

Decision 02-07-009 July 17, 2002

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Arrowhead Manor Water  
Company for a General Rate Increase.

Application 99-10-027  
(Filed October 19, 1999)

Investigation on the Commission's Own Motion  
into the Operations, Practices, and Water Quality  
of the Arrowhead Manor Water Company and to  
Evaluate whether the Utility Properly Handled  
Its Safe Drinking Water Bond Act Surcharge  
Revenues

Investigation 00-03-016  
(Filed March 16, 2000)

Kathleen I. Johnson and Lance L. Johnson, for  
Arrowhead Manor Water Company,  
applicant/respondent.

William J. Peters, for himself; Richard Thomas  
Pretzinger, Jr., for himself; and Kathy Wanser, for  
herself; interested parties.

Susan Weber, Attorney at Law, and David B.  
Anderson, Attorney at Law, for California  
Department of Water Resources, interested party.  
Cleveland Lee, Attorney at Law, for the Commission's  
Water Division.

**OPINION ON GENERAL RATE CASE AND INVESTIGATION**

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## **Summary**

The Commission finds that Arrowhead Manor Water Company, Inc., has been unable or unwilling to adequately serve its ratepayers, and has been unresponsive to the rules and orders of the Commission. The Commission's General Counsel is directed to petition the Superior Court of San Bernardino County to appoint a receiver for Arrowhead's water system in accordance with Public Utilities Code Section 855. The decision authorizes Arrowhead a general rate increase of \$47,815 (16.8%), and reinstates a Safe Drinking Water Bond Act (SDWBA) loan surcharge to replace the surcharge previously discontinued. The general rate increase and SDWBA surcharge are subject to a continuing condition that may result in their cancellation if specified compliance requirements are not met. Arrowhead is found to have improperly diverted SDWBA surcharge funds, but also to have accumulated an approximately equal uncollected balance in its purchased water balancing account; the two amounts are applied to offset and discharge one another. The Commission concludes that all penalties imposed by the California Department of Water Resources (DWR) on Arrowhead for failure to make timely loan payments are Arrowhead's obligations under its DWR contract and are not recoverable from ratepayers.

## **Background**

Arrowhead is Class C water utility providing service to approximately 560 customers in the unincorporated community of Cedar Glen and vicinity, one mile southeast of Lake Arrowhead, San Bernardino County. This is the second decision in a consolidated proceeding addressing an Arrowhead GRC (general rate case) application and a Commission investigation into Arrowhead's operations.

In mid-1997 Water Division dispatched an accountant to conduct an audit of Arrowhead's SDWBA loan and possibly to lay the foundation for an

Arrowhead general rate increase request. In about March 1998 Water Division assigned an engineer and an analyst from its Los Angeles office to begin the informal rate increase process. Those efforts were suspended in mid-1998. Water Division revisited the company in April 1999, and in June resumed with a full financial audit focused on Arrowhead's 1998 income statement and its SDWBA loan. With Water Division's assistance, Arrowhead in September 1999 submitted two draft advice letters seeking a total increase of \$203,266 (131.2%). One advice letter sought the entire GRC increase, and the second only the purchased water component of the overall increase. In October 1999, the Commission issued Resolution W-4167 granting Arrowhead a \$91,342 (57.5%) interim rate increase for purchased water, and Water Division shortly thereafter had Arrowhead's draft advice letter GRC request converted into Application (A.) 99-10-027.

By Interim Decision (D.) 00-07-036, the Commission approved an uncontested settlement agreement proffered by four of the five parties in the proceeding: Arrowhead, the Commission's Water Division, William J. Peters, and Richard Thomas Pretzinger, Jr. Arrowhead was authorized an interim 87.6% general rate increase, which included the 57.5% interim increase authorized earlier for purchased water costs. D.00-07-036 required Arrowhead to establish memorandum accounts for purchased water and for contract repair work and to charge or credit customers at six-month intervals for variations between actual expenditures and amounts allowed in rates. D.00-07-036 resolved all issues related to Arrowhead's GRC except the appropriate net revenue allowance, which the settling parties agreed should be deferred pending resolution of the issues in Order Instituting Investigation (OII, or I.) 00-03-016 in the investigatory phase of the proceeding. By today's decision, the Commission grants

Arrowhead an additional \$47,815 (16.8%) general rate increase, completing its consideration of the GRC issues.

