

Mailed
February 8, 2005
Ratesetting

WATER/KPC/rhg

Decision 05-01-047 January 27, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of DEL ORO WATER COMPANY, INC. U-61-W for authority to borrow approximately \$500,000 (and to issue evidence of indebtedness in connection herewith) in order to make certain capital improvements and contract engineering studies and for authority to recover all such costs and advances by increases in the respective water rates of customers in its Pine Flat District and Pine Mountain District in the vicinity of Pine Flat, Tulare County, California.

Application 04-10-018
(Filed October 13, 2004)

OPINION GRANTING AUTHORITY TO SECURE A LOAN

I. Summary

This order grants Del Oro Water Company, Inc. (DOWC) the authority requested in Application (A.) 04-10-018 (Application).

DOWC requests authority, pursuant to Pub. Util. Code §§ 816 through 819¹, to enter into a loan agreement with a bank or commercial lender for the purpose of borrowing \$500,000. The loan proceeds will be used to finance the cost of engineering studies and for capital improvements to be conducted within two of DOWC's newly acquired

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

water systems, Pine Flat Water Company (Pine Flat) and the Pine Mountain Water Company (Pine Mountain)².

DOWC may file for rate base offsets on portions of the project in Pine Flat and Pine Mountain that would be completed and are used and useful, subject to reasonableness review. No specific rate increase will be addressed in this proceeding because construction expenditures are unknown at this time.

Notice of the filing appeared on the Commission's Daily Calendar of October 19, 2004. No protests have been received.

II. Background

DOWC is a Class B water utility subject to the jurisdiction of this Commission. DOWC provides water to the unincorporated area of Magalia (Paradise Pines District and Magalia District); a portion of the southern boundary of the Town of Paradise and the entire former Lime Saddle Community Service District (Lime Saddle District); the City of Ferndale (Ferndale District); the unincorporated area of Johnson Park (Johnson Park District); a subdivision within the City of Bakersfield (Country Estates District); and its recent acquisitions near California Hot Springs (Pine Flat and Pine Mountain³). DOWC provides service to residential, commercial and industrial customers in each of its districts.

A. Pine Flat

About 1911, the Meyers Land Company, as part of its land sales operations, constructed a water system at Pine Flat, an area approximately

² By Decision (D.) 00-10-018 dated January 6, 2000 in A.99-07-016 and A.99-07-017, DOWC was granted authority to purchase Pine Flat Water Company and Pine Mountain Water Company. The actual sale was consummated on October 1, 2004.

³ On October 15, 2004, DOWC filed Advice Letter No. 132 to add Pine Flat and Pine Mountain to its service area. This filing was rejected without prejudice on November 4, 2004, because the service area map for Pine Flat submitted by DOWC is different from the most recently approved map.

45 miles southeast of the Town of Porterville In Tulare County. The intention, not implemented, was to eventually form a mutual. By 1936, the owner donated the system to the Pine Flat utility organized by K.H. Morse. In 1949, the company obtained a Certificate of Public Convenience and Necessity (CPCN) from the Commission by. D.42920.

Pine Flat currently serves 208 metered customers through 27,200 feet of two-inch standard screw mains and obtains its water from three wells, five springs, and purchases from Pine Mountain. It has five steel storage tanks with a total capacity of 84,374 gallons.

In Res. W-4039 dated May 21, 1997, the Commission indicated that the utility's existing mains should be replaced since they are over 70 years old and that 3,500 feet of 2-inch mains should be replaced with 6-inch mains. As of 2000, the replacements have not been done⁴.

In May 2004, the state Department of Health Services (DHS) issued Compliance Order No. 03-12-040-003 to Pine Flat for failure to comply with a requirement of the California Safe Drinking Water Act. Specifically, Pine Flat (1) does not have sufficient capacity to meet customer demand during periods of high usage, and (2) does not conduct sufficient and timely monitoring of wells to determine water quality.

The Pine Flat water system is supplied with water from three active groundwater wells that are permitted. There are five springs that are not currently permitted as active sources and do not provide any water to the water system. The wells are equipped with meters that are read monthly and water is pumped into a single pressure zone. The wells currently have the capacity to produce approximately 31 gallons per minute (gpm) of water based on the current condition of the water system. The total

⁴ As stated in D.00-01-018.

pumping capacity of the wells based on data from the well sheets is 61 gpm. The water system supplements its water supply by purchasing water from Pine Mountain. A total of 15.3 million gallons (MG) were purchased during 2001 from Pine Mountain. The intertie between Pine Flat and Pine Mountain is metered and read at the same time as the wells.

