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Decision 02-06-005 June 6, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Cypress Ridge Service Co., Inc., for a Certificate of Public Convenience and Necessity to Construct and Operate a Public Utility Sewer System in the Unincorporated Area of San Luis Obispo County, near Arroyo Grande, California and to Establish Rates for Service and to Issue Stock	Application 00-08-056 (Filed August 31, 2000)
Rural Water Company, Inc., a California Corporation, for a Certificate of Public Convenience and Necessity to Construct and Operate a Public Utility Sewer System in the Unincorporated Area of San Luis Obispo, near Arroyo Grande, California, and to Establish Rates for Service	Application 01-02-006 (Filed February 2, 2001)

Steven S. Wall, Attorney at Law, and Denis Sullivan, for Cypress Ridge Service Co., Inc., applicant.
Charles Baker, for Rural Water Company, Inc., applicant.
Julio Ramos, Attorney at Law, and Mohsen Kazemzadeh, for Office of Ratepayer Advocates, interested party.

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OPINION

Summary

Rural Water Company, Inc., is granted a certificate of public convenience and necessity to provide sewer service to the Cypress Ridge subdivision in San Luis Obispo County. Cypress Ridge Service Company's application for a certificate to serve the same area and for related relief is dismissed. The authority granted Rural is subject to a series of conditions, most of which were agreed to by all of the parties. Rates for Rural's new service are based on test year 2005. Rural is authorized to file rates for any new commercial customer types as they are needed, provided that rates for other customers are to be adjusted at the same time to achieve a zero net revenue effect. Rural is not required to charge the Cypress Ridge golf course for receiving effluent from the sewage treatment plant. The consolidated proceeding is closed.

Background

Cypress Ridge Community (Cypress Ridge) is a new residential development located in the northwest portion of the Nipomo Mesa in San Luis Obispo County, adjacent to the City of Arroyo Grande. It includes 386 single-family lots, a golf course, and a 6.3 acre commercial village with a community center, swimming pool and tennis courts, a post office, and other facilities. Some homes have already been built and occupied, and most of the remainder are to be completed over the next two to three years. The developer also has near-term plans to obtain approvals to construct and operate a hotel, restaurant and spa complex.

On August 31, 2000 Cypress Ridge Service Company, Inc. (Cypress), a California corporation,[1] filed Application (A.) 00-08-056 requesting a certificate of public convenience and necessity to provide sewer service to Cypress Ridge. On February 2, 2001 Rural Water Company (Rural) filed a competing application, A.01-02-006, for the same service territory. Rural has been a Commission-regulated water utility in the area for many years and in September 2000 expanded its water service territory to include Cypress Ridge. Cypress is currently providing sewer service in Cypress Ridge without charge. Cypress now supports Rural's sewer application and seeks its own sewer certificate only if the Commission were to deny Rural's application.

The assigned Administrative Law Judge (ALJ) issued a ruling consolidating the applications on July 25, 2001.

Both applications were protested by the Commission's Office of Ratepayer Advocates (ORA). A nearby public district, Nipomo Community Services District, initially protested on the grounds that the District could provide better service at lower cost, but subsequently officially withdrew entirely from the consolidated proceeding.

The ALJ held a prehearing conference in the first application on December 19, 2000, at which time Rural first appeared and indicated its desire to serve. The parties requested that evidentiary hearings be held in abeyance while Cypress and Rural jointly explored their options. A second prehearing conference was held on July 25, 2001, followed by two days of evidentiary

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[1] The developer is Cypress Ridge, L. P., consisting of general partner Cypress Ridge Development Corp. and limited partners CR Holdings, Inc. and Leucadia Financial, Inc.. Cypress Ridge Service Company, Inc. and Cypress Ridge Golf Course LLC are wholly-owned subsidiaries of the developer.

hearings on December 10 and 11, 2001. The consolidated proceeding was submitted on closing briefs due January 28, 2002.

Discussion

During the period leading up to the December 2001 evidentiary hearings, ORA, Cypress and Rural worked to narrow their differences. Those efforts culminated in a written stipulation on many initially contested issues entered into the record near the close of evidentiary hearings. The three parties provided testimony on most or all of those issues at the evidentiary hearing, so for the most part their initial positions and the merits of those positions are well developed on the record. After examining the outcomes they propose, we agree that they are reasonable, and that they are outcomes we most likely would have arrived at independently based on the evidentiary record had they not jointly stipulated to them. We summarize each briefly and then move on to discuss in greater detail the contested issues that remain.

