Decision **PROPOSED DECISION OF ALJ WALKER** (Mailed 3/28/2006)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Fruitridge Vista Water Company, a trust, for an order: 1) establishing a moratorium on new service connections; and 2) clarification of Tariff Rule 15 regarding payment for new facilities servicing new applicants.	Application 05-10-005 (Filed October 7, 2005)
Sacramento Housing and Redevelopment Agency and the Housing Authority of the County of Sacramento, Complainants, vs. Fruitridge Vista Water Company, Defendant.	Case 05-10-007 (Filed October 11, 2005)
County of Sacramento, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-10-011 (Filed October 7, 2005)

David R. Gonzalez & Donna L. Gonzalez, Complainants, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-011 (Filed September 6, 2005)
Mercy Properties California, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-012 (Filed September 6, 2005)
Victoria Station, LLC, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-09-027 (Filed September 22, 2005)
Park Place LLC, Complainant, vs. Fruitridge Vista Water Company, Defendant.	Case 05-11-015 (Filed November 15, 2005)

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OPINION APPROVING COMPREHENSIVE SETTLEMENT

1. Summary

We approve a comprehensive settlement agreement reached by the parties to this proceeding, including Fruitridge Vista Water Company (Fruitridge), the County of Sacramento, the Sacramento Housing and Redevelopment Agency, and several developers of residential housing and business. The settlement would permit Fruitridge, a private water company serving an unincorporated area south of Sacramento, to correct a severe water shortage caused by the closure of four polluted wells, tie into purchased water from the City of Sacramento, and make infrastructure improvements to serve 4,947 existing connections and 550 new connections. Funding would come from state loans and a state grant, developer funding, and an offset rate increase that would increase the monthly flat-rate cost of water for most existing customers from $15.69 to $20.07, plus a $2.18 surcharge to pay off a state loan. By expedited motion dated April 5, 2006, and approved by the Administrative Law Judge, the settling parties revised one provision of the settlement agreement to make clear that grant money provided by the state would not be added to rate base, a step prohibited by this Commission. The settlement agreement is opposed by the Commission's Division of Ratepayer Advocates (DRA) and by a local legislator,

who urge that the proceeding be bifurcated to (1) immediately authorize infrastructure improvements, and (2) later conduct a general rate case to deal with ratepayer funding. We find that overwhelming public policy benefits of the settlement outweigh the concerns expressed by DRA, and that DRA's alternative proposal is unworkable. The comprehensive settlement agreement is approved and Fruitridge is authorized to file the tariff sheets attached to the settlement agreement to implement the new rates.

2. Background

Fruitridge is a privately owned Class B water company serving approximately 15,000 people through 4,947 service connections in a four-square-mile unincorporated area adjacent to the southern boundary of Sacramento. About 86% of its customers are billed on a flat-rate basis, paying $15.69 per month for unlimited water. New connections added since 1992 are metered customers, typically paying a meter charge of $16.27 plus 46.7 cents per hundred cubic feet of water usage. Fruitridge has been in business since 1953.

Fruitridge has no storage capability in its distribution system. Its supply of water for customers is met through 17 wells, four of which are inactive because of chemical contamination. On August 29, 2005, the California Department of Health Services (DHS) issued Compliance Order 01-09-05-CO-002 citing Fruitridge for failure to maintain adequate water pressure in its distribution system. The DHS concluded that, because the contaminated wells were shut down, the source capacity of the system was about 8,330 gallons per minute instead of the 11,000 gallons per minute considered standard for a system of this size. According to the DHS, this created both a potential health risk for customers (because pathogens could enter the distribution system without sufficient pressure) and an inability to meet maximum daily flow requirements,

including fire flow requirements. Fruitridge was ordered to correct its pressure problems and provide additional sources of supply through new wells or purchased water.

On October 7, 2005, Fruitridge filed this application with the Commission seeking to establish a moratorium on new service connections pursuant to Pub. Util. Code § 2708 until the distribution problems could be resolved. It also sought authority to impose mandatory rationing on current customers, if necessary, in order to comply with its DHS domestic water supply permit. Pub. Util. Code § 2708 provides, in relevant part:

> Whenever the commission, after a hearing had upon its own motion or upon complaint, finds that any water company which is a public utility operating within this State has reached the limit of its capacity to supply water and that no further consumers of water can be supplied from the system of such utility without injuriously withdrawing the supply wholly or in part from those who have theretofore been supplied by the corporation, the commission may order and require that no such corporation shall furnish water to any new or additional consumers until the order is vacated or modified by the commission.

