the Application. After

¹ In addition to acquiring MU's electric generation and distribution assets, KMPUD is also purchasing MU's propane distribution assets and will assume operation of these assets to provide retail propane service. The Commission does not regulate propane services, except for safety purposes; therefore the sale and transfer of MU's propane assets under the Asset Purchase Agreement are exempt from Commission review. (Cal. Pub. Util. Code § 221; Decision (D.) 01-04-031 at 3.)

² MU and KMPUD entered into the APA on April 2, 2010. On February 12, 2011, the parties executed a First Amendment to the Asset Purchase Agreement.

³ Prehearing Conference Statement of the Division of Ratepayer Advocates at 2.

the conclusion of the concurrent PHC and evidentiary hearing, DRA confirmed that it had no outstanding concerns and did not intend to participate further in this proceeding.⁴ Pursuant to Rule 14.6(b), the Joint Applicants and DRA stipulated to waive the period of public review and comment on the proposed decision. As of May 13, 2011, this proceeding stands submitted. The assigned Commissioner and assigned Administrative Law Judge issued a scoping memo and ruling, which identified the issues to be determined and set a schedule for addressing those issues. No further filings by parties have been received since the issuance of the scoping memo on May 24, 2011.

3. Identification of Parties

3.1. Mountain Utilities, LLC

MU is a Delaware limited liability company whose sole member and parent is Mountainsprings-Kirkwood, LLC. Mountainsprings-Kirkwood, LLC is also the parent and sole member of Kirkwood Mountain Resort, LLC. MU is an electric microutility⁵ providing retail electric service in the Kirkwood, California area. MU has approximately 700 customers with a coincident peak load of 2.2 megawatts (MW) and an additional interruptible load of approximately 1.1 MW. Kirkwood Mountain Resort represents about 75% of MU's total winter load and about 55% of MU's summer load.⁶ Until January 1, 2010, MU served its customers exclusively from a utility grade diesel generator facility (the

⁴ May 4, 2011 Evidentiary Hearing Transcript (Tr.) at 65.

⁵ Cal Pub. Util. Code § 2780 defines an "electric microutility" as "any electrical corporation that is regulated by the commission and organized for the purpose of providing sole-source generation, distribution, and sale of electricity exclusively to a customer base of fewer than 2,000 customers."

powerhouse) that was installed in the 1970s and had a combined normal operating capacity of 4,200 kilowatts (kW) (6.325 MW nameplate capacity). On January 1, 2010, a fire completely destroyed the powerhouse. Since that time, MU has been providing service on an emergency basis using several portable diesel generators, which are less efficient than the original powerhouse.⁷

MU's service territory is approximately 2.5 miles by 0.75 miles and is located southwest of Lake Tahoe at an elevation of approximately 8,000 feet. MU is not connected (either directly or indirectly) to the transmission grid nor to any natural gas or diesel fuel pipelines.⁸ All energy needed to serve MU's load is generated by MU, and fuel for this generation is transported to MU by truck.

3.2. Kirkwood Meadows Public Utilities District

KMPUD is a non-profit public utility district formed in 1985 pursuant to the California Public Utilities Code⁹ and is governed by a five-member board of directors elected by the Kirkwood community. KMPUD currently provides water, sewer, fire department, recreation, cable television, refuse collection, snow removal, employee housing, and vector control services to the Kirkwood community. KMPUD's service territory is coterminous with MU's service territory. In 1999, KMPUD installed and began to operate three 360 kW generation units to meet its electric needs. Operation of these generation units

⁶ Application at 2.

⁷ The backup generators were applied for through the Great Basin Unified Air Quality Control District and permitted for temporary use; therefore no California Environmental Quality Act (CEQA) review was triggered. (Tr. at 7.)

⁸ See D.08-05-029 at 5-6.

⁹ Cal. Pub. Util. Code § 15701 et seq.

represents the extent of KMPUD's experience with owning and operating electric generation resources at this time.¹⁰ In December 2006, KMPUD applied to the Alpine County Local Agency Formation Commission (LAFCO) for authorization to provide electric and gas service. On April 17, 2007, the Alpine County LAFCO approved KMPUD's request to provide electric and propane retail distribution service within its service territory. The LAFCO approval was subsequently reviewed and approved by the Alpine County Counsel.¹¹

3.3. Division of Ratepayer Advocates

DRA is a ratepayer advocacy group, which statutorily is part of the Commission. As noted above, DRA has party status in this proceeding but, after discovery, has not protested the application.

4. Summary of Authority Sought

The Joint Applicants propose that KMPUD purchase all the electric generation and distribution assets and the propane distribution assets of MU and assume operation of these assets to provide retail electric and propane service to the Kirkwood community. Upon close of the sale and transfer of MU's electric and propane assets, MU requests to be relieved of its obligation to provide public utility electric service to customers within its service territory.

Under the APA, KMPUD is obligated to construct a replacement powerhouse; however, construction of the powerhouse by KMPUD does not

¹⁰ Tr. at 10. KMPUD currently provides propane services to all of its main structures. (Tr. at 10.)