Stipulated Matters

As noted, Cypress Ridge Service Company, Inc. is wholly-owned subsidiary of the developer, Cypress Ridge, L.P. The developer, through the service company, is currently providing sewer service at no charge and has applied for a certificate of public convenience and necessity so it could begin to recoup its investment and ongoing expenses. However, it would prefer that the responsibility for sewer service be taken on by Rural, a much more experienced public utility provider. ORA agrees that Rural is the better choice to be the sewer service provider for Cypress Ridge, and so do we.

Cypress is currently contracting with J. L. Wallace & Associates of San Luis Obispo, a State Certified Water Treatment Operator, to operate and maintain the sewer system, respond to customer complaints in the field, and handle customer accounts and billing. Wallace & Associates is supported by adequate

professional staff and has considerable experience performing similar duties for numerous small community services districts in the area and providing related engineering services for larger municipalities. Both applicants propose to continue using Wallace & Associates under a long-term management contract until at least 2005. Wallace & Associates' qualifications and proposed charges were developed in the record, and ORA believes it represents the most cost-effective operating alternative available in the near term. We agree. ORA recommends that Rural evaluate whether contracting out is still the most attractive option as part of its next general rate case proceeding.

The Cypress Ridge sewer plant includes a state-of-the-art sequencing batch reactor system providing tertiary treatment. It was financed and constructed by the developer and will be contributed to whichever applicant the Commission finally certificates. The contributed plant includes all the necessary gathering facilities in the subdivision, the treatment plant, all pumps and the backup electrical generation system. The parties concur that, consistent with the Commission's usual ratemaking accounting practices, this contributed plant is to be excluded from Rural's rate base for ratemaking purposes. Excluding contributed plant will have limited or no effect on rates in the near term because the parties have also agreed that sewer rates should be set using the operating ratio method (with the return set at 15% of operating expenses) rather than using rate of return on rate base.[2] Once set in this proceeding, Rural's sewer rates

[2] The Commission has long recognized that small water and sewer companies frequently have highly depreciated rate bases, so its standard ratemaking policy for small companies has been to use whichever method is more beneficial to the company. (*See* Decision 92-03-093). In this case, that will be the operating ratio method.

would remain constant through 2005. In late-2004 or 2005, Rural would file a test year 2006 general rate case for new rates to be effective January 1, 2006 and after.

Cypress installed the development's wastewater treatment plant and water system facilities in one shared building. The developer has already contributed the water system facilities to Rural as Cypress Ridge's public utility water supplier, and would contribute the remainder of the facilities to Rural should Rural be certificated as the sewer service provider. ORA recommends, and applicants agree, that all necessary titles to real property and easements should be transferred to Rural, recorded with the appropriate local authorities, and copies provided for the Commission's records.

Costs to operate Rural's co-located water and sewer facilities will be apportioned between them, and Rural will keep separate accounts for future ratemaking purposes. The parties agree that the current single electric power meter will be replaced with separate meters for water and sewer. Each operation would have its own set of tariffs, with the sewer utility tariffs showing separate schedules for residential rates and commercial rates.

Rural would not be allowed to charge sewer connection fees or other up-front charges to customers to obtain sewer service. Considering that all facilities needed to provide service to Cypress Ridge at full build-out are in place and will be contributed by the developer, we find this to be a reasonable condition. We will, however, limit this condition to Rural's sewer service in the Cypress Ridge Community areas at issue in this proceeding. If Rural should in the future expand its filed sewer utility service boundaries to other areas, the Commission would consider all possibilities for such charges in those areas at that time.

Rural initially projected its insurance costs through 2005 at $5,000 annually. In preparing for evidentiary hearings, it determined that its insurance

premiums will likely escalate to exceed that amount, possibly to as much as $17,500 annually when Cypress Ridge is fully built out. Rural and ORA discussed how this might be handled and agreed that any unanticipated insurance costs through 2005 should be tracked in a memorandum account. Under the standard memorandum account procedure, the company would request rate adjustments to cover any difference between Rural's actual insurance expense the amount allowed in rates, and the Commission would make a determination.[3] Memorandum account treatment for insurance would last through 2005 and thereafter lapse absent further Commission order.

Lastly, ORA recommends that Rural improve its responsiveness to its customers, to public health and other governmental authorities, and to the Commission staff. Staff related two recent incidents of difficulty in trying to reach somebody at Rural who could respond to a question or problem. The first concerned the local public health agency on a routine matter, and the second our staff on an urgent matter. ORA recommends Rural improve its performance by upgrading its telephone system and responding to all inquiries within 24 hours. Rural has agreed to do so.