**Table 1**  
**Revenue Requirement Increases**

	Test Year 2000 Revenue Increase	
Arrowhead Total A.99-10-027 Request	\$203,266	131.2%
Interim Purchased Water Increase Granted by Resolution W-4167	91,342	57.5%
Additional Interim GRC Increase Granted by D.00-07-036	41,296	30.1%
Total Interim Increase to Date	132,638	87.6%
Additional Increase by this Decision	47,815	* 31.6%
Total Increase	\$ 180,453	119.2%

\* 31.6% of pre-A.99-10-027 rates, equivalent to 16.8% increase in current rates.

On March 16, 2000, the Commission issued I.00-03-016 to examine allegations of SDWBA improprieties, noncompliance with Commission and California Department of Health Services (DHS) requirements, and failure to resolve customer complaints and inquiries. I.00-03-016 and A.99-10-027 were consolidated and evidentiary hearings set for July in the investigatory phase.

The Assigned Commissioner's April 6, 2000 scoping ruling in the consolidated proceeding's investigatory phase confirmed the Commission's preliminary ratesetting designation and stated the issues to be addressed:

Does Arrowhead have an effective system for receiving and resolving customer complaints and inquiries?

Has Arrowhead complied with applicable laws, and regulations and orders of the Commission and of the Department of Health Services in the provision of a reliable, adequate and healthful water supply to its customers?

Has Arrowhead complied with Commission requirements in collecting, accounting for, preserving, and applying for the benefit of its customers Safe Drinking Water Bond Act loan surcharges included in its rates?

If the Commission determines that Arrowhead has failed to meet its obligations in any or all of these three areas, what action(s) should the Commission take?

Assigned Administrative Law Judge (ALJ) McVicar held a prehearing conference for the investigatory phase on March 27, 2000 and three days of evidentiary hearing July 24 through July 26, 2000, both in Crestline. At the conclusion of those hearings, the ALJ determined that no party had provided reliable figures for several items critical to the investigation, so he directed Arrowhead and Water Division, and invited the other parties, to meet and attempt to reach agreement. Arrowhead and Water Division did reach agreement and filed a joint stipulation with the figures on November 6, 2000 (Attachment A to this decision). The proceeding remained on hold for much of 2001 on a series of optimistic projections that Arrowhead's owner was very near agreement to sell the water system. Four potential buyers were mentioned during that period, but no sale agreement was ever reached.

A second prehearing conference in the investigatory phase was held on October 31, 2001 and one day of evidentiary hearing on January 24, 2002 to update the record. The proceeding was submitted on receipt of concurrent briefs due February 28, 2002.

On May 3, 2002, the Commission staff relayed information that Lance L. Johnson, Arrowhead's only stockholder, the only corporate officer listed in its annual reports to the Commission and manager of the water utility, had passed away on April 30, 2002. We take official notice of Lance Johnson's death notice provided by DHS the following week.

In I.00-03-016, Ordering Paragraph 1, the Commission named as respondents in this investigation both “Arrowhead Manor Water Company, a water corporation, and Lance L. Johnson, an individual having control and management decision making authority in connection with Arrowhead Manor Water Company.” The parties in the proceeding typically did not focus their allegations on Lance Johnson as an individual separate from Arrowhead, and no party has advocated sanctions specific to him. Thus, this decision will focus on Arrowhead, the water corporation, and how it managed and operated its public utility water system.

## **Discussion – Investigatory Phase**

### **Responsiveness to Customer Complaints and Inquiries**

The OII provides a statement of the problem:

The Commission has received numerous complaints from Arrowhead's customers over the years regarding water quality, services, and billing problems. Most customers have attempted to contact the company to resolve their problems directly, but have failed to resolve them because of various reasons, including difficulty in reaching company personnel, no response from the company after leaving messages, delay or no action by the company after contacts were made to fix the problems. Thirty-six informal inquiries or complaints were received by the Commission's Consumer Affairs Branch during the period between June 6, 1998 and March 9, 2000. Apparently, the company has failed to develop effective methods for handling and resolving customers' concerns.

According to the Water Division analyst's declaration attached to the OII, 15 of those 36 Consumer Affairs Branch contacts were service-related, 13 concerned billing, and the remainder were classified as rates and rules, safety, or miscellaneous. At the evidentiary hearings, the analyst testified that the company's position was sustained in six of those 36 cases.

