

Decision 04-11-028 November 19, 2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California-American Water Company (U 210 W), a California Corporation, and Watertek, Inc, a California Corporation, as the sole Owner of Three Jurisdictional Wastewater Utilities (Communities of Spreckels, Oak Hills; and Indian Springs), for the following orders:

1. Authorizing Raymond Smith, the owner and sole shareholder of Watertek, Inc., to sell and transfer to California-American Water Company all of his outstanding stock of Watertek, Inc., which includes Watertek's ownership of three jurisdictional wastewater utilities (Communities of Spreckels, Oak Hills; and Indian Springs); and
2. Authorizing Watertek, Inc. to withdraw from providing wastewater utility services to the three jurisdictional wastewater utilities (Communities of Spreckels, Oak Hills and Indian Springs) and thereby terminating Watertek, Inc.'s obligations as a public utility; and
3. Authorizing California-American Water Company to merge all of the assets of Watertek, Inc.'s three jurisdictional wastewater utilities (Communities of Spreckels, Oak Hills and Indian Springs) immediately upon close of its purchase of the stock of Watertek, Inc.; and

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(Filed September 10, 2004)

4. Extending California-American Water Company's existing Monterey District Wastewater certificate of public convenience and necessity to include Watertek's existing service territories in the Community of Spreckels, Oak Hills Development; and Indian Springs Development; and

5. Authorizing California-American Water Company to engage in and carry on the wastewater utility service at the herein proposed rates to the Communities of Spreckels, Oak Hills; and Indian Springs wastewater system customers; and

6. Authorizing California-American Water Company under Public Utilities Code Sections 2718-2720 to use the combined total purchase price (cash plus debt) as the standard of fair market value when establishing the rate base value for the acquired wastewater systems.

OPINION GRANTING APPLICATION

I. Summary

Pursuant to Pub. Util. Code §§ 851-852 and 854(a),¹ the Commission authorizes California-American Water Company (Cal-Am) to acquire ownership of three wastewater utility systems serving the communities of Spreckels, Oak Hills and Indian Springs, respectively, in Monterey County. The systems are

¹ All statutory references are to the Public Utilities Code unless otherwise stated.

owned by Watertek, Inc. (Watertek), a family-owned company. Upon purchase of all outstanding Watertek stock, Cal-Am will assume Watertek's obligations as a public utility.

In granting the application, the Commission concludes that Cal-Am's acquisition satisfies all four requirements of § 2720(b): improved system reliability; better health and regulatory compliance; improved efficiencies with economies of scale; and, lower rates and better service for customers. Cal-Am is also authorized, under §§ 2718-2720 to set rate base for the acquired utilities at the fair market value of the utility properties, as measured by the acquisition price.

II. Procedural Summary

The application was filed on September 10, 2004. No protests were filed, no hearings are necessary, and this matter was submitted for decision on October 14, 2004, (Rule 44.1).

III. Background

A. Parties to the Transaction

1. Watertek

Watertek has been owned and operated since 1986 by Raymond L. Smith and Esther F. Smith.² Smith owns all outstanding Watertek stock and he desires to sell the systems because of his age. He wishes to ensure an orderly transfer to an experienced operator that can satisfy state and federal

² Until 2004, Watertek owned and operated three Commission-regulated water utilities and three Commission-regulated wastewater utilities. On January 8, 2004, the Commission granted Watertek's application to sell its three water utilities. (Decision (D.) 04-01-006.)

environmental regulations and provide improved service to the customers of the Watertek Systems.

2. Cal-Am

In 2003, the Commission approved Cal-Am's purchase of three wastewater systems from the County of Monterey. (D.03-02-044, 2003 Cal. PUC LEXIS 150.) As a result, Cal-Am currently provides wastewater service to these approximately 1,525 customers in accordance with its present Certificate of Public Convenience and Necessity (CPCN). Cal-Am is a subsidiary of American Water Works Company, Inc. (American Water), which owns wastewater operations in many states.

B. The Watertek Systems

1. Spreckels Wastewater System

The Spreckels Wastewater System serves an unincorporated area in Monterey County located near the City of Salinas and has approximately 204 customers. There is one collection system. Wastewater influent is treated through a primary pond system utilizing percolation ponds for effluent disposal. The primary utility assets of the Spreckels Wastewater System consist of two treatment ponds; 18,500 feet of collection pipeline; and one lift station.