At about the same time that Fruitridge filed its request for a moratorium, six formal complaints against the utility were filed by individual landowners in the service territory and by the County of Sacramento and the Sacramento Housing and Redevelopment Agency. All alleged that Fruitridge has a public utility obligation to find new sources of water to serve prospective new customers. The County's complaint was typical:

> Multiple FVWC [Fruitridge] wells are contaminated from underground storage tanks leaking petroleum hydrocarbon contaminates into the groundwater….This contamination has led to the FVWC taking some of their wells off-line while they pursue legal action against the companies responsible for the contamination.

> With this reduced well capacity, FVWC issued denial of "will serve" letters indicating that they will be unable to provide water service for approximately 450 new housing units and other commercial uses….FVWC has also indicated their inability to provide adequate water pressure for fire prevention for existing homes and businesses in the area. Sacramento County residents and property owners have been denied access to water for projects ranging from a new affordable housing development to commercial recreational activities (indoor soccer facility). FVWC apparently intends to wait until its litigation has been resolved before obtaining new water sources to serve its customers and property owners. County officials are very concerned for the safety of residents in the event of a fire and for the economic vitality and revitalization efforts that are stalled due to this situation. (Case 05-10-011, at 4.)

Fruitridge in its answers to these complaints admitted that the contamination problem has limited the utility's ability to serve new customers, but it added that it "is working daily toward the solution to this problem." (C.05-09-012 Answer, at 2.) It added that it has supplied "will serve" letters to applicants seeking some 550 new connections, but it also advised applicants of its pending application for a moratorium. Fruitridge claimed that the cost of purchasing water from the City of Sacramento was "exorbitant," and that the utility was studying the long-term options of water treatment of existing wells versus purchase of water from the City.

DHS operates the Drinking Water Treatment and Research Fund, which funds replacement or treatment of water sources contaminated by the gasoline additive MTBE (methyl tertiary butyl ether). DHS has provided $2.85 million to replace supply from one of the closed wells, and on February 2, 2006, as part of the settlement agreement in this proceeding, issued a letter of commitment for $4.54 million to fund replacement of well supply from two other closed wells. DHS will provide additional funding of $570,000 to test and destroy the four

contaminated wells. Fruitridge meanwhile is suing alleged oil company polluters. It is obligated to repay this DHS funding if those amounts are recovered in the litigation. DHS also is to loan Fruitridge $3.27 million from the State Revolving Fund for construction of two new wells and transmission mains.

3. Prehearing Conference and Mediation

A prehearing conference was conducted in Sacramento on December 6, 2005, where the parties announced that they had agreed to participate in the Commission's recently enhanced mediation process. (*See* Resolution ALJ-185, August 25, 2005.) Counsel for the Sacramento Housing and Redevelopment Agency stated that parts of the service territory are financially blighted and that ambitious redevelopment plans for the area have been brought to a standstill by the lack of water. Fruitridge's general manager stated that the company is suing alleged polluter companies and that it has investigated the availability of DHS funds for restoring polluted groundwater or purchasing a new source of water from the City of Sacramento. The City of Sacramento has a substantial water supply from surface water sources and is willing to provide purchased water to Fruitridge at its standard rates.

The parties and other interested entities (including DHS and the California Regional Water Quality Control Board) agreed to meet with ALJ Mediator Michelle Cooke on December 9 and 15 in the first of what would turn out to be four full-day sessions with all parties and numerous sessions with subsets of the mediation participants. Mediator Cooke also met privately by phone or in person with many of the participants.

A formal evidentiary hearing was scheduled January 24-27, 2006, dates that were subsequently stayed when Mediator Cooke reported that progress had been made toward settlement. On February 2, 2006, Mediator Cooke was

authorized by the parties to announce that a settlement in principle had been reached by all parties except DRA. By ruling dated February 14, 2006, parties were instructed to produce by February 24 the proposed settlement agreement and supporting documents and DRA's opposition testimony, with reply testimony due March 10, 2006.

The settling parties in this case are Fruitridge, the Sacramento Housing & Redevelopment Agency, the Housing Authority of the County of Sacramento, the County of Sacramento, David R. and Donna L. Gonzales, Mercy Properties California, Victoria Station LLC, Park Place LLC (Rivendale Project), Saia Motor Freight Line, Inc., Trench Plate Rental Co., and Soccer Planet. While not settling parties, DHS and the Central Valley Regional Water Quality Control Board also support the settlement.

A settlement hearing was conducted on March 13, 2006, in Sacramento, when the Commission heard from 12 witnesses for the settling parties and DRA. Because some developers indicated that they would withdraw or build elsewhere if water could not be made available soon, the settling parties urged the Commission to act upon the proposed settlement at its meeting on April 27, 2006. The parties were directed to file briefs by March 23 and replies by March 27, 2006, in order that the Proposed Decision could be mailed 30 days prior to the Commission meeting on April 27, 2006, pursuant to Pub. Util. Code § 311(d).

4. The Proposed Settlement

The proposed settlement agreement is attached to this decision as Exhibit 1 and is made part hereof. According to its sponsors, the settlement agreement is

designed to provide a comprehensive solution to comply with orders of DHS and the Regional Quality Control Board.[1] Further, its purpose is to develop a new water supply to allow Fruitridge to serve development projects in its service territory. The settling parties argue that all of the supply needs should be addressed now, with a combination of groundwater and City of Sacramento surface water supply, because a comprehensive solution will be less costly than pursuing piecemeal supply solutions. The settling parties also agree that the solution must include a way to make funding available so that Fruitridge is able to invest in infrastructure improvements.

The settlement includes two interconnections with the City of Sacramento, purchase of water from the City of Sacramento as needed, construction of three new wells, and associated piping and pressure infrastructure. The total estimated cost of the infrastructure improvements contemplated by the proposed settlement is $12 million. In addition, Fruitridge agrees to destruction of contaminated Wells 1, 2, 11, and 12, which will occur after testing consistent with the Regional Water Quality Control Board order. If the settlement agreement is approved by the Commission in April 2006, Fruitridge plans to begin implementation in May 2006 and complete it in the summer of 2007.

The $12 million cost of the proposed settlement is comprised of $6.3 million in infrastructure costs and $5.7 million associated with the buy-in and purchase costs for City of Sacramento water. Funding is to come from the DHS

[1] The Regional Water Quality Control Board issued an order under Water Code § 13267 in January 2003 requiring Fruitridge to submit a technical Report of Findings regarding contamination of Wells 1, 2, 11, and 12. The order requires specific testing and analysis be performed.

Drinking Water Treatment and Research Fund, a new special facilities fee, an expected 20-year financing agreement with the City of Sacramento, an expected DHS State Revolving Fund zero-interest loan, and ratepayers. Supporters of the settlement maintain that the settlement is the least-cost solution available, has limited ratepayer impacts, is based on reasonable cost assumptions, and supports future system improvements.

Commitments for $5.5 million in funding have been made as part of the mediation process. The upfront funding relies on a combination of funding from the DHS Drinking Water Treatment and Research Fund to replace water contaminated by MTBE, and a new special facilities fee. The settlement assumes that the City of Sacramento will finance up to 1.13 million gallons per day of the buy-in fee it charges via a 20-year financing agreement, with 2.11 million gallons per day funded outright by the Drinking Water Treatment and Research Fund and a Safe Drinking Water State Revolving Fund loan.

Fruitridge currently serves most of its residential customers under flat-rate service at a rate of $15.69 per month. By comparison, the 2006 rate for a 6-9-room residence receiving water directly from the City of Sacramento is $21.87 per month, increasing to $23.83 per month in Fiscal Year 2007. Mediation participants identified that most water districts in the Sacramento region charge between $30 and $35 per month for water service and, at hearing, witnesses testified that the nearby Golden State Water Company charges $31 per month, while ratepayers in Carmichael 12 miles away pay $49 per month.

Under the settlement agreement, ratepayers will pay a surcharge of $2.18 per month to repay the Safe Drinking Water Revolving Fund loan for 20 years. They also would see a rate increase of $4.38 per month associated with adding $1.98 million to ratebase. Under the settlement agreement, monthly bills for flat-

rate customers would be $22.25 per month. The service charge for metered service would increase from $16.27 to $24.55 for a 1-inch meter, while the water rate of 46.7 cents per 100 cubic feet of water would remain unchanged. If approved by the Commission, the tariff sheets attached to the settlement agreement would be implemented via an Advice Letter compliance filing 30 days after Commission approval.