Water Division also presented as witnesses the official responsible for the DHS Drinking Water Program for the central section of California and the DHS district engineer for the San Bernardino District, both of whom had oversight responsibilities for Arrowhead's system. DHS received 54 complaints from Arrowhead customers between 1990 and 1999, and 15 more since 1999. DHS's statistics show that annual complaint levels were relatively low in the early-1990's, climbed to a peak of 23 complaints in 1998, then declined to 14 in 1999 and dropped further in 2000. Approximately half of all Arrowhead customer complaints reaching DHS were for system leaks.

Arrowhead's own 2000 Annual Report to DHS bears out Consumer Affairs Branch's and DHS's figures: Arrowhead reported receiving 102 complaints in 2000. Of those, 59 were for leaks and another 39 related to water pressure or volume.

As troubling as these high complaint levels are, consistent reports of Arrowhead's non-responsiveness to those who complained are equally so. The record is replete with incidents and allegations of failure to return customer complaint calls, make repairs once a customer did reach the company, or respond to DHS calls and letters. William Peters appearing on behalf of himself and many other Arrowhead customers stressed local residents' frustration at their attempts over the years to get Arrowhead to respond to their water problems. Many, he observed, simply give up. This passage taken from a letter DHS wrote to Arrowhead in December 2000<sup>1</sup> illustrates the type of problem DHS has encountered, and is typical of other such DHS letters in the record:

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<sup>1</sup> Exhibit RRB-19, DHS December 22, 2000 letter to Arrowhead.



After receiving the complaints we left messages for you at your phone voice mail and called your staff at your office. We regret we have not received any response to our messages either from you or from your staff. We request you to report back to this office with the findings of your investigation of complaints and appropriate actions you have taken to resolve the problems....

\* \* \*

Please be advised that your continued unresponsiveness may result in potential health risks to your customers....

The Commission has itself experienced Arrowhead's non-responsiveness: In multiple instances, Arrowhead has failed to answer formal Commission complaints filed against it, failed to appear at formal hearings in those complaints, failed to respond to an ALJ's attempts to contact it, and so forth.<sup>2</sup> William Maple, who in D.99-09-056 prevailed in his complaint against Arrowhead, testified without opposition in this proceeding that he first called the company in May 1998 about a leak in front of his house, continued calling at least twice a week through June, and then filed an informal complaint in July 1998. He finally filed a formal complaint with the Commission in December 1998. Arrowhead did not file an answer to the complaint. When it did not respond to subsequent correspondence from the ALJ, the Commission found in Maple's favor by default. Maple testified that Arrowhead had never complied with the Commission's order to repair the leak and the damage it did to the street. He finally repaired the pipe leak himself, and the street was never repaired.

Arrowhead's response to these allegations is threefold. First, Arrowhead maintains the problem is overstated because the statistics its detractors cite

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<sup>2</sup> See D.00-12-022, D.99-09-056, D.98-12-052.

include many complaints for which the company was eventually found not to have been at fault.

Second, Arrowhead maintains that, despite its opponents' characterization of the problem, their real complaint is not (or should not be) that it has an inadequate complaint handling system, but rather that it is overwhelmed by the number of complaints. Arrowhead's water system actually consists of two very different parts, one of which dates back to the 1930's and is in dire need of replacement, and the other a much newer system rebuilt with SDWBA funds in the early 1980's. Over the decades mains in the older section have deteriorated to the point where there are frequent leaks and breaks. Repairs have become extraordinarily difficult because system records are inadequate or nonexistent and valves are lost, buried, or frozen from age. Dirt roads above the lines are constantly being regraded, lessening the cover over mains and making them more susceptible to traffic loading and wintertime freezing. The great bulk of Arrowhead's complaints are caused by these problems in the old system, and it is simply overwhelmed to the point where it is not possible to keep up satisfactorily. As discussed later, Arrowhead accuses the Commission of having kept it in perpetual penury, unable to adequately maintain or upgrade its deteriorating plant.