2. Oak Hills Wastewater System

The Oak Hills Wastewater System serves an unincorporated area in Monterey County located near the City of Salinas and has approximately 455 customers. There are two separate collection systems. Wastewater influent is treated through is a primary pond system utilizing spray fields for effluent disposal. The primary utility assets of the Oak Hills Wastewater System consist of three treatment ponds; 46,000 feet of collection pipeline; two grinding pumps; one turbine pump; and 20 acres of spray fields.

3. Indian Springs Wastewater System

The Indian Springs Wastewater System serves an incorporated area in Monterey County near the City of Salinas and has approximately 176 customers. There is one collection system. Wastewater influent is treated through an extended aeration package utilizing spray fields for secondary effluent disposal. The primary utility assets of the Indian Springs Wastewater System consist of one treatment pond; 15,500 feet of collection pipeline; one turbine pump; and 20 acres of spray fields.

IV. The Proposed Transaction

Under a stock purchase agreement, Cal-Am will purchase all Watertek stock and pay off the balance of a \$66,000 secured note related to the Spreckels Wastewater System for the total purchase price of \$585,000. Upon purchase, Cal-Am will merge Watertek's assets and the three systems into its operations.

V. Benefits of Proposed Transaction

The Commission requires a test of ratepayer indifference when evaluating the sale of a public utility. Under this test, the sale of a public utility should not have any net consequences that cause the ratepayer to prefer the seller to the buyer. For example, the ratepayer should not be subject to increased rates or reduced service as the result of a change of ownership. In more recent years, the Commission has further required the buyer to demonstrate that acquisition of the public utility yields a tangible benefit to the ratepayers. These considerations are addressed below.

A. Rate Base Increase

Section 2720(a) requires the Commission to use the fair market standard in establishing the rate base for an acquired water system. Subsection 2720(a)(2)

says that fair market value has the same meaning as in California Code of Civil Procedure (CCP) § 1263.320(a), which states:

[F]air market value ... is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.

Pursuant to § 2720(c), this requirement also applies to sewer systems such as Watertek. Cal-Am states that the \$585,000 purchase price is the fair market value of the property, because, as the product of arms-length negotiations between a willing, knowledgeable buyer and a willing, knowledgeable seller, it satisfies the standard an assessor would use under CCP § 1263.320(a). Cal-Am notes that, as summarized below, the \$585,000 purchase price exceeds Watertek’s current rate base but is less than Watertek’s net plant value.

	Oak Hills	Indian Springs	Spreckels	Consolidated
Under Watertek:				
Gross Plant	\$ 865,222	\$ 873,643	\$ 79,234	\$ 1,818,099
Less: Accumulated Depreciation	270,570	607,730	6,983	885,283
Net Plant	594,652	265,913	72,251	932,816
Contributions	336,956	257,649		594,605
Rate Base	257,696	8,264	72,251	338,211
Purchase Price	\$ 444,000	\$ 68,000	\$ 73,000	\$ 585,000

Cal-Am requests that as allowed under § 2720(b), the respective current rate bases for the three Watertek Systems be increased by the difference between the purchase price and the current rate base (Price Differential) as set forth below.

	Oak Hills	Indian Springs	Spreckels	Consolidated
Current Rate Base Under Watertek	\$ 257,696	\$ 8,264	\$ 72,251	\$ 338,211
Price Differential	186,304	61,736	749	246,789
Proposed Rate Base Under Cal-Am	\$ 444,000	\$ 68,000	\$ 73,000	\$ 585,000

Section 2720(b) allows the Commission to include in rate base the difference between the fair market value and the acquired utility's existing rate base, if certain requirements are met:

In determining whether the additional amounts are fair and reasonable the Commission shall consider whether the acquisition of the public water system will improve water system reliability, whether the ability of the water system to comply with health and safety regulations is improved, whether the water corporation by acquiring the public water system can achieve efficiencies and economies of scale that would not otherwise be available, and whether the effect on existing customers of the water corporation and the acquired public water system is fair and reasonable. (Emphasis added.)

Cal-Am asserts that the acquisition meets the above requirements as stated below.

System Reliability

Cal-Am already possesses the experience and expertise to own and operate wastewater utility systems; therefore, Cal-Am's purchase of the current Watertek Systems will maintain or improve the reliability of those systems. Further, compared to current ownership, Cal-Am will be better able to perform all needed system maintenance, invest in necessary capital improvements, and, in the event of an emergency, promptly deploy the resources required to resolve any reliability issues. Also, Cal-Am commits to investing \$235,000 for needed capital improvements in the three Watertek systems over the next three years.