¹¹ Application at 4.

require Commission approval.¹² Furthermore, KMPUD is the lead agency for the replacement powerhouse for purposes of CEQA as discussed below.¹³ The APA also requires KMPUD to examine ways to connect the Kirkwood area to the regional power grid through the construction of a new power line (the Out Valley Project). The Out Valley Project is not part of the assets being transferred in the APA and does not require Commission approval. The Out Valley Project is subject to CEQA and the National Environmental Policy Act, and a joint Environmental Impact Statement/Environmental Impact Report is currently being prepared for the project.¹⁴ If the Out Valley Project is eventually built and the Kirkwood area is connected to the transmission grid, the replacement powerhouse will be removed from primary service and used only for standby service.

The acquisition purchase price for MU's electric and propane assets is \$3 million.¹⁵ The Joint Applicants estimate the total cost to pay for the acquisition of MU's assets and to complete construction of the replacement powerhouse is at least \$15 million.¹⁶ KMPUD anticipates financing the asset

¹² KMPUD is a municipally operated and governed utility and is therefore not subject to Commission jurisdiction. (*See* Cal. Pub. Util. Code § 218.)

¹³ KMPUD as the lead agency has reviewed and issued a CEQA Notice of Exemption for the replacement powerhouse. (Application at 6.)

¹⁴ *Id.*

¹⁵ The cost associated with the electric assets is \$966,666 (Application at 13) and consists of only the electric distribution system. (Tr. at 15.)

¹⁶ Application at 6.

acquisition, replacement powerhouse construction, and other needed infrastructure improvements in phases.¹⁷

¹⁷ The first phase will consist of a bond anticipation note to cover the costs associated with the initial construction of the replacement powerhouse. In the next phase, KMPUD will issue revenue bonds or bond anticipation notes to cover the final construction for the replacement powerhouse and the asset acquisition. (Application at 6-7). Financing of the full cost of the project is anticipated to be complete by July 2011. (Application, Exhibit 2.)

4.1. Reason for the Sale and Transfer

MU offers several reasons for pursuing this transaction. First, MU's geographic location combined with its isolation from the transmission grid and limited generation options have historically made it difficult for MU to provide low cost, reliable service or to meet the State's environmental goals. MU's historical reliance on diesel-fuel generation means that the price of electricity is heavily dependent on the price of diesel fuel.¹⁸ The powerhouse fire has necessitated a significant near-term capital investment to construct a replacement powerhouse, and MU does not believe it can cost-effectively raise the necessary funds in the debt markets. Furthermore, for the past four years, MU has experienced net losses before income taxes for its electric service.¹⁹ In short, MU believes that KMPUD is in a much stronger position to make the capital investments necessary to improve service in both the near and long-term.

KMPUD states that the acquisition of MU's electric generation and distribution facilities will result in significant benefits to customers and is the will of the Kirkwood community. In January 2006, residents of the Kirkwood community approached KMPUD to request that KMPUD evaluate the feasibility and cost of providing retail electric service.²⁰ KMPUD then developed and distributed to the Kirkwood community a questionnaire regarding electric and

¹⁸ Since 2008, electric rates for KMPUD's customers have spiked as high as \$0.970/kWh and have averaged \$0.470/kWh over this period, which is significantly higher than the rates paid by customers of other small investor-owned utilities (IOUs) in California. (Application at 7.) MU's tariff allows for a pass-through of diesel fuel charges above \$0.75 a gallon. Fuel prices below \$0.75 a gallon are incorporated in MU's base rate and are around \$0.08/kWh. (Tr. at 20.)

¹⁹ Application at 8.

²⁰ Application, Exhibit 6.

propane services. Many respondents requested that KMPUD provide electric service.²¹ In July 2006, KMPUD presented a study to the community addressing the feasibility of KMPUD providing electric generation and propane services. The study contemplated three options: (1) KMPUD ramps up its own generation units to provide all non-Kirkwood Mountain Resort-related energy services to the Kirkwood community; (2) KMPUD acquires MU and provides all energy services to the Kirkwood Community and Kirkwood Mountain Resort from an upgraded powerhouse; and (3) KMPUD serves all load from a new interconnection to the regional electric grid. The study concluded that Option #2 provides a “foundation for further lowering overhead costs, further improving energy efficiency, enhancing local control and maximizing transparency.”²² The study also found that Option # 2 is a precursor to evaluating the long-run potential for interconnection in Option #3.

The Joint Applicants assert that the proposed acquisition will benefit customers and is in the public interest. KMPUD states that it can provide and improve service more cost effectively than MU, it can increase reliability and improve power quality, and it is better positioned to respond to requests from the community.²³ KMPUD states that because it is a non-profit public utility district, it has the ability to finance the construction of the replacement powerhouse and any other needed infrastructure improvements at a

²¹ While the initial response rate in favor of KMPUD providing electric service was less than a majority, community support for the project is strong, as evidenced by the April 8, 2011 letter of support with 456 signatories. Furthermore, KMPUD held public meetings to seek customer input on the proposed transaction. (Tr. at 37.)

²² Application, Exhibit 8 at 3.

²³ Application at 11.

significantly lower cost to customers than MU.²⁴ Furthermore, KMPUD estimates that operational savings of more than \$300,000 per year can be realized through overhead efficiencies, property tax savings, and reduced regulatory costs.²⁵ The Joint Applicants assert that construction of the new powerhouse will lower air emissions in the Kirkwood Meadows Valley. For the preceding reasons, the Joint Applicants request that the Commission approve the application and relieve MU of its obligation to provide public utility electric service to customers within its service territory.