Golf Course Effluent Disposal

Cypress Ridge's sewage treatment facility discharges its effluent to holding ponds located within and owned by the adjacent golf course, which then uses it for golf course irrigation. The most contentious issue in the proceeding

[3] "Commission approval for memorandum account treatment conveys authority to track, and later seek to recover, amounts relating to some stated purpose. It carries no implication of Commission pre-approval of reasonableness for later recovery. Before utilities may recover in rates amounts booked to memorandum accounts, they must request and receive additional Commission authorization." (Decision 00-03-053).

was ORA's recommendation that Rural be required to charge the golf course for that treated effluent.

ORA's Argument

ORA has in fact two related recommendations here: It would have the Commission establish a tariffed rate to be charged to the golf course for receiving the treated effluent; and to ensure the sewer utility's continuing discharge rights, it would have the Commission condition Rural's CPCN on the two parties' entering into a formal agreement guaranteeing Rural's continuing right to discharge effluent to the golf course.

ORA would set the golf course's price of reclaimed water at 85% of Rural Water Company's tariffed quantity rate for potable water. Rural currently charges $1.48 per one-hundred cubic feet for potable water, so ORA's recommended reclaimed water rate would be $1.258 per one-hundred cubic feet.[4] The parties estimate this would generate approximately $68,000 annually (35% of Rural's total sewer revenue requirement) at full build-out in 2005. That amount would be imputed in full now to establish Rural's sewer rates through the end of 2005.

In support, ORA points out that there are other Commission-regulated utilities which sell treated wastewater. "If, for example, this sewer facility [were] located across the property line and [were] owned by another entity other than the developer, the owner of the golf course would likely be purchasing reclaimed water from the sewage treatment plant as a lower cost

[4] ORA's witness chose the 85% figure as being that used by San Gabriel Valley Water Company. He noted as well that San Gabriel Valley also offers individual contracts for reclaimed water that may result in rates significantly lower than 85% of those for San Gabriel Valley's potable water.

alternative to potable drinking water and paying market set rates for this valuable commodity." ORA charges the developer with building in additional filtration capability to make the treatment plant's effluent suitable for the golf course's purposes, filtration capability that would not have been needed otherwise. Rural's sewer ratepayers should not be required to bear those additional expenses.

As ORA notes, the subdivision, including the sewage treatment plant and golf course, was planned, designed, constructed and permitted as a whole. The golf course and sewage treatment facility were always intended to work hand-in-glove to deal with Cypress Ridge's wastewater, and both the environmental impact report and the California Regional Water Quality Control Board (RWQCB) discharge permit were approved assuming this effluent disposal arrangement. Further, ORA believes that the golf course is required under Water Code Section 13550 to use recycled water rather than potable domestic water where recycled water is available. ORA thus views the golf course as a captive customer for treated effluent and argues on brief, "The RWQCB order requiring the golf course to utilize the effluent rather than well water increases the value of the effluent. [T]he reality [is] that the use of effluent to water the golf course is a regulatory mandated cost of doing business" for the golf course. Further, ORA argues, if the underlying groundwater basin were to be adjudicated in the future, reclaimed water might then become an even more valuable commodity.

ORA's second disposal-related recommendation was that the Commission require an agreement guaranteeing Rural's continuing right to discharge effluent to the golf course. That agreement would provide that

> [T]he golf course would agree to take Rural's effluent, would agree to pay the annual cost of the golf course's

> capital investment (land, grading, improvements, etc.) associated with, and the annual maintenance and operating expenses of, handling the effluent, would agree to bear the costs of disposing of the effluent and would agree to comply with the RWQCB Waste Disposal Permit applicable to the golf course property; provided, however, the golf course would have no liability for any costs related to future modifications or upgrades of Rural's sewer system that might be required in order to meet discharge requirements.

Applicants' counsel described for the record what all parties agreed would be the resulting recorded drainage and flowage easement:

> The concept is that there would be a binding, permanent, recorded flowage/drainage easement over the golf course property running in favor of Rural Water Company that would give permanent rights of record with the County Recorder to continue the discharge of effluent in the manner that it's currently designed for, and that to a certain extent, it is currently using. Included as part of that recorded agreement would be sufficient rights to protect the utility in the event that some future operator of the golf course failed to properly discharge those obligations. This would include the right to demand that the correct discharge procedures be followed pursuant to the permit, and if the golf course operator continued to refuse to comply, then the right in favor of the utility to go onto the golf course property and do the work necessary to be done so that effluent continued to be discharged in the manner permitted. Thereafter, there would be a mechanism whereby the utility could recover that cost from the nonperforming party, the ... hypothetical future golf course that fails to perform the agreement. Once again, all of this would be built into a document that would be of record and binding on all future owners of the golf course and running in favor of the land and in favor of Rural Water Company as the utility.... [T]his easement would be a

> first-priority easement. It would be free and clear of any prior liens and encumbrances.