Third, Arrowhead points to improvements it has made in repairing leaks and handling complaints since this proceeding began. By Resolution W-4167 and D.00-07-036, we granted Arrowhead a combined 87.6% interim rate increase.<sup>3</sup> D.00-07-036 also ordered Arrowhead to establish memorandum

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<sup>3</sup> Note, however, that by I.00-03-016 the Commission also required Arrowhead to stop billing its SDWBA surcharge, which it did effective April 15, 2000. Arrowhead had

*Footnote continued on next page*

accounts for contract repair work and for purchased water and to file advice letters twice a year to seek a billing surcharge or surcredit for the accumulated balances. With a mechanism in place to reimburse it, Arrowhead says, it was finally able to retain qualified contract help with sufficient labor and a backhoe on site to respond to leaks and other problems. Since mid-2000, this has helped it to reduce the number of complaints and respond to them more effectively.

In an effort to demonstrate that Arrowhead does have a well-defined, functional complaint handling system, one of its witnesses described in detail the methods Arrowhead uses to receive, record, dispatch and track complaints. The Water Division staff witness agreed that Arrowhead does have such a system; the problem as he saw it was the need to satisfy those complaints at the utility level so they don't escalate to the Commission (or DHS) level. He also agreed that an important cause of the high number of customer complaints reaching the Commission and DHS may be that many complaints were about things that Arrowhead found impossible to fix.

The evidence does support Arrowhead's contention that its response to leaks has improved since it retained a qualified contractor under the D.00-07-036 memorandum account procedure. For example, DHS noted in its Annual Inspection Report dated October 17, 2001 and accompanying Annual Inspection Letter some progress in repairing leaks and handling complaints, but at the same time DHS also stressed that many problems remain. From the Summary section of that 2001 Annual Inspection Letter:

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been improperly diverting those surcharge receipts, about \$58,000 annually in 1998 and 1999, to help fund ongoing operations.

During the inspection it was noted that since the last Annual Inspection of the Company in 1999, some operational improvements have been made in its water system, namely, the Company is almost up-to-date with the source water quality monitoring and tries to provide of late timely response to the customer complaints. We appreciate your efforts to improve the water system. However, there are still many deficiencies related to operation and maintenance of the system, which need to be addressed....

Peters also acknowledges Arrowhead's improvement in his brief: "It was not until July 2001, with the participation of an outside contractor, Darel Davis, that any real and effective leak repair program took place."

From the evidence, we draw the following conclusions. First, while Arrowhead may take issue with the specific complaint statistics DHS and our staff presented, it is clear that Arrowhead's complaint levels have been unacceptably high. Second, the most significant cause of Arrowhead's customer complaints has been its high incidence of leaks, which is in turn due to the deterioration of the older section of its system. Third, Arrowhead has failed to accept and acknowledge customer complaints, has failed to correct problems reported by customers, has failed to respond to DHS calls and letters, and has failed to cooperate with the Commission's process and orders involving customer formal complaints. Lastly, Arrowhead's performance has improved during the past year, due at least in part to relief granted in the interim decision in this proceeding.

We conclude that there is persuasive evidence in the record to sustain the charge set forth in the OII and quoted at the beginning of this discussion section.

### **Compliance with Health Requirements**

The OII describes the Commission's concerns with Arrowhead's DHS citations:

G.O. [General Order] 103 requires Commission regulated water utilities to comply with the regulations and orders of DHS. Arrowhead has regularly violated DHS health and safety regulations and standards and DHS has cited the company for non-compliance over the years. Presently, DHS has two outstanding citations issued to Arrowhead denoting 35 separate, uncorrected health and safety deficiencies.

The staff declaration and attached DHS documentation presented in the OII were admitted into evidence with supporting testimony. The most recent DHS Annual Inspection Report and Deficiency List available at the time the OII was issued showed that as of June 1999 Arrowhead had approximately 36 uncorrected deficiencies. The OII in fact understated the extent of Arrowhead's citation problems. In February 2000 DHS supplied the following summary:

According to [DHS's] 1998 Annual Inspection Letter dated August 11, [1998,] since 1990 the Department has issued a total of 12 citations to the Company for failure to comply with various regulations and requirements. A review of the available records indicates that the Company has complied with some provisions of the citations, however, not with many others. In addition, the Company has also failed to pay penalties assessed in two citations, which amount to a total of \$5,900 as of November 20, 1995.<sup>4</sup>

At the January 2002 evidentiary hearings, the DHS district engineer updated Arrowhead's compliance status to show that DHS had issued two additional citations, one in May 2001 and another in January 2002, and that Arrowhead had still not fully complied with requirements of four citations from 1998 and earlier. The most recent DHS Deficiency List from the October 2001

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<sup>4</sup> Exhibit RRB-5, Document 5.