5. Standard of Review

As discussed in the scoping memo, we apply Pub. Util. Code §§ 851 and 854(a) as the appropriate standards of review for this application. Section 851 applies generally to the sale of assets, while § 854 addresses transfers of control, among other things. To approve the proposed sale of assets and transfer of control, the Commission must find the proposal meets the public interest standard that prior Commission decisions define for § 854 and § 854(a). Typically, the Commission has required an applicant to show that a proposed transfer is “not adverse to the public interest.”²⁶ The Commission has developed

²⁴ The Joint Applicants state that, as a result of the construction of the replacement powerhouse, ratepayers will see an increase in rates going forward, regardless of whether MU or KMPUD is the service provider. However, KMPUD is in a better position to make the necessary infrastructure investments at a lower cost to ratepayers than MU. (Application at 12.)

²⁵ Application at 9.

²⁶ See, for example, D.07-05-031, which approved the transfer of control over California-American Water Company (CalAm) at the holding company level:

Footnote continued on next page

criteria by which to make this determination. For example, in D.00-06-079, the Commission observed: "...our decisions over the years have laid out a number of factors that should be considered in making the determination of whether a transaction will be adverse to the public interest."²⁷ D.00-06-079 mentions several factors – purchase price, value of consideration exchanged, efficiencies, operating costs savings – among others. Not every factor found in our case history is relevant to every review under § 851 and § 854(a), and we consider only the applicable factors in this review.

While the legal standard of review for § 851 and § 854(a) is that the proposed transfer is not "adverse to the public interest," the Commission has occasionally articulated the standard of review as requiring a showing that the transfer is "in the public interest."²⁸ Given several factors that are central to this application, including the potential impact on rates of the construction of the new powerhouse, the broad community support for the transaction, and the fact that the transfer and sale represents a transfer out of our jurisdiction, we evaluate this application both under the legal standard and this heightened standard of review.

5.1.1. Public Utilities Code § 851

Section 851 applies generally to the sale of assets by a public utility:

A public utility...shall not sell, lease, assign, mortgage or otherwise dispose of, or encumber the whole or any part of its railroad, street

The primary standard used by the commission to determine if a transaction should be authorized under § 854(a) is whether the transaction will adversely affect the public interest. (D.07-05-031 at 3, citing D.00-06-079 at 13.)

²⁷ D.00-06-079 at 14.

²⁸ D.07-05-031 at 3 and D.10-10-017 at 11.

railroad line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or any right thereunder, or by any means whatsoever, directly or indirectly, merge or consolidate its railroad, street railroad, line, plant, system, or other property, or franchises or permits or any part thereof, with any other public utility, without first having either secured an order from the commission authorizing it to do so for qualified transactions valued above five million dollars (\$5,000,000)...

Section 851 continues:

For a qualified transaction valued at five million dollars (\$5,000,000) or less, the commission may designate a procedure different than the advice letter procedure if it determines that the transaction warrants a more comprehensive review.

Similar to the matter in this application, D.88-04-027 evaluated a proposed property and asset sale by CP National Corporation, an electric utility regulated by the Commission, to the Lassen Municipal Utility District under § 851. The acquisition included all of the property and assets associated with CP National Corporation's electric distribution and transmission systems in Lassen and contiguous counties. While the above example involved a transaction valued at greater than \$5,000,000, and the one before us does not, we find that given the similarities between these two cases, and the heightened standard of review we wish to apply to this transaction, it is appropriate to examine this case under § 851 through an application.

5.1.2. Public Utilities Code Section 854

Consistent with the scoping memo, our review of the transfer under § 854 focuses on § 854(a). Section 854(a) pertains generally to utility transfers of control:

No person or corporation, whether or not organized under the laws of this state, shall merge, acquire, or control either directly or indirectly any

public utility organized and doing business in this state without first securing authorization to do so from the commission. The commission may establish by order or rule the definitions of what constitutes merger, acquisition, or control activities which are subject to this section. Any merger, acquisition, or control without that prior authorization shall be void and of no effect. No public utility organized and doing business under the laws of this state, and no subsidiary or affiliate of, or corporation holding a controlling interest in a public utility, shall aid or abet any violation of this section.

Historically, the Commission has determined the applicability of § 854 on a case-by-case basis. Review under § 854 is consistent with this Commission's procedural approach in D.05-03-010, which approved the sale of Avista Corporation's South Lake Tahoe gas facilities to Southwest Gas Corporation. In that proceeding, we applied § 854 because Southwest Gas Corporation was acquiring control over all of Avista Corporation's public utility operations in California. D.05-03-010 explains:

Since the purpose of § 854 is to enable [this Commission] to review and set conditions on the transfer of a public utility authority in California, the transaction here falls within the meaning of § 854(a).²⁹

In this application, we find a similar situation, where MU is requesting permission from this Commission to transfer all of its public utility operations in California to KMPUD, thus relieving MU of its obligation to provide public utility electric service to customers within its service territory. We find it prudent to apply § 854 to this application.

Subsections (b) and (c) of § 854 require additional scrutiny when any party

²⁹ D.05-03-010 at 11.

to the transaction has gross annual California revenues of more than \$500 million. The Application shows that both MU and KMPUD have annual revenues far below \$500 million.³⁰ Therefore, subsections (b) and (c) of § 854 are not applicable in this case.