According to the Annual Report to the Drinking Water Program (ARDWP) for 2001, the total amount of water produced by Pine Flat's wells was 6.8 MG. The 6.8 MG together with the 15.3 MG purchased brings the total water supplied to the customers of the water system to 22.094 MG for the year 2001.

Pine Flat's water system does not have sufficient capacity to meet the average daily demand on its own and must ensure that the intertie between Pine Flat and Pine Mountain remains active. The production numbers for the year 2002 appear to be the exact same numbers as noted in the 2001 ARDWP. No report was received for the year 2003.

Pine Flat's water system's storage facilities consist of 2 pressure tanks and 3 atmospheric tanks. If the tanks can be filled, the total available storage capacity is about 87,250 gallons. Contributing to the dilemma is the pressure inadequacy of the water system, the inadequate size of the water mains (mainly 2 inch steel water mains with a few $\frac{3}{4}$, 1-1/4, and 1 inch lines), and the inadequate availability of water source capacity as it currently exists.

In addition to the above, Pine Flat does not provide any disinfection treatment of the distribution system. It has failed to conduct the chemical monitoring of wells and has also failed to conduct the monitoring for the lead and copper rule in a timely manner.

DOWC states in the Application that the capital improvement program for the Pine Flat project is estimated at \$333,663 for 2005. This amount includes \$28,000 for developing a Water Master Plan as required by DHS and major infrastructure replacement consisting of a new tank site, well exploration, mainline replacement, and the installation of meters. DHS Compliance Order No. 03-12-040-003 requires Pine Flat to develop a plan (including drawings and specifications) to construct system improvements to alleviate the deficiencies. An engineering system planning document is required in order to provide guidelines to address needed short- and some long-term water system improvements.

B. Pine Mountain

In 1966, Pine Mountain was granted a CPCN by D.70198. Pine Mountain currently serves 88 unmetered customers through 11,800 feet of four- and six-inch transite mains located in a mountain area approximately 45 miles from the Town of Porterville in Tulare County. Pine Mountain operates from four wells and a 64,000-gallon reservoir. It also sells water on a metered basis to adjacent Pine Flat.

In 1997, the Commission stated in Res. W-4037, granting Pine Mountain a general rate increase, that the utility had failed some recent water quality samplings.

As the utility's new owner, DOWC now contemplates conducting an engineering study to assess the condition and status of the water system; to address needed short- and long-term water system improvements; and to construct system improvements necessary to provide safe and reliable source of supply.

As part of its 2005 capital improvement program, DOWC is projecting an estimated \$166,826 for Pine Mountain. This amount includes

\$12,000 for developing a Water Master Plan, well exploration, mainline replacement, and installation of meters.

III. Discussion

DOWC proposes to make certain capital improvements and contract engineering studies in Pine Flat and Pine Mountain at an estimated cost of \$500,000. By this Application, DOWC seeks authority to borrow up to \$500,000 from a bank or commercial lender.

A. Construction Budgets

DOWC’s estimated construction budgets for 2005 through 2009⁵, as shown in its supplemental data to the Application, are as follows:

i. Pine Flat

<u>Components</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Construct New 350M Welded Steel Storage Tank w/ Earthquake Resistant Foundation		\$225,225			
Land Acquisition for Storage Tank & Booster Facility	\$90,090				
Construct New Booster Pump Facility at the Storage Tank		45,045			
Construct New Water Well & Pumping Facility	90,090				
SCADA/Telemetry System Installation				\$13,515	\$13,512
Water Master Plan	28,000				
Water Meter Installation Project	27,027	27,027	\$27,027	27,027	27,027
Main Replacement Project ⁶		40,540	40,540	40,540	40,542

⁵ The construction budget is estimated on a weighted scale based on number of service connections (Pine Flat with 208 connections and Pine Mountain with 88 connections). Pine Flat’s capital costs are estimated at 70% of the total construction budget.

⁶ Based on the replacement of 1,000 linear feet of pipeline per year.

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Intertie Project	<u>98,456</u>	_____	_____	_____	_____
Total	<u>\$333,663</u>	<u>\$337,837</u>	<u>\$67,567</u>	<u>\$81,082</u>	<u>\$81,081</u>

ii. Pine Mountain

<u>Components</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Construct New 350M Welded Steel Storage Tank w/ Earthquake Resistant Foundation		\$96,525			
Land Acquisition for Storage Tank & Booster Facility	\$38,610				
Construct New Booster Pump Facility at the Storage Tank	19,305				
Construct New Water Well & Pumping Facility	38,610				
SCADA/Telemetry System Installation				\$5,791	\$5,792
Water Master Plan	12,000				
Water Meter Installation Project	11,583	11,583	\$11,583	11,583	11,583
Main Replacement Project ⁷		17,374	17,374	17,374	17,374
Intertie Project	<u>66,023</u>	_____	_____	_____	_____
Total	<u>\$166,826</u>	<u>\$144,787</u>	<u>\$28,957</u>	<u>\$34,748</u>	<u>\$34,749</u>

According to DOWC, the proposed engineering studies and improvements to Pine Flat and Pine Mountain are intended to promote safe and reliable source of water, derive mutual benefits from the improvements made to both service areas, and to achieve some economies of scale.

Pine Flat is under a compliance order from DHS and requires water supply from Pine Mountain. At the present, Pine Mountain is receiving an

⁷ Based on the replacement of 1,000 linear feet of pipeline per year.

uninterrupted water supply. However, this present situation does not necessarily mean that Pine Mountain will not face any interruption in the future or that system improvements will not be required.

We recognize DOWC's efforts to assess the condition and status of the Pine Flat and Pine Mountain water systems. However, we will not make a finding in this decision on the reasonableness of DOWC's proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues that are normally addressed in rate base offset advice letters.

B. Water Master Plan

The Water Master Plan for the Pine Flat and Pine Mountain water systems developed by Luhdorff and Scalmanini Consulting Engineers consist of the following recommendations:

1. A field review of the existing facilities and records.
2. A review of past and present water usage including a cursory analysis of potential future growth. From this review, a determination of present and future water usage will be made. The result from this task will be utilized to determine the required production capacity, and serve as a basis for a hydraulic analysis of the system.
3. Perform a hydraulic analysis of the water system for use in the development of a main replacement and storage facility installation program.
4. Perform a geological review of the service area in an attempt to determine the best locations to construct and develop ground water well(s). The review will consist of a field visit, a review of available literature on existing sources of supply and previous geological studies, followed by a letter report of findings with recommendations.

5. Provide a detailed capital improvement plan that will describe the facilities to be added, modified, and/or replaced, a cost for the improvement, and a time frame for the work to be accomplished.
6. Provide a letter report that will encapsulate all findings from the field and records review, the system hydraulic analysis, incorporation of the geological review, and recommendations for improvements along with the associated improvement program.

C. Description of Financing

DOWC has not at the present time entered into any contract for the loan requirement. However, North Valley Bank has submitted a letter of intent, attached as Exhibit D to the Application, for a commercial term loan of \$500,000 at a fixed rate of 6.75% for the first five years and converting every five years to a fixed rate equal to the 11th District Cost of Funds Index (then in effect) plus 3.50%. Total term is 15 years. Requests for disbursements are to be accompanied by itemized listing of costs and invoices. The lender will also require the utility to adhere to certain financial ratios and may require inspection of the project by a third party inspector.

Many projects, including this Application, are built to comply with new drinking water regulations and utility requirements. Since the funding process is a lengthy one, it is not unusual for project construction to commence before the project is funded. DOWC states in the Application that it may use money from its treasury to initially fund the project in the interest of being in compliance with DHS and to provide improved service to customers. When the Application is approved, the loan proceeds will subsequently reimburse DOWC's treasury for costs

incurred, if any. The proposed project is not included in Pine Flat's and Pine Mountain's current rates.

D. Loan Approval

Article 5 of Chapter 4 of the Public Utilities Act (which is Part 1 of Division 1 of the Pub. Util. Code) sets forth conditions a public utility must satisfy to issue debt. One condition is that the debt be for a permitted purpose listed in § 817. That Section states, in relevant part, as follows:

Section 817: A public utility may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others:

(b) For the construction, completion, extension, or improvement of its facilities.

(h) For the reimbursement of moneys actually expended from income or from any other money in the treasury of the public utility not secured by or obtained from the issue of stocks or stock certificates or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness of the public utility, for any of the aforesaid purposes except maintenance of service and replacements, in cases where the applicant has kept its accounts and vouchers for such expenditures in such manner as to enable the commission to ascertain the amount of money so expended and the purposes for which such expenditure was made.

The proposed project is for the public good, and thus qualifies under this provision. Another permissible purpose is for the reimbursement of money actually expended from the treasury of a public utility not secured by or obtained from the issuance of debt or equity securities.

E. Rate Base Treatment

DOWC requests phased-in rate base offsets for the proposed plant improvements in Pine Flat and Pine Mountain when various installations are used and useful, and upon completion of engineering studies that will propose projects to correct water quantity and quality problems and eliminate the need to deliver water that may not meet the primary drinking water standards. DOWC proposes to submit reports to the Director of the Water Division on project capital expenditures no later than thirty (30) days after any portion of the project is used and useful.

For capital costs to be included in rate base, DOWC should file an advice letter once the additions to plant have been completed. The filing will be subject to reasonableness review and will require Commission approval.

IV. Categorization and Need for Hearings

In Resolution (Res.) ALJ 176-3141 dated October 28, 2004, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3141.

Notice of the Application appeared in the Commission's October 19, 2004 Daily Calendar. There is no objection to the ratesetting categorization of this Application and there were no protests to the Application. A hearing is not necessary.

V. Comments on Draft Decision

This is an uncontested matter in which the Decision pertains solely to a water company. Accordingly, pursuant to § 311(g)(3), the 30-day period for public review and comment does not apply.

VI. Assignment of Proceeding

Kevin P. Coughlan is the assigned Examiner in this proceeding.

Findings of Fact

1. DOWC, a California corporation, is a water utility subject to the jurisdiction of this Commission.
2. DOWC needs external funds to be used for improvements in Pine Flat and Pine Mountain.
3. The money, property, or labor to be procured or paid for by the proposed borrowing is reasonably required for the purposes specified in the Application.
4. The DHS, responsible with the California Public Utilities Commission for the public health and safety of California residents, is best equipped to establish and enforce water treatment requirements.
5. The reasonableness of any resulting interest rate and cost of money arising from debt capital are normally subject to review in cost of capital or general rate case proceedings.
6. The Commission does not by this decision determine that DOWC's construction budget presented herein is necessary or reasonable for ratemaking purposes.
7. The proposed borrowing is for proper purposes.

8. Notice of the filing of the Application appeared on the Commission's Daily Calendar of October 19, 2004. There is no known opposition to this Application, and the authority requested should be granted.

Conclusions of Law

1. This is a ratesetting proceeding.
2. A public hearing is not necessary.
3. The Application should be granted to the extent set forth in the order that follows.
4. This authorization is not a finding of the value of DOWC's stock or property, nor does it indicate approval of matters subject to review in ratemaking proceedings.
5. DOWC should pay the fee determined in accordance with § 1904(b). The amount subject to the fee is \$500,000. The fee is determined as follows: $\$2 \times (500,000 / 1,000) = \$1,000$.
6. The following order should be effective on the date of signature.

ORDER

IT IS ORDERED that:

1. Del Oro Water Co., Inc. (DOWC) is authorized, pursuant to § 816 et seq. of the Pub. Util. Code, to secure a loan in an amount not to exceed \$500,000 upon terms and conditions substantially consistent with those set forth or contemplated in Application 04-10-018 (Application)
2. DOWC shall apply the proceeds of the loan for capital improvements within the Pine Flat and Pine Mountain service areas.

3. A copy of the promissory note and loan contract agreement shall be filed with the Water Division within 15 days after execution.

4. DOWC shall retain all invoices related to the capital expenditures financed by the loan so that Commission staff may confirm that the loan was properly used for the stated purpose.

5. DOWC shall maintain adequate records to enable Commission staff to audit the payments of principal and interest on the loan.

6. DOWC shall maintain adequate records to facilitate review of amounts expended and amounts drawn upon its income to pay for capital expenditures in Pine Flat and Pine Mountain service areas.

7. DOWC shall submit reports to the Water Division on any portion of the project that is completed no later than thirty (30) days from completion.

8. In order to include capital expenditures for Pine Flat and Pine Mountain service areas in rate base, DOWC may file two advice letters once the plant additions have been completed and are being used and useful, subject to reasonableness review.

9. The authority granted by this order shall become effective when DOWC pays \$1,000, the fee required by Pub.Util. Code § 1904(b).

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10. Application 04-10-018 is closed.

This order is effective today.

Dated January 27, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
SUSAN P. KENNEDY
Commissioners