Annual Inspection listed approximately 30 current deficiencies. Arrowhead's response to the latest DHS Annual Inspection Letter addressed each deficiency, showing many as having been corrected recently and others to be corrected later this year, and acknowledged that some deficiencies cannot be addressed in the near term absent a large infusion of construction financing. Arrowhead's latest response letter was too recent for DHS to have received and evaluated it in the last evidentiary hearing.

The section chief responsible for DHS's Drinking Water Program for the central section of California described her view of Arrowhead at the July 2000 evidentiary hearing:

I would characterize the Department's dealings with Arrowhead Manor Water Company as one that does not typify our dealings with a public water system. Namely, the Department repeatedly had to request the completion of water quality monitoring, issued citations, issued follow-up citations in some cases with fines to get a suitable response. We have a number of deficiencies that continue to exist with regard to some of the operation and maintenance documents that we have on file for public water systems, and there are a number of outstanding reliability issues that the water company has not yet complied with. The distribution system, as I understand it, is the main problem. It's old. It's deteriorated. But there are just a number of monitoring water quality deficiencies that have just gone on for years and years before they were finally addressed.<sup>5</sup>

Quoting again from the district engineer's November 2001 letter to Arrowhead summarizing the results of DHS's 2001 Annual Inspection:

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<sup>5</sup> RT 332.

We appreciate your efforts to improve the water system. However, there are still many deficiencies related to operation and maintenance of the system, which need to be addressed. A commitment and a plan are required for the Company to be in compliance with the Waterworks Standards and regulations in view of monitoring delinquencies and other deficiencies, identified during the current and previous inspections, for which corrective action should be promptly taken.

In testimony in the January 2002 evidentiary hearings he gave a similarly mixed review:

Based on information available so far, the water currently being served by the Water Company to the public meets federal and State standards and the Water Company generally is up-to-date with monitoring frequency with one exception of lead and copper monitoring in the distribution system....

\* \* \*

An evaluation of the current and past levels of maintenance and operation of the Water Company, and other circumstances and conditions, suggests that the Company's technical, managerial and financial capacity is seriously inadequate to ensure compliance with relevant federal and State regulations and provide a reliable and adequate supply of water at all times, and also to ensure the water supplied does not endanger the health of customers, because of potential risks arising from failure to take timely actions of monitoring and conducting repairs. The Water Company does not have a certified operator, has been seen as too slow to respond, with leaks large and small, going on for months and years without repairs, and thereby wasting precious water resources in the area.<sup>6</sup>

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<sup>6</sup> Exhibit RRB-16, Declaration of Kalyanpur Baliga.

While not in agreement on many counts, Arrowhead does acknowledge its difficulties:

The status of the system and the deficiencies with regard to DHS requirements are clearly stated in the testimony. What's important is not what happened in 1990, but rather what's happened since the Memorandum Accounts were established in mid-2001.<sup>7</sup>

Arrowhead blames its DHS deficiencies on the same factors it cited for leaks and customer complaints: the deteriorating older section of its system, and extreme financial hardship due to lack of rate relief over the past decade. In January 2000 the district engineer summarized DHS's view of Arrowhead's responses to its 1999 Annual Inspection Letter:

[W]e would like to underline one more time that you need to make every possible effort to comply with existing regulations. We can consider a reasonable schedule to correct the deficiencies [and] prioritizing the activities, but non-availability of funds is not a defense of non-compliance. Otherwise you will continue to be in violation of California Safe Drinking Water Act and we will take all necessary enforcement actions to assure compliance with drinking water and water works standards.<sup>8</sup>

DHS does not consider financial hardship an acceptable reason for noncompliance, and neither do we.

The evidence proves that Arrowhead has not complied with DHS's regulations and orders. The Commission's G.O. 103, Section II.1.a. provides,

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<sup>7</sup> Arrowhead Brief, page 8.

<sup>8</sup> Exhibit RRB-5, Document 4.



Any utility serving water for human consumption shall hold or make application for a permit as provided by the Health and Safety Code of the State of California, and shall comply with the laws and regulations of the state or local Department of Health Services.

Thus, failure to comply with DHS requirements also constitutes failure to comply with the orders of this Commission.