Similar to § 854(a), subsection (d) applies to any transfer of control without limitation to annual revenues. Section 854 (d) provides:

When reviewing a merger, acquisition, or control proposal, the commission shall consider reasonable options to the proposal recommended by other parties, including no new merger, acquisition, or control, to determine whether comparable short-term and long-term economic savings can be achieved through other means while avoiding the possible adverse consequences of the proposal.

No other party provided alternative options for consideration; therefore, subsection (d) of § 854 does not apply in this case. However, in considering whether this application is adverse to the public interest, we considered no acquisition and transfer of control as an alternative under § 854(a).

6. The Transfer Application: Discussion

Below, we evaluate the Application against a number of applicable criteria in order to make a determination that the proposed transaction is not, at a minimum, adverse to the public interest. We primarily focus on the impact on rates; however, we also evaluate the impact on utility service as well as the impact on quality of management and the effect of the transfer and sale on current MU employees.

6.1. Impact on Rates

³⁰ Application at Exhibits 11, 20.

Mountain Utility customers currently see average rates around \$0.470/kilowatt hour (kWh), which are significantly higher than residential retail rates paid by customers of other small IOUs in California.³¹ A large component of the current rate structure is a pass-through of diesel fuel costs, which can fluctuate widely from month to month.³² MU's tariff is set such that customers see a base rate of \$0.280/kWh, which includes approximately \$0.080/kWh of built-in diesel fuel costs and \$0.200/kWh attributable to overhead and cost of capital.³³ The built-in diesel fuel costs amount to a diesel fuel price of approximately \$0.75/gallon. In recent times, diesel fuel prices have been far greater than \$0.75/gallon, resulting in the high rates seen by MU customers.

KMPUD anticipates offering a similar rate structure upon completion of the transfer of control. As Tom Henie, General Manager for KMPUD, stated during the evidentiary hearing, "You're dealing with an isolated utility, not on the grid. You're dealing with a small customer base, and you're dealing with diesel prices that, as we all know, can fluctuate widely. And if you didn't set up some type of fluctuating rate based on diesel prices, there would just be no way that you could run the utility."³⁴

As discussed below, Joint Applicants acknowledge that construction of the new powerhouse will, necessarily, result in rate increases going forward, regardless of whether MU or KMPUD is the service provider.³⁵ Construction of

³¹ Application at 7.

³² Tr. at 20-21.

³³ *Id.*

³⁴ Tr. at 22.

³⁵ Application at 12.

the new powerhouse will require a significant capital investment to be recovered from a small customer base.³⁶ As such, our evaluation of the impact on rates will focus heavily on which provider is better equipped to provide electricity service to Kirkwood residents at the least cost, despite the inevitable increase in rates that customers will see in the near future.

6.1.1. Sale Price

The acquisition purchase price for MU's electric and propane assets is \$3 million.³⁷ The Joint Applicants estimate the total cost to pay for the acquisition of MU's assets and to complete construction of the replacement powerhouse is at least \$15 million.³⁸ KMPUD anticipates financing the asset acquisition, replacement powerhouse construction and other needed infrastructure improvements in phases. As discussed below, even when considering the costs of construction of the new powerhouse, the difference in rates for customers will be minimal due to efficiencies inherent in operating new, more efficient engines.³⁹ Therefore, the sale price of \$3 million for acquisition of MU's assets will have a negligible impact on rates. As a result, we focus more heavily on the cost of constructing the replacement powerhouse.

³⁶ *Id.*

³⁷ The cost of the electric assets is \$966,666 (Application at 13) and consists of only the electric distribution system. (Tr. at 15.)

³⁸ Application at 6.

³⁹ Tr. at 25-26.

6.1.2. Reconstruction of the Powerhouse

Joint Applicants estimate that the cost to construct the replacement powerhouse is around \$13.8 million.⁴⁰ Mountain Utilities does not believe that it can cost-effectively raise this amount in the debt markets due to its historical losses, small customer base, extreme seasonal electricity usage patterns, and lack of load diversity (one customer- Kirkwood Mountain Resort-represents the large majority of MU's load).⁴¹ Despite being faced with many similar circumstances, KMPUD is a non-profit public utility district, putting it in a better position to make the necessary infrastructure investments at a lower cost to ratepayers due to access to tax exempt financing, among other efficiencies. In the Application, Joint Applicants present a table detailing estimated rates per kilowatt-hour for MU and KMPUD absent fuel adjustment costs. The table shows a difference of nearly \$0.140/kWh between the two utilities' estimated costs to build the new powerhouse and operate the system. The difference is attributable to the debt service interest rate available to each entity and to KMPUD's expected \$300,000 in annualized savings due to efficiencies in providing all utility services to the Kirkwood community as part of one operation.⁴²

The Joint Applicants expect the overall increase in rates to be minimal if KMPUD undertakes construction of the new powerhouse. Joint Applicants explain that, while the new powerhouse will result in an increase in rates, much of the increase will be offset by reduced diesel fuel usage as a result of operating

⁴⁰ Application at 8.

⁴¹ Application at 8.

⁴² Application at 13.

new, more efficient turbines.⁴³ We find that KMPUD is in the best position to build and operate the new powerhouse at the least cost to ratepayers. While ratepayers may experience a small increase in rates, such an increase was inevitable, and KMPUD's access to low-cost financing as well as other operational efficiencies will mitigate rate increases that would result if MU undertook construction of the replacement powerhouse.