When funds from the Safe Drinking Water State Revolving Fund and the Drinking Water Treatment and Research Fund are awarded to Fruitridge, $3.7 million of these proceeds will go to the City of Sacramento in order to obtain the right to purchase 2.11 million gallons per day to satisfy the DHS Compliance Order. Approximately $4.12 million of these funds will be used to construct two wells and associated infrastructure and two interconnections with the City of Sacramento.

As part of the settlement, developers have agreed to make payments for special facilities fees on a schedule independent of the actual date of issuance of building permits. Mercy Housing will pay $560,000 by June 30, 2006, based on 80 residential unit permits. Victoria Station, LLC will pay $140,000 by August 15, 2006, followed by three monthly payments of $70,000 based on 50 residential unit permits. Saia Motor Freight Line, Inc. would pay $232,183 in special facilities fees by July 15, 2006. Soccer Planet will pay $139,199 by June 30, 2006. The Sacramento Housing and Redevelopment Agency will advance $420,000 to Fruitridge by June 30, 2006. The County of Sacramento has agreed that it will not grant building permits to developers without payment of the special facilities fees.

The settling parties state that ratemaking treatment for the settlement is complex, given the number of funding sources. They urge that the City of

Sacramento buy-in financing be considered plant under utility accounting practice and that, therefore, $1.98 million would be added to rate base as an offset rate increase. Fruitridge in the settlement commits to an annual system investment of at least $80,000, which is the estimated difference between the amount of return it will collect and the annual payments to the City of Sacramento associated with the $1.98 million buy-in fee.

The settling parties state that, as a result of the mediation, the following actions have already occurred:

- Fruitridge has submitted its Compliance Plan to the DHS (December 30, 2005).
- DHS has invited Fruitridge to apply for a Safe Drinking Water State Revolving Fund loan, and Fruitridge has done so (December 30, 2005).
- The City of Sacramento and Fruitridge have begun discussions regarding the terms of a City of Sacramento water supply (February 2006).
- DHS has begun environmental review of the Fruitridge Vista Compliance Plan (January 3, 2006).
- DHS has issued a commitment letter specifying the funding available from the Drinking Water Treatment and Research Fund (February 2, 2006).
- DHS has approved new well locations (January 17, 2006).

5. DRA's Opposition

DRA opposes the settlement to the extent that it proposes drilling of new wells and to the extent that it imposes additions to rate base (and corresponding increases in customer rates) not justified by Fruitridge capital investment. DRA proposes either that the Commission bifurcate this proceeding to authorize infrastructure improvements and deal later with ratemaking issues, or that the settlement be rejected, that evidentiary hearings be scheduled, and that the

Commission ultimately order Fruitridge to import purchased water from the City of Sacramento. It argues that, for current customers, the cost of this purchased water can be met through DHS funding. For new customers, DRA argues that the Commission and the parties should explore contributed funds from developers that would not cause an increase in rate base. As interim measures, DRA urges the imposition of mandatory rationing measures and renovation of Well 15 (now on standby mode) to eliminate second-tier chemical contamination.

At hearing, DRA's witness cited what she termed Fruitridge's reluctance to work with the City of Sacramento and to cooperate with DHS in developing a new source of water to serve current customers and to resolve an admittedly inadequate water supply for fire protection. She contended that the utility's current rates are lower than most other water utilities because the owners have failed to invest enough of their own funds in infrastructure and earn a return on that investment. She also criticized the proposed settlement for seeking a rate increase based on state funds, citing the Commission's recent holding in Decision (D.) 06-03-015 that utilities should not earn a return on grant-funded additions to plant.

On examination by the Administrative Law Judge (ALJ), she acknowledged that a Class B water company may impose an offset rate increase for investments in rate base without the necessity of a general rate case.

DRA's witness testified that a moratorium on new water connections will be unnecessary if Fruitridge is ordered by the Commission to accept DHS funding to import water for current customers and to impose contributions and advances by developers for new services under Tariff Rule 15, the Main Extension Rule.

Assemblyman David Jones, D-Sacramento, testified in support of DRA's position, stating that he attended a public hearing called by Fruitridge on March 8, 2006, to describe the settlement and proposed rate increase to customers. He estimated that 95% of those attending the meeting opposed the proposed rate increase and the rate-basing of public dollars. Jones said the median income in Fruitridge's service area in 1999 was $28,227, little more than half the state's median average, and that the proposed increase in rates would work a hardship on those with fixed incomes.