Applicants joined ORA in this agreement and easement proposal, but would emphatically disown it if the Commission were to require the golf course to pay for the effluent.

Applicants' Argument

Applicants consider requiring the golf course to pay for the sewage treatment plant's effluent completely unjustified and a condition that the golf course could not and would never accept. In addition, the developer would in that case not be willing to contribute the sewage treatment plant and all of the associated facilities to the new sewer utility without charge.

Applicants argue that reclaimed wastewater may well have value elsewhere, but not in the Cypress Ridge local area. There is simply no nearby market for it, and Rural could not deliver it to any user at a cost that is comparable to or less than the user's cost for its existing water supplies.

Applicants' second argument is that the golf course is not, contrary to ORA's assertions, agreeing to accept treated effluent for irrigation because treated effluent is its most economical supply. Its most economical supply is water from its three existing wells located within the golf course. Applicants estimate the golf course's annual cost of disposing of the effluent at $23,500, contrasted to about $4,500 annually for irrigating with well water. Between one-third and one-half of the total effluent the golf course would be required to purchase flows in during the four wet months of the year due to heavy runoff into the sewer system. It gets no benefit from those amounts because during the wet months it has no need for irrigation water. Moreover, unlike legitimate reclaimed water customers, the golf course would have no control over the

amount of effluent it would be required to purchase, and that amount could increase in the future.

Effluent Disposal Discussion

We conclude that there is no potential for Rural to sell its effluent in the local area. Disposing of it to the golf course without charge is Rural's only realistic, economic option, and the option of greatest benefit to it and its ratepayers.

Our first conclusion is supported by the presentations of Applicants' two expert witnesses, both familiar with the situation in the local area. One of them, an economist, acknowledged ORA's observation that reclaimed water is sold in some other areas:

> Several projects have been established throughout California that sell recycled wastewater.... These markets are typically located in either highly populated urban areas or heavily agricultural regions, in which governmental agencies are willing to subsidize the cost of transporting the effluent to the users. Thus, a significant portion of the cost of making the effluent available is borne by taxpayers.

After analyzing the local situation, however, he concluded that the Cypress Ridge treatment facility is not in a viable reclaimed water market area.

The second witness, a licensed civil engineer familiar with the area and experienced in wastewater treatment projects, also testified that there is no financially viable market for reclaimed water there. He named and described four local wastewater reclamation facilities which had been unable to find buyers for their reclaimed water and had provided it to neighboring golf courses without charge. He also cited a water recycling study by the South San Luis Obispo County Sanitation District that identified ten possible users of the sanitation district's reclaimed water and priced projects to serve each of them.

Its figures showed investment costs typically above $10 million per project, and reclaimed water that would have cost the recipients at least several times their cost of potable water.

It is clear that the golf course is not, and cannot be considered, a customer for reclaimed water here in the usual sense. Rather, the golf course holding ponds are a feature of the sewage treatment system's overall design. If the golf course were able to reject the effluent, it would do so and realize considerable savings in its irrigation water cost. If the sewage treatment plant were required to find an alternative disposal method, that would be either percolation into the groundwater or evaporation. Both of those possibilities were explored on the record and the evidence shows that both would be extremely costly for ratepayers compared to discharging effluent to the golf course.

We agree with Applicants and ORA that Rural and the golf course should make an agreement and record an easement guaranteeing Rural's continuing right to discharge effluent to the golf course.

ORA argued that Water Code Section 13550 and the state policy underlying it require that the sewer system's effluent be used by the golf course. Regardless of our decision in this proceeding, no party has indicated that the effluent will be discharged anywhere except to the golf course as the sewer system design, the RWQCB permit and the subdivision's environmental impact report anticipated. Thus there is no need to address Water Code Section 13550 further here.

Revenues and Rates

Applicants and ORA agree in principle that both residential and commercial rates should be fixed now and remain constant through the end of 2005. Rates thereafter would be revised based on a test year 2006 general rate

case. ORA and applicants took opposing positions on calculating rates and revenues in two significant respects.

First, each party has calculated a set of commercial rates based on the amount of sewage flow each type of commercial service would typically produce compared to an assumed standard residence unit's demand. A commercial source producing, e.g., twice the daily flow of a residence would have its rate set at twice the residence rate. ORA assumed that a standard residence produces 100 gallons per person per day while Applicants assumed 80 gallons. Each presented credible expert witness testimony to support its figures. Applicants point out in their opening brief that their 80 gallon figure actually results in shifting a small part of the revenue requirement to commercial customers from residence customers compared to ORA's figure. In its reply brief, ORA continued to recommend its own figure, but also recognized that "[Applicants'] 80 gallons per capita per day figure is also within the acceptable lower range of estimated usage for this particular Application." Considering the beneficial effect on residence rates and ORA's flexibility here, we will adopt Applicants' 80 gallon per person per day figure. If additional data through 2005 leads either party to refine its calculations, it is free to advocate a different result in Rural's next general rate case.

The parties' second difference involves commercial rates for a hotel, restaurant and spa complex the developer hopes to build in Cypress Ridge. At the time of the evidentiary hearings, the developer had not yet prepared plans or obtained approvals for the complex, but was aiming for a June 2004 opening. Applicants excluded the complex from their rate calculations because of the uncertainty that it will be built as projected. ORA, on the other hand, recognized the estimated revenues it might generate in its 2005 revenue requirement calculation. Since the 2005 revenue requirement is the foundation for the fixed

2002 through 2005 rates, ORA's assumption that the hotel will be on the system by 2005 generates commercial revenues that are used to lower the residence rates for all four years. If we adopt Applicants' position that the hotel should not be considered now and the hotel is built as projected, Applicants will receive a windfall in 2004 and 2005 and residence rates will be higher than they should be. If we adopt ORA's position and the hotel is not built, residence rates would be lower than they should be and the utility would suffer the loss. Neither result would be equitable.

During the evidentiary hearings, Applicants shifted their position to offer a middle proposal – a second set of rates that would go into effect automatically if and when the hotel, restaurant and spa complex does open. ORA neither supported nor opposed the idea. Given the considerable uncertainties, we think it would be prudent to adopt a modified version of that proposal here. We will set rates assuming there will be no hotel, restaurant or spa on the system through 2005. Then, if and when the rates for those or any other new commercial customer types are needed, Rural should file one or more compliance advice letters establishing rates for them and simultaneously reducing its rates for all other customers to produce a zero net revenue effect. The new rates would go into effect upon Water Division's determination that Rural's filing complies with this order.

The adopted results of operations for test year 2005 are attached as Appendix A to this decision. The rates we authorize are shown in Appendix B. Water Division will work with Rural to assemble a complete set of standard sewer tariffs that includes these new rates.

Future Sale

To address the possibility that Rural may sell its sewer system in the future, ORA recommends the Commission impose two conditions in granting

Rural its certificate. First, if the system is sold to another investor owned utility, the rate base used for ratemaking should continue to be set at the system's book value. This would ensure that contributed plant continues to be excluded from rates. Second, if the sewer system is condemned by or sold to a government-owned entity, the value of contributed plant should be split equally between Rural or its successors and Rural's ratepayers.

The Commission's standard ratemaking practice has long been to exclude contributed plant from rate base, recognizing that contributed plant does not represent investment by a utility's shareholders on which ratepayers should be required to pay depreciation and a return. Applicants have accepted that longstanding practice here for setting Rural's rates. Although it is a fact that contributed plant may be resurrected as a factor in ratemaking under the treatment mandated by Public Utilities Code Section 2720 if and when a *water* system is ever sold,[5] that section does not apply to sewer systems. Similarly, when a government-owned entity acquires a Commission regulated utility, whether through a voluntary sale or a condemnation, the premium it pays for the contributed component of plant presumably results in future rates that are higher than they would be absent contributed plant.

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[5] § 2720(a) provides, "The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting." The Commission's recent experience has been that contributed plant represents value to potential buyers, and that value generates a higher purchase price. The Commission may reject any acquisition pursuant to its authority under § 851, or the purchaser may propose an alternative ratesetting method for the future. If neither occurs in the case of a *water* system sale, and all else being equal, customers thereafter pay higher rates to the new owners for the same service, due at least in part to the existence of contributed plant.

The Commission has previously rejected similar recommendations by its staff and others:

> Approximately $12 to $13 million in facilities will be contributed to SCWC [Southern California Water Company] by the Developer, and will be excluded from rate base for ratemaking purposes. Staff and the City on brief propose that any approval of the SCWC applications should be conditioned by a requirement that SCWC should not receive compensation for the cost or value of these contributed facilities in the event of a subsequent sale, condemnation, or transfer of the utility systems in the Planned Community.
>
> This is not a new proposal. The Commission's general position in the past has been that the matter should be addressed only on a specific case-by-case basis when the issue arises; that the Commission will not prejudge either Superior Court or a future Commission's ability to judge each case on its merits (See New Water Main Extension Rule (1982) 7 CPUC2d 778, where expert witnesses from both the then Hydraulic Branch and the Revenue Requirements Division of the Commission opposed adoption.) In addition, contributed plant may be an element in whether a premium over rate base is found in a just compensation proceeding.[6]

While our earlier determinations were in the context of water systems rather than sewer systems, the same principle applies and we reach the same conclusion. Our position has not changed.

Stock Issuance

In A.00-08-056, Cypress Ridge Service Co., Inc., requested authority to issue 100% of its stock to Cypress Ridge, L.P., the developer. At the second prehearing conference it was determined that the issuance had already taken

[6] D.00-10-029 (October 5, 2000).

place as part of the formation of the service company, and no further financing was planned. The ALJ and the parties discussed whether Commission authorization was needed under Public Utilities Code Section 818 and the consensus was that it was not, because the issuing company was not then a utility (and it will now not become one). No party has raised the topic since that time. We agree, and conclude that no such authorization was or is required.

CEQA

A Final Environmental Impact Report (FEIR) for Cypress Ridge subdivision was certified by the Board of Supervisors of San Luis Obispo County by Resolution 97-134 adopted March 18, 1997. A copy of that resolution and the FEIR were submitted with A.00-08-056. The subdivision project was built without significant changes to the sewer system described in the FEIR, and that sewer system is now being operated on an interim basis without charge to residents by Cypress Ridge Service Company, a subsidiary of the developer and one of the two applicants in this proceeding. The subdivision FEIR named Rural as the anticipated sewer service provider.

Applicants Cypress and Rural now seek Commission issuance of a certificate of public convenience and necessity for Rural to succeed Cypress to provide public utility sewer service using exactly the same facilities as are now in place and in operation. Rural does not anticipate any new construction or changed operating practices, and will in fact contract with the same State Certified Water Treatment Operator, J. L. Wallace & Associates, as Cypress has been using to operate and maintain the sewer system.

The project in this proceeding is the issuance of a certificate of public convenience and necessity to Rural and the transfer to and operation by Rural of the existing Cypress Ridge sewer system. Since it can be seen with certainty that there is no possibility that granting the relief requested will have a significant

impact on the environment, the project qualifies for an exemption from the California Environmental Quality Act (CEQA) pursuant to Section 15061(b)(3) of the CEQA guidelines. Therefore, no further environmental review by the Commission is required.

Comments on Draft Decision

The principal hearing officer's proposed decision in this proceeding was filed with the Commission and served on the parties in accordance with Public Utilities Code Section 311(d) and the Commission's Rules of Practice and Procedure, Rule 77.1.

Cypress filed comments recommending the Commission adopt the proposed decision without change. No other comments were filed.

Findings of Fact

1. Nipomo Community Services District has withdrawn from this proceeding and is no longer a party.

2. As between the two applicants in this proceeding, Rural and Cypress, all parties agree that Rural is the preferred sewer service provider for Cypress Ridge subdivision.

3. Rural is qualified to provide public utility sewer service to Cypress Ridge.

4. Contracting with J. L. Wallace & Associates to operate, maintain and provide related services to the Cypress Ridge sewer system is the most cost-effective operating alternative available to Rural through 2005. Rural should evaluate whether contracting out remains the most attractive option in test year 2006 and beyond as part of its next general rate case proceeding.

5. All necessary plant to provide sewer service today in Cypress Ridge is being contributed by the developer. That plant should be excluded from Rural's rate base for future ratemaking purposes.

6. All necessary titles to real property and easements for Cypress Ridge sewer system should be transferred to Rural, recorded with the appropriate local authorities, and copies provided to the Commission for its records.

7. Rural's sewer rates through 2005 should be set using the operating ratio method with Rural's return set at 15% of operating expenses. Rural should file a test year 2006 general rate case requesting new rates to become effective January 1, 2006.

8. All shared costs for Rural's water and sewer operations should be apportioned between them. Rural's co-located water and sewer facilities serving Cypress Ridge should have their electric power metered separately for sewer and for water.