Compliance with Health and Safety Regulations

Cal-Am has access to full-time, experienced personnel dedicated to compliance with health and safety regulations, and it has an excellent track record of compliance with health and safety regulations.

Efficiencies and Economies of Scale

Due to efficiencies and economies of scale, Cal-Am's projected operating expenses are less than Watertek's current operating expenses. Not only will Cal-Am be able to draw upon the resources of its existing Monterey Wastewater District and the wastewater operations of its parent company, but its cost of capital is significantly lower than it would be for any small water or wastewater utility.

Effect on Existing Customers

Because of its operating efficiencies and lower cost of capital, Cal-Am will actually reduce customer rates from current levels, even while investing in new system facilities. Moreover, because Cal-Am is currently operating the Watertek Systems under an operations and maintenance agreement, the transition will be seamless to ratepayers.

B. Rates

The ratepayer indifference test requires that projected rates be no more than if the Watertek Systems remained under the same ownership. In its application, Cal-Am provides a four-year comparison of projected rates, projected operating results and projected capital expenditures for each of the systems under Watertek ownership and under Cal-Am ownership. According to Cal-Am, under its ownership the customers in each of the Watertek Systems will receive immediate and tangible benefits, and will enjoy lower rates than if Watertek retained ownership. Specifically, all customers will (i) receive

immediate rate relief upon the close of the transaction, (ii) continue to enjoy lower rates over the next four years, (iii) be served by improved infrastructure; and (iv) realize greater stability in rates over the long-term. Under Cal-Am's proposed Four-Year Rate Plan for the Watertek Systems, customer rates across the board will be reduced by 5% in Year 1, and thereafter, increase annually at a rate of 1.4% to recover cost increases associated with inflation and capital expenditures over the next three years. The overall projected impact on rates and related benefits to residential customers of the Watertek Systems under the proposed Four-Year Rate Plan are summarized below

	Current	Year 1	Year 2	Year 3	Year 4
Oak Hills					
Quarterly Rate	\$ 120.00	\$ 114.00	\$ 115.71	\$ 117.45	\$ 119.79
Amount Increase/(Decrease)		(6.00)	1.71	1.74	2.35
% Increase/(Decrease)		-5.0%	1.5%	1.5%	2.0%
Annual Cost Savings Per Customer		24.00	17.16	10.22	0.82
Accumulated Cost Savings Per Customer (Four Years)					52.20
Indian Springs					
Monthly Rate	49.54	47.06	47.77	48.49	49.21
Amount Increase/(Decrease)		(2.48)	0.71	0.72	0.73
% Increase/(Decrease)		-5.0%	1.5%	1.5%	1.5%
Annual Cost Savings Per Customer		29.72	21.25	12.65	3.93
Accumulated Cost Savings Per Customer (Four Years)					67.56

Spreckels – Residential					
Quarterly Rate	\$ 108.50	103.03	104.64	106.21	107.80
Amount Increase/(Decrease)		(5.47)	1.61	1.57	1.59
% Increase/(Decrease)		-5.0%	1.5%	1.5%	1.5%
Annual Cost Savings Per Customer		\$ 21.90	\$ 15.46	\$ 9.18	2.81
Accumulates Cost Savings Per Customer (Four Years)					\$ 49.34

Cal-Am states that it will include the Watertek Systems in its general rate case filing for the Monterey Wastewater District, scheduled for 2008. The Commission will therefore be able to review and set new rates for the Watertek Systems before the end of the Four-Year Rate Plan, based on several years of actual operating results under Cal-Am ownership.

Further, Cal-Am states that as part of the proposed Four-Year Rate Plan, it will invest on a combined basis \$235,000 in needed system improvements for the Watertek Systems. Cal-Am points out that as part of American Water/RWE Thames Water, one of the largest water and wastewater services companies in the world, Cal-Am is able to finance system projects at significantly lower capital cost rates than Watertek, a tangible and long-term benefit to ratepayers.

C. Service Quality

Cal-Am intends to operate the three wastewater operations as part of its existing Monterey Wastewater District. The Indian Springs and Spreckels systems are adjacent to Cal-Am's Monterey Las Palmas wastewater system and the Oak Hill system is located nearby along the Highway 156 corridor. Initially, Cal-Am expects to add two full-time employees to serve the Watertek Systems, and then expects to realize some labor savings in Years 2 and 3 due to gaining

knowledge about system operations and making system improvements. Cal-Am believes current Watertek wastewater customers will experience a benefit from improved service quality and system reliability due to its resources and expertise.