6.1.2.1. Viability of KMPUD Financing

KMPUD anticipates financing the asset acquisition, replacement powerhouse construction, and other needed infrastructure improvements in phases. The first phase will consist of a bond anticipation note to cover the costs associated with the initial construction of the replacement powerhouse. In the next phase, KMPUD will issue revenue bonds or bond anticipation notes to cover the final construction for the replacement powerhouse and the asset acquisition.⁴⁴ Financing of the full cost of the project is anticipated to be complete by July 2011.⁴⁵ As of the writing of this decision, KMPUD has already secured a \$5.5 million bond⁴⁶ and has put together a financial package seeking the additional funds.⁴⁷

Given that KMPUD has already secured a large portion of the necessary funds to purchase MU's assets and build the replacement powerhouse, we find that KMPUD is likely to obtain the remaining financing. Joint Applicants plan to

⁴³ Tr. at 24.

⁴⁴ Application at 6-7,

⁴⁵ Application at Exhibit 2.

⁴⁶ *Id.*

⁴⁷ Tr. at 54.

finish construction of the replacement powerhouse in 2011⁴⁸, and acquisition of the remaining financing is a central component to maintaining this timeline. If KMPUD is unable to obtain the necessary financing in 2011 and the close of the transaction is delayed beyond the end of 2011, we direct Mountain Utilities to submit a letter to the Director of the Commission's Energy Division and serve it on the official service list in this proceeding within 15 days of knowledge of the delay detailing the reason for the delay and the anticipated remedy (along with an updated estimated completion schedule).

The temporary energy generation configuration in use by MU is unsustainable in the long-run. We encourage the Joint Applicants to move forward with the close of the transaction and construction of the new powerhouse as quickly as possible. In an excess of caution, we wish to put forth a course of action in the event that the APA is terminated, for whatever reason. If the APA is terminated, MU must come before this Commission within 30 days of the termination date with a plan to finance and construct a replacement powerhouse.

6.1.3. The Out Valley Project

The APA requires KMPUD to examine ways to connect the Kirkwood area to the regional power grid through the construction of a new power line (the Out Valley Project).⁴⁹ The Out Valley Project is not part of the assets being transferred, nor does it require Commission approval; however, we find it prudent to consider the potential impact on rates of its construction as part of our

⁴⁸ Construction of the replacement powerhouse began in 2010. (Tr at 16).

⁴⁹ Application at 12.

overall evaluation. There are several advantages of connection to the regional power grid including service stability, lower fuel costs and reduced air emissions from obtaining electricity from sources that are cleaner than diesel fuel generators; however, construction of the new power line comes with a cost, and such costs must be borne by a small number of ratepayers.

Joint Applicants estimate that the impact on electric rates for Kirkwood residents as a result of construction of the new power line will be around \$0.070/kWh in addition to the minimal increases already seen from construction of the replacement powerhouse. The costs of the new line will be offset in large part by the reduced (and more stable) energy costs of grid power.⁵⁰ We find that, despite the potential cost implications of construction of the new power line, it is in the best interest of Kirkwood ratepayers for reasons of stability and reduced air emissions to pursue consideration of the Out Valley Project.

6.2. Impact on Quality of Service

As a result of the January 1, 2010 fire, MU has been providing service on an emergency basis using several portable diesel generators, which are less efficient than the original powerhouse. As discussed above, construction of the new powerhouse will result in the use of more fuel-efficient generators that are optimally configured to meet the generation needs of the Kirkwood area. Furthermore, KMPUD is in a better position to obtain financing to construct the replacement powerhouse, thus resulting in a more expeditious removal of the portable diesel generators. KMPUD's operation of the electric system will result in overall operational efficiencies as a result of overhead efficiencies that come

⁵⁰ Tr. at 27.

from operating all utility services under one roof. Finally, if KMPUD proceeds with the Out Valley Project, which would connect the Kirkwood area to the electricity grid, long-term electric service stability for the area will be achieved. We find that there will be no adverse impacts to ratepayers in the quality of electric service as a result of the transfer and sale. In fact, we believe service improvements are likely both in terms of quality of electricity generated and the ease of obtaining all utility services through one company.

6.3. Impact on Quality of Management

KMPUD's current experience with owning and operating electric generation resources comes solely as a result of owning three, 360 kW generation units used to meet its own electric needs. However, as discussed below, KMPUD is currently interviewing MU employees for the purposes of retaining local expertise in the electric system. Furthermore, KMPUD provides most, if not all, other public utility services to the Kirkwood community, and managerial synergies most likely exist across public utility operations. We find that KMPUD will have competent, professional management in place to operate electric generation resources.

6.4. Impact on Mountain Utilities' Employees

Kirkwood is a small, relatively isolated community located in the Sierra Nevada Mountains. As such, any change in the overall electric or propane operations in the Kirkwood area could have a significant impact on MU's current employees. Therefore, our evaluation of the proposed sale and transfer should weigh the impact on current MU employees as members of the public against the overall public benefit of the transaction. Joint Applicants state that "to ensure there is no degradation in service upon closing of the acquisition and that transaction is fair and reasonable to affected MU employees, KMPUD is

interviewing MU employees for purposes of retaining local expertise in the electric system.”⁵¹ Joint Applicants note that although the benefits of this action are difficult to quantify, they are substantial. We agree and find that current MU employees will not be harmed as a result of the transaction.