9. Rural should establish and maintain a separate set of accounts in accordance with the Commission's Uniform System of Accounts for its Cypress Ridge sewer service.

10. Rural should be required to have a complete, separate set of sewer tariffs for its Cypress Ridge sewer service. Rural's residential sewer rates should be on separate tariff schedules from its commercial sewer rates.

11. It is reasonable not to allow Rural to charge sewer connection fees or other up-front charges to customers to obtain sewer service within the Cypress Ridge area for which we are granting Rural a certificate in this proceeding.

12. Rural's insurance expenses are difficult to project accurately between now and approximately 2005 when Cypress ridge is fully built out. It would be reasonable to allow Rural to establish a memorandum account for such expenses, to last through 2005 and thereafter to lapse absent further Commission order.

13. Rural should improve its responsiveness to its customers, to public health and other governmental authorities, and to the Commission staff, by upgrading its telephone system and responding to all inquiries within 24 hours.

14. There is no potential for Rural to sell its Cypress Ridge sewer system treated effluent in the foreseeable future. Disposing of it to the golf course without charge is Rural's only realistic, economical option, and the option of greatest benefit to it and its ratepayers.

15. The Cypress Ridge subdivision, including the golf course and sewage treatment plant, was planned, designed, constructed and permitted as a whole. The golf course and its holding ponds are a feature of the sewage treatment system's overall design. The golf course and sewage treatment facility were always intended to work hand-in-glove to deal with Cypress Ridge's wastewater, and both the subdivision's environmental impact report and the sewer treatment system's RWQCB discharge permit were approved assuming the sewage treatment and effluent disposal arrangement in use today.

16. Rural should discharge its treated effluent to the golf course without charge.

17. To ensure the sewer utility's future effluent discharge rights, the Commission should condition its grant of Rural's certificate on Rural's formalizing an agreement with the owners of the golf course and obtaining an easement guaranteeing Rural's continuing right to discharge effluent to the golf course.

18. For purposes of deriving a relationship between commercial sewer rates and residential sewer rates, it is reasonable to assume that a standard residence produces 80 gallons of effluent per person per day.

19. No party can predict with reasonable certainty when, or if, the Cypress Ridge hotel, restaurant and spa complex discussed in this proceeding will be completed.

20. Setting rates now using an assumption that there will be no hotel, restaurant or spa on the system through 2005, and making provisions for

adjusting rates if and when there is, would be equitable to both Rural and its ratepayers.

21. The sewer rates set forth in Appendix B, and the adopted results of operations for test year 2005 in Appendix A upon which those rates are based, are reasonable.

22. Rural will provide public utility sewer service using the same facilities as are now in place and in operation under Cypress. Rural does not anticipate any new construction or changed operating practices in operating and maintaining the sewer system.

23. It can be seen with certainty that there is no possibility that the relief we grant in this proceeding will have a significant impact on the environment.

Conclusions of Law

1. Rural should be granted a certificate of public convenience and necessity to provide public utility sewer service to Cypress Ridge.

2. It is not necessary to examine the applicability of Water Code Section 13550 to any issue in this proceeding.

3. It is neither necessary nor advisable for the Commission in this proceeding to establish requirements for sharing the value of contributed plant at the time of any future sale of Rural's Cypress Ridge sewer system to a public entity; or to attempt to place restrictions on the ratemaking methodology to be used in the event the system is sold to another regulated utility. Those are matters that should be addressed on a case-by-case basis considering the specific facts presented at the time the issues arise.

4. There is no requirement under Public Utilities Code Section 818, or under any other provision of law, for a non-utility such as Cypress to obtain Commission authorization to issue stock.

5. The CEQA project in this proceeding is the issuance of a certificate of public convenience and necessity to Rural and the transfer to and operation by Rural of the existing Cypress Ridge sewer system.

6. Since it can be seen with certainty that there is no possibility that the relief we grant in this proceeding will have a significant impact on the environment, the project qualifies for an exemption from CEQA pursuant to Section 15061(b)(3) of the CEQA guidelines. Therefore, no further environmental review by the Commission is required.

O R D E R

IT IS ORDERED that:

1. Rural Water Company, Inc., (Rural) is granted a certificate of public convenience and necessity to provide sewer service to the Cypress Ridge subdivision in San Luis Obispo County, subject to the requirements of the ordering paragraphs that follow.

2. Cypress Ridge Service Company's (Cypress) application for a certificate of public convenience and necessity to provide sewer service to the Cypress Ridge subdivision and for related relief is dismissed.

3. Cypress and Rural shall arrange to transfer to Rural and record with the appropriate local authorities all necessary titles to real property and easements for Cypress Ridge sewer system. Rural shall by letter to the Commission's Water Division certify that the parties have done so, and shall provide copies of the related documents for the Commission's records

4. All plant contributed by the developer or its affiliates to provide sewer service to Cypress Ridge shall be excluded from Rural's rate base for future ratemaking purposes.

5. Rural shall establish and maintain a separate set of accounts in accordance with the Commission's Uniform System of Accounts for its Cypress Ridge sewer service.

6. All shared costs for Rural's water and sewer operations shall be apportioned between them. Rural's co-located water and sewer facilities serving Cypress Ridge shall have their electric power metered separately for sewer and for water.

7. Rural may not charge sewer connection fees or other up-front charges to customers to obtain sewer service within the Cypress Ridge Community service territory at issue in this proceeding.

8. Rural is authorized to establish a memorandum account for insurance expenses for its public utility sewer service. That memorandum account shall remain in effect only through December 31, 2005 and thereafter shall lapse absent further Commission order.

9. Rural shall improve its responsiveness to its water and sewer service customers, to public health and other governmental authorities, and to the Commission staff, by upgrading its telephone system and responding to all inquiries within 24 hours.

10. Rural shall enter into a formal agreement with the owners of the Cypress Ridge golf course, and shall obtain an easement guaranteeing the sewer utility's continuing right to discharge effluent to the golf course. The provisions of the agreement and easement shall be consistent with those outlined in the discussion section of this decision. The parties to the agreement are free to include a provision binding Rural to providing treated effluent to the golf course without charge.

11. Rural shall file in accordance with General Order 96 an advice letter stating its acceptance of the certificate granted in this order and establishing a

complete set of tariffs for its Cypress Ridge sewer service. Rural's sewer service tariffs shall apply the rates included in Appendix B of this order. Rural's sewer service tariffs shall be separate from its water service tariffs, and residential sewer rates shall be on separate schedules from commercial sewer rates. The new tariffs shall be reviewed by Water Division and shall go into effect upon Water Division's determination that Rural has complied with the requirements of this order.

12. Rural shall file in accordance with General Order 96 an advice letter(s) with appropriate work papers establishing rates for any new type(s) of commercial customer taking service after the effective date of this decision, and simultaneously reducing rates for all other customers to produce a zero net revenue effect. The new rates shall be reviewed by Water Division and shall go into effect upon Water Division's determination of compliance with this order.

13. The authority granted in this order shall expire if not exercised within six months of effective date of this order.

14. Application 00-08-056 and Application 01-02-006 are closed.

This order is effective today.

Dated June 6, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

APPENDIX A

Rural Water Company
Adopted Summary of Earnings
Test Year 2005
Sewer Operations

Number of Customers		379*
Residential Flat Rate Revenue @ $42.62 per month	$ 193,836	
Commercial Flat Rate Revenue	2,544	
Total Annual Revenue		$ 196,380
Operating Expenses		
Employee Labor		
Materials		
Contract Work – Laboratory		
Contract Work – Other		82,774
Transportation		
Other Plant Maintenance		
Sewer Lease		
Other Salaries		
Management Salaries		7,210
Employee Health & Pension		
Uncollectibles		
Other Service & Rent		
Other Supplies		
Insurance		5,000
Regulatory Expense		6,008
General Expenses		
Parts & Supplies	$ 3,540	
Utilities	40,500	
Fuel Oil & Chemical Costs	7,000	
Permits & Fees	2,500	
Sewer Clearing	7,000	
Sludge Disposal	3,000	
General Expense Total		63,540
Subtotal Expenses		164,532
Return at 15% Operating Ratio		24,680
Depreciation		0
Franchise Fee		0
Property Taxes		0
Payroll Taxes		
State Income Taxes		2,817
Federal Income Taxes		4,357
Total Expenses and Return		$ 196,386

* 386 lots, less 7 lots for possible future hotel and related facility.

(END OF APPENDIX A)

APPENDIX B

Rural Water Company

Authorized Sewer Rates
2002 through 2005

	Rate, per Connection per Month
Residential Sewer Service	$ 42.62
Commercial Sewer Service	
Golf Pro Shop	$ 28.56
Golf Maintenance Facility	69.26
Commercial/Office Facility	57.11
Pavilion	57.11

(END OF APPENDIX B)