D. Service Continuity

Since Cal-Am is already operating the Watertek Systems under an operations and maintenance agreement, Cal-Am believes the proposed transition will be orderly and service continuity will be preserved.

E. Environmental Compliance

Cal-Am represents that it is presently in compliance with all state and federal wastewater laws, regulations and orders.

F. Discussion

We conclude that the application should be granted. Both parties request that the Commission approve the transfer of the Spreckels, Indian Springs, and Oak Hills' wastewater systems from Watertek to Cal-Am on an *ex parte* and expedited basis. Raymond Smith seeks to retire from the wastewater utility business because of his age, and he wishes to insure a smooth transition to an experienced operator. Cal-Am is an experienced wastewater utility operator, both locally and in many states, and is presently operating the three Watertek systems. Based on Cal-Am's showing, we may reasonably conclude that service will improve, capital investments will increase, rates will go down, and Cal-Am will maintain reliable wastewater systems, while complying with all state and federal wastewater laws, regulations, and orders.

VI. Public Notification

Watertek has sent notices to all customers of the three systems regarding the proposed transfer of ownership. In addition, Cal-Am and Watertek have held meetings at each community. At these meetings, they discussed the

proposed acquisition and potential impacts on customers, as well as solicited and received community input. Also, Cal-Am has published a notice of the general terms of this application in newspapers serving the area. No protests have been received by the Commission

VII. Categorization and Need for Hearings

In Resolution ALJ 176-3139 dated September 23, 2004, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that hearings were not necessary. Based on the record, we conclude that a public hearing is not necessary, nor is it necessary to alter the preliminary determinations in Resolution ALJ 176-3139.

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

VIII. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Bertram D. Patrick is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. Watertek seeks authority to transfer ownership of three regulated wastewater systems serving the communities of Spreckels, Oak Hills and Indian Springs, located in Monterey County.
2. Cal-Am, the prospective new owner, is experienced in operating wastewater systems and currently owns or operates Commission-regulated wastewater systems in Monterey County.
3. Customer rates will decrease and service will be maintained or improved as a result of the change in ownership of the systems.

Conclusions of Law

1. The purchase price of \$585,000 is the fair market value of the three systems under CCP Section 1263.320(a).
2. The proposed transaction meets the requirements of Section 2720; therefore, the difference between the fair market value and the utility's existing rate base should be included in rate base for the three newly acquired wastewater systems.
3. Transfer of ownership of the three wastewater systems meets the test of ratepayer indifference, in that customers will be unaffected or better off in terms of service, future rates and continuity of service.
4. Cal-Am's existing CPCN for its Monterey Wastewater District should be expanded to include the three newly-acquired wastewater systems.
5. Cal-Am's proposed tariffs are reasonable.
6. It is in the public interest for Cal-Am to acquire the three wastewater systems and the application should be granted, effective immediately.

O R D E R

IT IS ORDERED that:

1. The owners of Watertek, Inc. (Watertek) are authorized to sell and transfer to California-American Water Company (Cal-Am) all of their outstanding stock of Watertek, which includes Watertek's ownership of three jurisdictional wastewater utilities in the communities of Spreckels, Oak Hills and Indian Springs.
2. Watertek is authorized to withdraw from providing wastewater utility services to these three wastewater utilities, thereby terminating Watertek's obligations as a public utility.

3. Cal-Am is authorized to merge all of the assets of Watertek's three wastewater utilities immediately upon close of its purchase of the stock of Watertek.

4. Upon completion of the transaction, Cal-Am is authorized to expand its existing wastewater Certificate of Public Convenience and Necessity to include Watertek's existing service territories.

5. Cal-Am is authorized to file with the Commission the proposed service area maps, tariff rules and rates included in the application.

6. Cal-Am is authorized to implement the rates set forth in its Four-Year Plan. Year 1 rates shall be effective upon completion of the acquisition and shall remain in effect through the calendar year 2005.

7. Cal-Am is authorized under Pub. Util. Code §§ 2718-2720 to use the standard of fair market value equal to the purchase price, when establishing the rate base value for the acquired wastewater systems.

8. This matter is categorized as ratesetting and hearings are not necessary.

9. This proceeding is closed.

This order is effective today.

Dated November 19, 2004, at San Francisco, California.

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners