

Decision **PROPOSED DECISION OF ALJ WALKER** (Mailed 6/4/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of F. Patrick Flynn & Joyce H. Flynn to sell 100% of the Outstanding Stock of Mesa Crest Water Company (U-333-W) and California-Michigan Land and Water Company, Which Operates a Water System in Los Angeles County, to Buy 100% of the Outstanding Stock of Mesa Crest Water Company, pursuant to Public Utilities Code Sections 851 through 854.

Application 04-01-024
(Filed January 14, 2004)

Christine J. Hammond, Attorney at Law, Steefel, Levitt & Weiss, PC., for Mesa Crest Water Company, applicant
Kristine A. Blom, Greenridge LCF Association,
for Dr. & Mrs. Ronald G. Blom, and Gilbert Dreyfuss,
for La Canada Flintridge Country Club, protestants.

O P I N I O N

1. Summary

This decision grants authority to F. Patrick Flynn and Joyce H. Flynn to sell their outstanding shares of common stock of Mesa Crest Water Company (Mesa Crest), and to transfer the Mesa Crest water system to MCWC, Inc., a wholly owned subsidiary of California-Michigan Land and Water Company (Cal-Mich). Mesa Crest serves 710 connections and is near the City of La Canada Flintridge in Los Angeles County. Cal-Mich operates the East Pasadena Water

Company (East Pasadena Water), which serves 2,802 connections in an area contiguous to Pasadena and San Marino in Los Angeles County.

Two formal protests to the application have been filed, each urging that approval of this sale be deferred while customers seek to form a special district or to interest another public entity in acquiring and operating Mesa Crest. Because the evidence at hearing on May 18, 2004, showed that formation of a special district or an acquisition by another public entity can proceed regardless of Mesa Crest's new ownership, we deny the protests.

2. Procedural Background

This application was filed on January 14, 2004, and reviewed by the Commission's Water Division. In Resolution ALJ 176-3129 dated February 26, 2004, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. Since two protests have been received, our order today amends the categorization to find that a public hearing is necessary. The scope of this proceeding is set forth in the application and the two protests.

The application was amended on April 16, 2004, to identify the newly formed subsidiary of Cal-Mich that would acquire and operate Mesa Crest pursuant to Pub. Util. Code §§ 851-854. Mesa Crest notified ratepayers and conducted a public meeting to describe the proposed transfer on March 24, 2004. Seven ratepayers attended.

When two formal protests to the application were filed soon after the public meeting, this application was reassigned from the Commission's Water Division to the Administrative Law Judge (ALJ) Division, and the assigned ALJ accepted the protests and scheduled a public hearing in Los Angeles on May 18, 2004. At hearing, the Commission heard from two witnesses for Mesa Crest and Cal-Mich and two witnesses representing the protestants. The matter was deemed submitted for Commission decision upon receipt of transcripts on May 20, 2004.

3. Description of the Applicant Water Companies

Mesa Crest was granted public utility authority in 1957 in Decision 55615 and has been operated since that time by the Flynn family. The service area consists of approximately 600 acres, known as Mesa Crest, located north of and adjacent to the Angeles National Forest in or near the City of La Canada Flintridge.

The water system includes a Metropolitan Water District (MWD) connection through the Foothill Municipal Water District, from which Mesa Crest purchases all of its water supply. The water system has five pumping stations ranging from 15 to 100 horsepower capable of pumping 300-800 gallons per minute, along with five reservoirs with a total capacity of 3.5 million gallons. The system has 55,587 feet of water main and 710 active services with 710 meters installed and 60 available for installation. The system has 79 fire hydrants.

For the 12 months ended December 31, 2002, Mesa Crest reported total operating revenues of \$907,842 and net income of \$16,145. The Water Division has analyzed the company's balance sheet as of December 31, 2002, and summarizes it as follows:

<u>Assets and Deferred Charges</u>	<u>Amount</u>
Net Utility Plant	\$424,135
Investments	-
Current and Accrued Assets	<u>295,068</u>
Total Assets and Deferred Charges	<u>\$719,203</u>
<u>Capitalization and Liabilities</u>	
Common Stock	\$355,000
Preferred Stock	60,000
Retained Earnings	<u>112,498</u>
Total Capital and Retained Earnings	\$527,498
Long Term Debt	-
Current and Accrued Liabilities	71,513
Deferred Credits	49,893
Net Contributions in Aid of Construction	<u>70,299</u>
Total Liabilities and Other Credits	\$191,705
Total Capitalization and Liabilities	<u>\$719,203</u>

Mesa Crest's owners seek authority to sell their water system and transfer their public utility water service responsibilities to Cal-Mich and its subsidiary MCWC, Inc. A copy of the acquisition offer and key terms and conditions are attached to the application. The original cost of the utility plant being transferred is \$1,613,367, and the depreciation reserve as of December 31, 2002 is \$1,189,232, resulting in a net book cost of \$424,135. The selling price is \$425,000 cash on closing.

Cal-Mich owns 100% of the outstanding stock of East Pasadena Water, a Class B water company regulated by this Commission. The water system serves the East Pasadena area, contiguous to the cities of Pasadena and San Marino and is within a portion of and contiguous to the cities of Arcadia and Temple City. East Pasadena Water has operated its system since 1931. It has 2,802 active metered service connections, with 109 fire hydrants.

For the 12 months ended December 31, 2002, East Pasadena Water reported total operating revenues of \$1,636,653 and net income of \$227,620. The Water Division has analyzed the company's balance sheet as of December 31, 2002, and summarizes it as follows:

<u>Assets and Deferred Charges</u>	<u>Amount</u>
Net Utility Plant	\$3,229,654
Investments	-
Current and Accrued Assets	500,325
Deferred Charges	<u>33,086</u>
Total Assets and Deferred Charges	<u>\$3,763,065</u>
 <u>Capitalization and Liabilities</u>	
Common Stock	\$ 338,751
Other Paid-In Capital	4
Retained Earnings	<u>1,871,157</u>
Total Capital and Retained Earnings	\$2,209,912
 Long Term Debt	
Advances from Associated Companies	300,000
Current and Accrued Liabilities	318,231
Deferred Credits	463,975
Net Contributions in Aid of Construction	<u>470,947</u>
Total Liabilities and Other Credits	\$1,553,153
 Total Capitalization and Liabilities	 <u>\$3,763,065</u>

4. Evidentiary Hearing

At hearing, Timothy J. Flynn, vice president and general manager of Mesa Crest, testified that sale of the utility to a larger operator will facilitate needed capital improvements. These improvements include recoating of the five steel reservoirs, replacement of aging booster pumps and some mains, and installation of a new interconnection with La Canada Irrigation District for a secondary source of water. Cost of the work is estimated at about \$700,000. Flynn stated that the current owners (his parents) are having difficulty obtaining financing for this work, and that Cal-Mich has agreed to accomplish this.

Mesa Crest pointed out, correctly, that the capital improvement work is not part of this application for transfer of control. Capital improvements will be addressed in a general rate case that Mesa Crest anticipates will be filed in the near future. If and when a general rate case is filed, both ratepayers and the Commission will have an opportunity to address the application and its effect on rates.

Formal protests to this application were filed by La Canada Flintridge Country Club, which is Mesa Crest's largest customers, and by a residential customer, Charles K. Thomas. At hearing, Gilbert Dreyfuss, the country club's president, asserted that the formation of a special district to operate the utility or transfer of the utility to an existing public agency would better serve the needs of ratepayers. In particular, he argued, the needed capital improvements could be financed by a public agency with less effect on rates. On cross-examination, he acknowledged that efforts to form a special district or to transfer the utility to a public agency can continue regardless of the transfer of ownership since these agencies can proceed at any time through a purchase offer or through eminent domain.

Kristine Blom, president of a homeowners' association served by Mesa Crest, testified that the Foothill Municipal Water District has expressed an interest in acquiring the utility. She acknowledged that there has been no formal approach by the district and that the district does not now have the capability to conduct retail water operations.

5. Discussion

Proposed water utility transfers are reviewed on the basis of Pub. Util. Code § 851-854 and Pub. Util. Code §§ 2718-2720 (the Public Water System Investment and Consolidation Act of 1997). Sections 851-854 prohibit the sale or transfer of control of a public utility without the advance approval of this Commission. Sections 2718-2720 encourage the acquisition of small water companies by larger, more financially secure utilities.

Applicants here have shown that Mesa Crest needs substantial capital improvements, and that Cal-Mich and MCWC, Inc., have the financial resources to accomplish this work. Applicants also have shown that Cal-Mich, because of its experience with a larger Class B water utility, will be able to operate Mesa Crest efficiently, with the possibility of economies of scale that otherwise would not be available. No increase in rates is contemplated as a result of the acquisition, and terms and conditions of service will remain unchanged.

Under the terms and conditions of the sale, Mesa Crest will warrant that all assets of the company are unencumbered, except for a loan and a facility lease. It also will warrant that the company has filed all required federal and state income and franchise tax returns and estimated tax statements and has paid all taxes that are due on or prior to the closing date of the Purchase Agreement. The proposed agreement requires the approval of the Commission and of

Los Angeles County. Approval by the California Department of Health Services (DHS) will also be required.

MCWC, Inc., proposes to adopt the filed tariffs of Mesa Crest and agrees to be bound by any outstanding Commission decisions or directives involving the water system being transferred.

The proposed transfer will provide a number of benefits for ratepayers, particularly in ensuring greater financial resources for capital improvement of the system. The current owners of Mesa Crest are in their 70s and desire to pass the responsibilities of operating the system and arranging financing to other qualified operators. The new owners will retain the contractual services of two of Mesa Crest's managers (the sons of the current owners) to ensure a smooth transition. Rates and terms of service to ratepayers are unaffected by the sale and transfer of control. The applicants have demonstrated that the transfer is in the public interest.

As shown at hearing, the efforts of some ratepayers to explore formation of a special district or other public ownership of the water utility can be pursued regardless of the ownership of Mesa Crest. A public entity can negotiate for the purchase of the water system or, if necessary, it can proceed by way of eminent domain to acquire the system. It is premature in this case to address the possibility of increased rates that may result from any substantial capital improvement project. As part of a general rate case, such a project and its effect on rates would have to be approved by this Commission, and both ratepayers and the Commission's Office of Ratepayer Advocates will have the opportunity to examine and oppose some or all of the utility's capital improvements if and when a general rate case is filed. Rate of return on new capital investments by Mesa Crest also is subject to review and approval in the general rate case.

We conclude that the proposed sale and transfer of control of Mesa Crest is reasonable, is in the public interest, and will provide tangible benefits to ratepayers. We will approve the application and dismiss the formal protests without prejudice to renewal of those protests at the time any rate proceeding is filed by Mesa Crest.

6. User Fees, DHS Approval

Water and sewer utilities subject to Commission jurisdiction were required by the Legislature beginning January 1, 1983, to impose user fees on customers' bills. (*See* Pub. Util. Code §§ 401, et. seq.) MCWC, Inc., will continue to collect and remit these fees to the Commission. For the period prior to transfer, Mesa Crest is required to collect and remit these fees before it can be relieved of its public utility responsibilities.

The sale will relieve Mesa Crest's owners of their duty to provide public utility water service to the service area. MCWC, Inc., is to record the acquisition of Mesa Crest at original cost in accordance with the Uniform System of Accounts for Water Companies.

Pursuant to the provisions of California Health and Safety Code (H&S) § 116525(a), any person or entity operating a public water system must have a permit from DHS to operate that system. A change in ownership of a public health system requires the prospective new owner to apply to and satisfy the DHS requirement that the new owner "possesses adequate financial, managerial, and technical capability to assure the delivery of pure, wholesome, and potable drinking water" (H&S Code § 116540). Accordingly, apart from the authorization from the Commission and the County for the acquisition of Mesa Crest, the new owner also must apply to DHS for re-issuance of the existing permit of Mesa Crest.

This application involves only a proposed change in control and operation of existing water facilities. No new construction or changes in the source of water supply are being proposed. Accordingly, there is no possibility that the transaction may have any significant effect on the environment.

The authority granted by our order today is not a finding of the value of the rights and property to be transferred.

7. Comments on the Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. In comments, La Canada Flintridge Country Club and Kristine Blom urge that approval of the proposed sale of the water system be conditioned on approval of the utility's upcoming general rate case. In this way, they say, a public agency interested in acquiring the system will be apprised of the extent of capital improvements planned by Mesa Crest. Mesa Crest points out, however, that the planned capital improvements have been set forth in detail both in an advice letter filing available to the public and in a public meeting conducted by the utility. In view of this, we see no need to condition our approval of the proposed sale on the outcome of the general rate case.

8. Assignment of Proceeding

Commissioner Carl W. Wood is the Assigned Commissioner and Glen Walker is the assigned ALJ for this proceeding.

Findings of Fact

1. Mesa Crest serves 710 connections around the community of the City of La Canada Flintridge in the County of Los Angeles.
2. Mesa Crest finds it difficult to financially maintain the system and provide service to its customers.

3. Cal-Mich owns 100% of the outstanding stock of East Pasadena Water, a Class B regulated water company with 2,802 connections.

4. Cal-Mich has long experience in supplying water in the East Pasadena area and in the cities of Arcadia and Temple City, Los Angeles County.

5. Cal-Mich has formed a wholly owned subsidiary that will acquire 100% of the outstanding stock of Mesa Crest.

6. It can be seen with certainty that the sale and transfer of this system will have no significant effect on the environment.

7. As a public utility, Mesa Crest remains responsible to the Commission for remittance of the Public Utilities Commission Users Fees collected up to the date of sale and transfer. Thereafter, the new owner will continue imposing the user fees on customers' bills.

8. A change in ownership of a public health system requires the prospective new owner to satisfy DHS requirements to operate a public water system.

9. Protestants who seek public ownership of the water system may continue to pursue that objective regardless of the transfer of ownership at issue here.

10. After consummation of the sale and transfer, the current owners of Mesa Crest will no longer provide public utility water service in the La Canada Flintridge area, with Cal-Mich and its subsidiary MCWC, Inc., having assumed these duties and obligations.

Conclusions of Law

1. Cal-Mich has the legal capacity and experience to acquire and operate the water system of Mesa Crest.

2. The acquisition of ownership and control of Mesa Crest by Cal-Mich is in the public interest and will provide tangible benefits to ratepayers.

3. Upon completion of the sale and transfer, and remittance of pending Public Utilities Commission Users Fees collected to the date of sale and transfer, the current owners of Mesa Crest should be relieved of their public utility water duties and obligations.

4. Cal-Mich and MCWC, Inc., should apply to DHS for re-issuance of the existing permit of Mesa Crest.

5. Resolution ALJ 176-3129 is amended to show that public hearing in this matter is necessary.

6. The scope of this proceeding is set forth in the application and the two protests.

7. This order should be made effective immediately so as to permit prompt consummation of the sale and transfer.

O R D E R

IT IS ORDERED that:

1. On or after the effective date of this order, F. Patrick Flynn and Joyce H. Flynn are authorized to sell 100% of their outstanding shares of common stock of Mesa Crest Water Company (Mesa Crest) to the California-Michigan Land and Water Company or its wholly-owned subsidiary MCWC, Inc. (Buyer) upon terms and conditions substantially consistent with those set forth in Application (A.) 04-01-024, as amended.

2. Mesa Crest shall remit to the Commission the Public Utilities Commission Users Fees collected up to the date of sale and transfer within 90 days of the date of sale and transfer of its water system.

3. The Buyer and Mesa Crest shall jointly notify the Director of the Water Division in writing of the actual transfer date as authorized herein and file tariffs under the name of the Buyer within ten (10) days of the transfer. A true copy of

the instrument of transfer or other related transfer document(s) shall be attached to the written notification.

4. The Buyer shall provide the Director of the Water Division a copy of the State of California's Secretary of State Certificate of Status of Domestic Corporation and a copy of its Articles of Incorporation, within 10 days of the date of the transfers.

5. The Buyer shall provide the Director of the Water Division a copy of the permit to operate the water system granted to it by the Department of Health Services, within 20 days of receiving such permit.

6. Sixty days after the transfer of the water system to the Buyer, Mesa Crest shall provide the Director of the Water Division with the 2004 Annual Report to the Commission covering operations from January 1, 2004 to the date of sale.

7. On or before the March 31, 2005, Buyer shall provide the Director of the Water Division with the 2004 Annual Report to the Commission covering operations from the date of transfer of the water system to the end of calendar year December 31, 2004.

8. The Buyer shall, upon Commission staff request, make all books and records available for review and inspection. In the event such books and records are required for inspection by the Commission or its staff, the Buyer shall either produce such records at the Commission's offices or at another location in California, or reimburse the Commission for the reasonable costs incurred in having the Commission staff travel out of State to the offices where the books and records are maintained.

9. The Corporate Identification Number assigned to the Buyer is U-333-W, which shall be included in the caption of all original filings with the Commission, and in the titles of other pleadings filed in existing cases.

10. The Buyer shall record the acquisition of Mesa Crest at original cost in accordance with the Uniform System of Accounts for Water Companies.

11. The authority granted in Ordering Paragraph 1 shall expire if not exercised within 12 months after the effective date of this order.

12. Upon compliance with this order, the current owners of Mesa Crest shall be relieved of their public utility obligation, and the Certificate of Public Convenience and Necessity will be transferred to Buyer.

13. The preliminary determination on the need for hearing is changed. Public hearing in this matter is necessary.

14. The scope of this proceeding is set forth in the application and the two protests.

15. The application is granted as set forth above.

16. A.04-01-024 is closed.

This order is effective today.

Dated _____, at San Francisco, California.