6.5. Impact on Commission Jurisdiction

MU requests that, upon close of the transfer and sale, it be relieved of its obligation to provide public utility electric service to customers within its service territory. It has long been established that this Commission does not have jurisdiction to regulate municipal electric utilities.⁵² Thus, the transfer and sale of MU’s electric generation assets to KMPUD also represents a transfer out of our jurisdiction.

6.6. Conclusion

This authority sought in the application is granted. For the above reasons, we find that the transfer and sale of MU’s electric assets to KMPUD is not adverse to the public interest and will, in fact, be in the public interest. KMPUD is in a better position to provide electric service to the Kirkwood community at the lowest possible cost. Furthermore, KMPUD can provide the Kirkwood community with the simplicity of almost all, if not all, utility services being provided by one company. Finally, connection to the regional power grid will likely provide long-term service and price stability to Kirkwood area ratepayers. Rejection of the transfer and sale of assets would obligate MU to pursue

⁵¹ Application at 14.

⁵² *City of Pasadena v. Railroad Commission of California* (1920) 183 Ca. 526, 536, Cal. Constitution, Art. XII, § 3, Cal. Pub. Util. Code § 218.

rebuilding the powerhouse at a significantly higher cost to ratepayers and is not an optimal outcome.

Upon final closure of the sale and transfer of MU's assets to KMPUD, MU will be relieved of its obligation to provide public utility electric service to customers within its service territory. MU must notify the Director of the Commission's Energy Division in writing of the transfer and sale of assets of MU to KMPUD within 30 days of the date of the transfer and must serve the letter on the official service list for this proceeding.

7. Allocation of Gains/Losses

D.06-05-041, as modified by D.06-12-043 spells out our process for allocating gains (and losses) between ratepayers and shareholders when an electric utility (among others) sells depreciable or non-depreciable assets formerly used to serve utility customers and where the asset sale price is less than \$50 million and the after-tax gain (or loss) from the sale is \$10 million or less.⁵³ The allocation in D.06-05-041 can also apply to losses up to \$50 million unless any party requests a different allocation.

D.06-05-041 reaffirms our application of the Redding II Ratepayer Harm Test (*Redding II*) adopted in D.89-01-016, under a narrow set of circumstances where (1) a public utility sells a distribution system to a governmental entity, (2) the distribution system consists of part or all of the utility operating system located within a geographically defined area, (3) the components of the system are or have been included in the rate base of the utility, and (4) the sale of the system is concurrent with the utility being relieved of, and the governmental

⁵³ D.06-05-041 at 15.

entity assuming, the public utility obligations to the customers within the area served by the system. If all of these circumstances are present, then the gains or losses from the sale of the system should be allocated to utility shareholders, provided that ratepayers have not contributed capital to the distribution system and remaining ratepayers are not adversely affected by the transfer of the system.⁵⁴

In their May 6, 2011 Response to the ALJ Request for Information, MU and KMPUD agree that the four circumstances detailed in the *Redding II* test are present in this case and therefore gains (or losses) should be allocated to utility shareholders. Furthermore, as stated during the evidentiary hearing, the sale of MU's assets will result in losses, and the Joint Applicants affirm that these losses will be allocated to shareholders.⁵⁵ Finally, the Joint Applicants state that there will be no remaining MU ratepayers after the transaction; thus, ratepayers will not be harmed by the losses associated with this transaction.

We find that the proposed transaction does meet the four criteria for application of the *Redding II* test. Losses from the sale of the distribution system should, therefore, be allocated entirely to shareholders. The *Redding II* test, however, only applies to the sale of the electric distribution system. While Joint Applicants state that, as a result of the powerhouse fire, MU's electric assets consist almost entirely of the electric distribution system, Joint Applicants are silent on the treatment of the gains (or losses) of non-distribution assets (namely the old powerhouse site). Because the sale price of MU's electric assets is below

⁵⁴ D.06-05-041 at 32.

⁵⁵ Tr. at 32.

\$50 million and the gains (or losses) are below \$50 million (and no party has asked for specific allocation of the losses to shareholders), we would ordinarily state that gains and losses should be allocated according to D.06-05-041, as modified by D.06-12-043. However, as Joint Applicants note, upon the close of the transfer and sale, there will be no remaining MU ratepayers to absorb any gains or losses. Therefore, all gains (or in this case, losses) on the sale of any remaining depreciable or non-depreciable assets, including the electric distribution system, shall be allocated entirely to MU shareholders.

8. Compliance with the California Environmental Quality Act (CEQA)

The sole remaining issue is whether, as Joint Applicants assert, the proposed transfer and sale qualifies for an exemption from CEQA. Under Public Resources Code § 21080 et seq., known as the California Environmental Quality Act (CEQA) and pursuant to Rule 2.4 of the Commission's Rules of Practice and Procedure, we are required to consider the environmental consequences of projects that are subject to our discretionary approval. While a change of ownership and/or control may result in environmental impacts by altering an existing project, resulting in new projects, or changing facility operations, that does not appear to be the case here.

Joint Applicants state that "[f]or the assets subject to the APA, there will be no change in the operation of the assets serving customers in the Kirkwood area."⁵⁶ The CEQA Guidelines state that a proposed "activity [that] will not result in a direct or reasonably foreseeable indirect physical change in the

⁵⁶ Application at 15.

environment” is exempt from CEQA.⁵⁷ Similarly, where “it can be seen with certainty that there is no possibility that the [proposed] activity in question may have a significant effect on the environment, the activity is not subject to CEQA.”⁵⁸

While KMPUD does intend to construct a replacement powerhouse, KMPUD is the lead agency for that project under CEQA, not this Commission. The Joint Applicants state that KMPUD has considered the application of CEQA, and has issued a Notice of Exemption for the construction of the replacement powerhouse on the grounds that the project is statutorily exempt from CEQA as an “emergency replacement of service facilities” necessary to maintain service essential to the public health, safety or welfare.⁵⁹

Based on the record before this Commission, we uphold the initial ruling in our scoping memo that the proposed project qualifies for multiple exemptions from CEQA, including CEQA Guideline § 15269(b) as an emergency repair of publicly or privately owned service facilities, §15302(c) as a replacement or reconstruction of existing utility systems and/or facilities, and § 15061(b)(3) as having no significant impact upon the environment. Accordingly, the Commission need perform no further CEQA review for this application.

9. Categorization and Need for Hearing

In the scoping memo of this proceeding, we confirmed the preliminary determination that this is a ratesetting proceeding (Resolution ALJ 176-3270, March 10, 2011) and that hearings were necessary. An evidentiary hearing was

⁵⁷ CEQA Guideline § 15060(c)(2)

⁵⁸ CEQA Guideline § 15061(b)(3).

held concurrent with the PHC on May 4, 2011. No changes are needed to the determinations upheld in the scoping memo.

10. Comments on Proposed Decision

Pursuant to Rule 14.6(b) of the Commission's Rules of Practice and Procedure, all parties stipulated to waive the 30-day public review and comment period required by Section 311 of the Public Utilities Code and the opportunity to file comments on the proposed decision. Accordingly, this matter was placed on the Commission's agenda directly for prompt action.

11. Assignment of Proceeding

Catherine J.K. Sandoval is the assigned Commissioner and Melissa K. Semcer is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. MU is a microutility providing retail electric service in the Kirkwood, California area. One customer, Kirkwood Mountain Resort, represents 75% of MU's total winter load and about 55% of MU's summer load. Until January 1, 2010, MU served its customers exclusively from a utility grade diesel generator facility (the powerhouse) that was installed in the 1970s. MU is not connected either directly or indirectly to the transmission grid or to any natural gas or diesel fuel pipelines.

2. KMPUD is a non-profit public utility district formed in 1985 pursuant to Cal. Pub. Util. Code § 15701, et seq. and is governed by a five-member board of directors elected by the Kirkwood community. KMPUD's service territory is coterminous with MU's service territory. KMPUD currently provides most, if

⁵⁹ Application at 16, referencing CEQA Guideline §§ 15269(b) and (c).

not all, other utility services to the Kirkwood Community. KMPUD has been exploring the option of providing electric and propane generation services, including the possibility of acquiring MU, since 2006.

3. On January 1, 2010 a fire completely destroyed MU's powerhouse. Since that time, MU has been providing service on an emergency basis using several portable diesel generators, which are less efficient than the original powerhouse.

4. Through the execution of an APA, MU wishes to sell and transfer control of its electric generation and distribution assets, along with its propane distribution assets, to KMPUD. Upon close of the sale and transfer of MU's electric assets, MU wishes to be relieved of its obligation to provide public utility electric service to customers within its service territory.

5. Under the APA, KMPUD is obligated to construct a replacement powerhouse as well as examine ways to connect the Kirkwood area to the regional power grid through the construction of a new power line (the Out Valley Project).

6. The acquisition price for MU's electric and propane assets is \$3 million. The Joint Applicants estimate that the total cost to pay for the acquisition of MU's assets and to complete the replacement powerhouse is at least \$15 million.

7. The Kirkwood community supports the transfer and sale of MU's electric generation and distribution assets and propane distribution assets to KMPUD.

8. In 1999, KMPUD installed and began to operate three, 360 kW generation units to meet its electric needs. Operation of these generation units represents the extent of KMPUD's experience with owning and operating electric generation resources at this time.

9. KMPUD has applied for and received authority from the Alpine County LAFCO and the Alpine County Counsel to provide electric and gas service.

10. In 2006, KMPUD presented the results of a study analyzing the feasibility of KMPUD providing electric generation and propane services. The study concluded that acquisition and operation of MU's electric and propane assets was the best option for lowering overhead costs, further improving energy efficiency, enhancing local control and maximizing transparency. The study also concluded that acquisition of MU's assets was a precursor to evaluating the long-run potential for regional grid interconnection.

11. MU's historical reliance on diesel generation means that its generation costs depend on and fluctuate with the price of diesel fuel. MU's retail electric rates have averaged around \$0.470/kWh since 2008.

12. Construction of the replacement powerhouse will require a significant capital investment to be recovered from a small customer base and will result in a rate increase going forward, regardless of whether MU or KMPUD is the service provider.

13. MU's geographic location combined with its isolation from the transmission grid and limited generation options have historically made it difficult to provide low cost, reliable service or to meet the State's environmental goals.

14. The powerhouse fire has necessitated a significant near-term capital investment to construct a replacement powerhouse, and MU cannot cost-effectively raise the necessary funds in the debt markets.

15. KMPUD has already secured \$5.5 million in financing and anticipates having the additional necessary financing by July 2011. KMPUD is likely to obtain the remaining financing.

16. Operational savings of more than \$300,000 per year can be realized by KMPUD through overhead efficiencies, property tax savings, and reduced regulatory costs.

17. Installation of new, more efficient generators will offset most of the cost increases associated with construction of the replacement powerhouse.

18. While ratepayers may experience a small increase in rates due to construction of the replacement powerhouse, KMPUD's access to lost-cost financing combined with other anticipated savings will mitigate rate increases.

19. Construction of the Out Valley Project could result in rate increases of approximately \$0.070/kWh.

20. Although not specific to the operation of electric generation assets, KMPUD has extensive experience in providing many other utility services.

21. The quality of electric service received by ratepayers should be the same, if not better, than the quality of service under MU.

22. KMPUD intends to interview MU employees for the purposes of retaining local expertise in the system.

23. KMPUD will have competent, professional management in place to operate electric generation resources upon close of the transaction.

24. Current MU employees will not be harmed as a result of the transaction.

25. The transfer and sale of MU's electric generation and distribution assets to KMPUD will not be adverse to the public interest and will, in fact, be in the public interest.

26. The sale of MU's assets will result in losses for MU's shareholders.

27. There will be no remaining MU ratepayers to absorb gains or losses on the sale of depreciable and/or non-depreciable assets.

28. The sale and transfer of MU's assets will not result in operational change and no new facilities are proposed.

29. The proposed sale of assets and transfer of control will have no significant effect on the environment because there will be no change in operation of the assets.

30. KMPUD will be the lead agency for CEQA review of the replacement powerhouse and the Out Valley Project.

31. This application is uncontested.

Conclusions of Law

1. The sale and transfer of MU's propane assets under the APA should be exempt from Commission review.

2. The Commission does not have jurisdiction to regulate municipal electric utilities.

3. The proposed transfer and sale of assets should be reviewed under Cal. Pub. Util. Code § 851, which typically governs sales of assets, as well as § 854, which generally governs transfers of control.

4. No party has introduced facts to describe any alternative for the Commission to consider under § 854(d).

5. The *Redding II* Ratepayer Harm Test as confirmed in D.06-05-041, as modified by D.06-12-043, should apply to the sale of MU's electric distribution system. The *Redding II* test applies under a narrow set of circumstances where:

- a) a public utility sells a distribution system to a governmental entity;
- b) the distribution system consists of part or all of the utility operating system located within a geographically defined area;
- c) the components of the system are or have been included in the rate base of the utility; and

- d) the sale of the system is concurrent with the utility being relieved of, and the governmental entity assuming, the public utility obligations to the customers within the area served by the system.

If all of these circumstances are present, then the gains or losses from the sale of the system should be allocated to utility shareholders, provided that ratepayers have not contributed capital to the distribution system and remaining ratepayers are not adversely affected by the transfer of the system.

6. Any additional gains and/or losses, if they exist, from the sale of MU's electric assets should be allocated to MU's shareholders.

7. The authority requested by MU to sell its electric generation and distribution assets should be granted.

8. Upon the close of the transfer and sale of assets to KMPUD, MU will no longer be under Commission jurisdiction.

9. MU should be relieved of its obligation to provide public utility electric service to customers within its service territory. MU should be relieved of all other obligations pursuant to jurisdiction of this Commission.

10. Based on the record before this Commission, the proposed project should be exempt from multiple CEQA guidelines, including CEQA Guideline § 15269(b) as an emergency repair of publicly or privately owned service facilities, §15302(c) as a replacement or reconstruction of existing utility systems and/or facilities, and § 15061(b)(3) as having no significant impact upon the environment.

11. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The joint application of Mountain Utilities, LLC (U906E) and Kirkwood Meadows Public Utility District for the sale and transfer of control of Mountain Utilities, LLCs' electric assets pursuant to Public Utilities Code Section 851 and Section 854(a) is granted in all respects. Effective upon the final closing date of the transfer and sale of assets, Mountain Utilities, LLC will be relieved of its obligation to provide public utility electric service to customers within its service territory and will be relieved of any and all obligations under Commission jurisdiction.
2. Mountain Utilities, LLC must notify the Director of the Commission's Energy Division in writing of the transfer and sale of assets of Mountain Utilities, LLC to Kirkwood Meadows Public Utility District within 30 days of the effective date and serve the letter on the official service list for this proceeding.
3. If Kirkwood Meadows Public Utility District is unable to obtain the necessary financing in 2011 and the close of the transaction is delayed beyond the end of 2011, Mountain Utilities, LLC must submit a letter to the Director of the Commission's Energy Division and serve it on the official service list in this proceeding within 15 days of knowledge of the delay detailing the reason for the delay and the anticipated remedy (along with an updated estimated completion schedule).
4. If the Asset Purchase Agreement is terminated for any reason, Mountain Utilities, LLC must come before this Commission within 30 days of the termination date with a plan to finance and construct a replacement powerhouse.

5. Mountain Utilities, LLC must allocate all gains (or in this case losses) from the sale of its electric distribution system to Mountain Utilities, LLC shareholders.

6. Mountain Utilities, LLC must allocate gains (or losses) from the sale of all other depreciable and non-depreciable assets to shareholders as there will be no remaining Mountain Utility, LLC ratepayers.

7. Application 11-02-020 is exempt from review under the California Environmental Quality Act.

8. Application 11-02-020 is closed.

This order is effective today.

Dated June 23, 2011, at San Francisco, California.

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

[D1106032 ATTACHMENT A](#)