Jones also cited Senate Bill (SB) 2198 providing for DHS grants to water companies affected by MTBE contamination, adding that the Legislature's intent was that public dollars would not become part of a utility's rate base. On cross-examination, however, he acknowledged that SB 2198 did not deal with private utility ratemaking.

DRA called four ratepayers to testify. They each acknowledged the need for infrastructure improvements for Fruitridge but added that they would have preferred smaller rate increases imposed gradually over time.

6. Support for Proposed Settlement

The settling parties called a panel of witnesses to testify in support of the proposed settlement. The panel included Troy Givans, director of housing development for Mercy Housing California, which proposes to build affordable housing units in the area; Chris Glaudel, senior project manager for the county's Department of Economic Development, which proposes 20 development projects in the area; and Robert C. Cook, Jr., general manager of Fruitridge. They testified that the proposed settlement is a comprehensive solution to the utility's water problems and that, even with the rate increase, monthly water rates will continue to be among the lowest in the region.

Illa Collin, county supervisor for 28 years for District 2, which encompasses the Fruitridge service area, testified that her staff had participated in the mediation process and that the County Board of Supervisors unanimously approved the proposed settlement. She said:

> I care very deeply for the people who reside in this area and who have been homeowners in this area, waiting for so very long to see the area revitalized. We have a lot of interest in the area now: Victoria Station, other housing developments, a major soccer complex, other investment by business owners, many of whom are minority business owners….You know, there's no settlement everybody's happy about…At the same time, this area desperately needs upgrading and investment dollars, and people who believe in it. That's why I felt such a sense of urgency. (Transcript, at 56-57.)

On cross-examination, Collin acknowledged that the Board of Supervisors did not discuss the proposed increase in rates in the settlement, but she noted that the new flat rate will be less than half the monthly water rate that her daughter pays in nearby Carmichael.

Cori Condon, senior engineering geologist with the Central Valley Regional Water Quality Control Board, testified that she participated in the mediation and supports the settlement. For one thing, she stated, it will permit the destruction of polluted wells so that further spread of the MTBE plume can be prevented. Further, the settlement provides for conjunctive use of groundwater and surface water, providing more reliable service in case of drought. She added that preliminary testing of the locations for the proposed new wells indicates that the wells will not be drilled in areas threatened by MTBE.

Carl Lischeske, chief of the Northern California region for field operations for DHS, explained the sources of loans and a grant to Fruitridge under the settlement agreement. On cross-examination, he stated that while DHS supports

cost-effective solutions to water supply problems, it does not have jurisdiction to determine whether associated rate increases are reasonable.

7. Modification to Settlement Agreement

The settling parties filed their proposed settlement agreement six days before the Commission issued D.06-03-015 on March 2, 2006. That decision, entitled "Opinion Adopting Rules to Govern the Receipt and Use of All Future State Grant Funds Received by All Classes of Regulated Water Utilities," made it clear (if it was not clear before) that Commission-regulated water utilities will not be permitted to earn a return on additions to infrastructure funded by state grants. The guiding principle, as stated by Assemblyman Jones at our hearing, is that ratepayers should not pay twice – once in taxes and once in a return on rate base – for public dollars granted to a public utility for additions to plant. While D.06-03-015 defers rules on state loans to public utilities, it is unequivocal in prohibiting a return on rate base occasioned by a grant of tax-funded money by a state agency.

The Proposed Decision in this case, issued on March 28, 2006, deleted one paragraph of the settlement agreement dealing with the disposition of state grant money if and when it was repaid to the state, allowing the parties 20 days to withdraw from the settlement if the deletion was unacceptable. Instead, the settling parties moved for expedited approval of a modification of the paragraph in question. The modification removed the reference to "contributions" from the state's Drinking Water Treatment and Research Fund. Instead, it provides that in the event that Fruitridge is able to recover monies directly from alleged polluters in its pollution lawsuit, infrastructure improvements funded by these monies, up to $5 million, would be added to rate base and earn a return of 10%. The ALJ granted the modification, stating:

> If and when such a court-ordered award is made (and it is by no means certain that it will be), the utility here will forgo monies it presumably would have used for plant investment in order to repay the state's Drinking Water Treatment and Research Fund. Moreover, since the settlement agreement obligates the utility to destroy 4 of its 17 wells that allegedly were polluted through no fault of the utility, it would seem manifestly just that a court-ordered pollution award permit the utility to restore to rate base the equivalent value of its lost wells.
>
> Again, a general rate case would have permitted closer scrutiny of the effects of these events on rate base. But the Commission does not have a general rate case before it. It has a proposed settlement, the benefits of which – restoring water pressure necessary for health and fire safety and permitting welcome investments in low-cost housing, recreation and new jobs and businesses – are not seriously contested by any party. A rejection of the settlement, or a withdrawal from the settlement if its give-and-take terms are sought to be altered, would leave the Commission with little alternative but to grant an immediate moratorium on new connections and stringent water conservation measures to preserve pressure levels this summer. (ALJ Ruling on Motion to Modify, at 1-2.)

If it ultimately occurs, a $5 million addition to rate base could increase the monthly flat rate of most of Fruitridge's customers to around $30, depending on the calculation of rate base at the time. That rate would still be low in comparison with other water systems in the Sacramento area, and it would continue to apply to unlimited water usage by the great majority of customers.

The ALJ also recommended that the utility should not be precluded from seeking a return on this investment amount commensurate with a higher return if such higher return is granted in a subsequent rate case. (The current authorized rate of return for Fruitridge is 11%.) The Commission's accounting staff recommends that, as a matter of policy, a uniform rate of return on all plant should apply. We agree, and our order today provides that, while a 10% return on the invested funds will apply in the future to this discrete investment, nothing

in the settlement agreement will preclude the utility from seeking a return on this investment commensurate with a higher return if such higher return is granted in a subsequent rate case.

Our order today permits rate-basing upon filing of an advice letter of the $1.98 million of the buy-in fee for the utility to receive purchased water from the City of Sacramento. We agree that a buy-in fee for purchased water is considered a non-depreciable addition to plant, and we exercise our discretion to authorize an offset rate increase for this legitimate addition to base that is immediately necessary and useful on behalf of ratepayers and that is financed with a city financing arrangement that must be paid by the utility. Similarly, we authorize the monthly surcharge of $2.18 that will go into a trust account for repayment of a DHS Revolving Fund loan. The remainder of the $12 million in infrastructure costs contemplated by the proposed settlement agreement is not part of rate base and does not affect rates.

The settling parties announced that, with the approval of their motion to modify the settlement proposal, no settling party elected to withdraw from the settlement. The settlement proposal that we adopt today, including the modification of one paragraph, is attached to this decision as Exhibit 1.

8. Discussion

The general criteria for Commission approval of settlements are stated in Rule 51.1(e) of the Rules of Practice and Procedure. The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest. Taken together, the application, complaints, the settling parties' motion and proposed agreement, and the testimony at hearing provide sufficient

information for the Commission to judge the reasonableness of the proposed settlement.

For the issues that are resolved by the settlement, we conclude that the outcome is reasonable because it constitutes what appears to be the least-cost solution to the DHS compliance order, resolves the water pressure problems that threaten both the health and safety of existing customers, offers additional water to serve new development, provides a schedule and financing plan for implementing the supply solution, and maintains water rates for customers at a level that will continue to be among the lowest of water utilities that serve the Sacramento County region.

The settlement is consistent with all applicable statutes and does not contravene prior Commission decisions. The proposed settlement allocates cost responsibility for the comprehensive solution fairly among the parties and pursues non-ratepayer funding sources first, in order to limit ratepayer exposure to increased rates. It resolves system volume and pressure issues and the resulting health and fire safety concerns expressed by DHS. It supports the development of affordable housing and the economic revival of an economically challenged community.

The participants in the mediation process included state regulatory agencies responsible for the health of the drinking water systems and the water aquifers, and local government representatives with close ties to the community served by Fruitridge. Although no one is happy about potential rate impacts, the proposed new rates are reasonable in light of the results of restoring volume and pressure to the Fruitridge water system.

9. Category and Need for Hearing

In Resolution ALJ 176-3161 on October 27, 2005, the Commission preliminarily categorized this application as ratesetting. The Scoping Memo dated December 14, 2005 confirmed the categorization and ruled that a hearing would be necessary because of the complaint cases consolidated with the application. Because much of the proceeding dealt with adjudicatory matters, the Scoping Memo also imposed a ban on ex parte communications.

10. Comments on Proposed Decision

The proposed decision of the ALJ was mailed to the parties pursuant to Pub. Util. Code § 311(d) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed by the parties.[2] The settling parties urge that the proposed settlement be approved, noting that it is supported by two state regulatory agencies, DHS and the Regional Water Quality Control Board, and that "the impact on ratepayers is reasonable, with rates remaining among the lowest, if not the lowest, in the area." (Settling Parties' Comments, at 3.) DRA criticizes the Proposed Decision as a "rush to judgment." (DRA Comments, at 9.) It urges the Commission to reject the settlement, arguing that the $1.98 million buy-in for City of Sacramento water should be surcharged instead of rate-based, and that rate-base treatment of "speculative" litigation recoveries is premature. DRA also

[2] Comments have also been filed by Exxon Mobil Corporation (Exxon), an interested party that did not take part in the hearing in this case. Exxon contests the degree of MTBE contamination in Fruitridge wells, commenting that this is a matter to be determined in Fruitridge's civil suit against Exxon and other oil companies. This decision does not address the degree of MTBE contamination in Fruitridge wells. Exxon takes no position on whether the proposed settlement should be approved.

faults the manner in which the Proposed Decision was modified during the comment period.

There is no rush to judgment in this proceeding that began in October 2005, but there is recognition that public health and fire safety are likely to be affected this summer unless infrastructure is quickly improved. The ratesetting treatment of some of the funds involved in the $12 million settlement package is within the discretion of the Commission in weighing the undisputed benefits of the settlement and acknowledging the give-and-take nature of elements of any settlement. As to the change in the Proposed Decision during the comment period, it is not unusual for a Proposed Decision to be changed as a result of parties' comments. That is the purpose of seeking comments. In this case, settling parties chose to urge a modification to the settlement agreement by way of motion rather than in their comments, and this gave DRA the opportunity to respond to the proposed change.

In reply comments, Assemblymember Jones supports the position of DRA and urges that the Commission conduct a general rate case to determine whether the $1.98 million buy-in fee to City of Sacramento water and a portion of possible pollution recovery should be added to rate base.[3] He acknowledges that some increase in rates "is inevitable" but suggests that the Commission "wait and see" what source of loans, grants and financing agreements are in fact forthcoming before it approves the ratebasing of any funds. (Dave Jones Comments, at 1-2.)

[3] According to the record, the last general rate case for this utility, conducted in the year 2000, took approximately 18 months to complete.

DRA and Assemblymember Jones assume that funds to repair this failing water system will be available even if the settlement is rejected. The record suggests otherwise. Much of the proposed funding by the state and the City of Sacramento and all of the $2 million in developer advances are negotiated terms of the settlement that will shrink or disappear without countervailing commitments by the utility. Public health and fire safety – along with development of low-income housing and new and expanded recreation and business investment – are at risk if the water system is not promptly repaired. A wait-and-see approach to these risks is not in the public interest.

11. Assignment of Proceeding

Geoffrey F. Brown is the Assigned Commissioner and Glen Walker is the assigned ALJ for this proceeding.

Findings of Fact

1. Fruitridge is a privately owned Class B water company regulated by this Commission.

2. Fruitridge has 4,947 service connections in a four-square-mile unincorporated area adjacent to the southern boundary of Sacramento.

3. About 86% of Fruitridge's customers are billed on a flat-rate basis, paying $15.69 per month for unlimited water.

4. The utility's supply of water is met through 17 wells, four of which are inactive because of chemical contamination.

5. DHS on August 29, 2005, cited Fruitridge for failure to maintain adequate pressure in its distribution system.

6. Lack of pressure creates the dangers of a potential health risk for customers and an inability to meet fire flow requirements.

7. DHS ordered Fruitridge to correct its pressure problems and provide additional sources of water supply.

8. Fruitridge on October 7, 2005, filed this application seeking to establish a moratorium on new service connections and authority to impose mandatory rationing until distribution problems could be resolved.

9. Six formal complaints against the utility have been filed by landowners and by the County of Sacramento and the Sacramento Housing and Redevelopment Agency.

10. Fruitridge has supplied "will serve" letters to applicants seeking 550 new connections, but it has advised these applicants of its pending application for a moratorium.

11. At a prehearing conference on December 6, 2005, the parties agreed to meet with ALJ Mediator Cooke to try to resolve the utility's water problems.

12. Following four full-day sessions with all parties and numerous private sessions with the mediator, Mediator Cooke on February 2, 2006 announced that a settlement in principle had been reached by all parties except the DRA.

13. The settling parties are Fruitridge, the Sacramento Housing & Redevelopment Agency, the Housing Authority of the County of Sacramento, the County of Sacramento, David R. and Donna L. Gonzales, Mercy Properties California, Victoria Station LLC, Park Place LLC (Rivendale Project), Saia Motor Freight Line, Inc., Trench Plate Rental Co., and Soccer Planet. While not settling parties, DHS and the Central Valley Regional Water Quality Control Board also support the settlement.

14. The proposed settlement permits compliance with orders of DHS and the Central Valley Regional Water Quality Control Board for the benefit of current

customers and proposes new water sources to serve new development projects in the service territory.

15. The proposed settlement includes two new interconnections for the purchase of water from the City of Sacramento and construction of three new wells and associated infrastructure.

16. Settlement costs of $12 million include $6.3 million in infrastructure costs and $5.7 million associated with buy-in and purchase costs for City of Sacramento water.

17. Upfront funding relies on funds from the DHS Drinking Water Treatment and Research Fund and a new special facilities fee.

18. Developers have agreed to pay special facilities fees, and the County of Sacramento has agreed that it will not grant building permits to developers without payment of the new fees.

19. The City of Sacramento buy-in fee is considered to be plant under utility accounting practice.

20. Approximately $1.98 million for the buy-in fee would be added to rate base at Fruitridge's authorized rate of return of 11%.

21. Under the settlement, ratepayers would pay a surcharge of $2.18 per month to repay a Safe Drinking Water Revolving Fund loan over 20 years.

22. Ratepayers would pay a rate increase of $4.38 per month associated with adding $1.98 million to rate base.

23. For flat-rate customers, the monthly water service rate would increase from $15.69 per month to $22.25.

24. A monthly water rate of $22.25 is generally less than that imposed by the City of Sacramento and most other water districts in the region.

25. If Fruitridge recovers monies from alleged polluters in its pollution litigation, up to $5 million of that recovery would be added to rate base at a 10% return.

26. If and when $5 million is added to rate base through monies recovered in pollution litigation, flat rates for the majority of Fruitridge's customers could increase to approximately $30, depending on the calculation of rate base at the time.

27. DRA opposes the settlement to the extent that it proposes drilling of three new wells and to the extent that it imposes additions to rate base not justified by Fruitridge capital investment.

Conclusions of Law

1. The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

2. The Commission should approve the settlement agreement, as modified, on the basis that the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

3. The Commission should exercise its discretion to authorize an offset rate increase for $1.98 million of the buy-in fee for Fruitridge to receive purchased water from the City of Sacramento.

4. The proposed settlement agreement is reasonable because it constitutes what appears to be the least-cost solution to state compliance orders, resolves the water pressure problems that threaten the health and safety of existing customers, offers additional water to serve new development, provides a schedule and financing plan for implementing the supply solution, and

maintains water rates for customers at a level that continues to be lower than that of most other water utilities in the Sacramento County region.

5. The settlement is consistent with all applicable statutes and does not contravene prior Commission decisions.

6. Fruitridge should be authorized to implement the tariffs set forth in Attachment A to the Settlement Agreement attached hereto and made part hereof as Exhibit 1.

7. If Fruitridge recovers damages from alleged polluters as a result of its pollution litigation, Fruitridge should be authorized to add to rate base up to $5 million of such recovery that has been used for infrastructure improvements.

8. Any addition to rate base attributable to infrastructure improvements through damages awarded in the pollution litigation should earn a return of 10%; provided, however, that nothing in the settlement agreement should preclude the utility from seeking a return on that investment commensurate with a higher return if such higher return is granted in a subsequent rate case.

9. The application and the complaints identified in this proceeding should be dismissed.

O R D E R

IT IS ORDERED that:

1. The motion to approve the "Settlement Agreement for a Comprehensive Solution to the Fruitridge Vista Water Supply Situation" (the Settlement Agreement) that is attached hereto and made part hereof as Exhibit 1 is approved.

2. Fruitridge is authorized to file the tariffs set forth in Attachment A to the Settlement Agreement, as amended.

3. Any addition to rate base up to $5 million attributable to infrastructure improvements through damages awarded in the pollution litigation shall earn a return of 10%; provided, however, that nothing in the settlement agreement shall preclude the utility from seeking a return on that investment commensurate with a higher return if such higher return is granted in a subsequent rate case.

4. Upon approval of the Settlement Agreement, the following proceedings are closed: Application (A.) 05-10-005, Case (C.) 05-10-007, C.05-10-011, C.05-09-011, C.05-09-012, C.05-09-027, and C.05-11-015.

This order is effective today.

Dated _____, San Francisco, California.