We therefore find that Arrowhead has not complied with applicable orders of the Commission and regulations and orders of the Department of Health Services.

### **Compliance with SDWBA Loan Requirements**

As part of its evaluation of Arrowhead's GRC, the Commission staff conducted an audit of Arrowhead's SDWBA accounting practices and entries. That audit identified a number alleged discrepancies, which the OII summarized as:

1. Arrowhead opened a trust account at the beginning of the loan, subsequently abandoned its use and finally, in 1995, closed out the trust account.
2. Arrowhead failed to deposit fully its SDWBA surcharge collections into the trust account or to make the necessary semi-annual loan payments to DWR.
3. Arrowhead failed to account properly [for] the reduction of its tax liability by normalizing the investment tax credit earned on the plant financed by the SDWBA loan.
4. Arrowhead failed to maintain accurate accounting records in tracking its SDWBA loan activities.
5. Arrowhead applied the surcharge collections from customers to uses other than the intended repayment of loan principal and interest.

In this section, we review the record developed in the proceeding to answer the question posed in the OII: Has Arrowhead complied with Commission requirements in collecting, accounting for, preserving, and applying for the benefit of its customers the Safe Drinking Water Bond Act loan surcharges included in its rates?

### **Arrowhead's SDWBA Loan History**

In 1980, the Commission authorized Arrowhead to enter into a \$910,520 loan agreement with DWR under the Safe Drinking Water Bond Act of 1976. That loan provided funds to rebuild a portion of Arrowhead's water system.<sup>9</sup> Arrowhead was authorized a \$64,691 annual customer surcharge (\$58,810 for payments to DWR, plus \$5,881 additional to build a reserve) to accumulate funds to repay the loan principal and interest over 35 years. It was to track surcharge receipts, DWR repayments, and utilized ITC in a balancing account, with any surplus in the account to be refunded or applied on behalf of customers as directed by the Commission. In 1984 the Commission reduced the surcharge to \$50,500 annually<sup>10</sup> because the balancing account had built up a surplus greater than the required reserve fund. The Commission likely approved one or more subsequent surcharge adjustments, but the record here does not reliably reflect them.

In 1988, Lance Johnson and Sally Johnson Hollingsworth<sup>11</sup> purchased Arrowhead.<sup>12</sup> After this point, the record is incomplete and the parties differ on

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<sup>9</sup> D.92178, as corrected by D.92372.

<sup>10</sup> D.84-09-097.

<sup>11</sup> Then Sally Johnson.

what happened. According to Arrowhead, the Johnsons were having cash flow problems and had to take out a loan on their home in 1991 and a Small Business Administration loan in 1993 to make ends meet. The record does show that revenues from the SDWBA surcharge were less than the DWR payment in every year from 1985 through 1992. According to Arrowhead's testimony here, it requested a surcharge increase in June 1990 that was not granted until October 1992. The staff auditor saw things differently: "Right after the [1988 transfer to the Johnsons], DWR raised the interest rate on the SDWBA loan but Mr. Johnson failed to increase his payments [presumably into the trust account] enough to cover the new semi-annual installments."

In either case, the parties agree that from 1995 on, with one exception, Arrowhead made no significant payments to the trust account or DWR, the trust account was closed in 1995, and the bank paid the \$1,783 remaining balance to DWR. The single exception was a \$50,000 lump sum payment Arrowhead made to DWR from company funds in 1998. Arrowhead and Water Division concur that Arrowhead's SDWBA surcharge continued to generate revenues for the company, an average of just over \$60,000 annually between 1995 and 1999. By the time Arrowhead discontinued the surcharge in April 2000 at the Commission's direction in I.00-03-016, Arrowhead had collected \$321,557 more in SDWBA surcharges (including interest) than it had paid out.

There have been several amendments to Arrowhead's SDWBA loan contract over the years, the most recent being Amendment A-4 executed on

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<sup>12</sup> D.88-06-018. Lance Johnson bought out Sally Johnson Hollingsworth's 50% share of Arrowhead in January 1995. Sally Johnson Hollingsworth is no longer associated with Arrowhead, although she did testify on its behalf.

October 20, 2000. As a result of those amendments, the interest rate is now 7.4% per annum on the unpaid balance. DWR's Chief of the Safe Drinking Water Office testified to this summary of the loan status as of December 31, 2001:

**Table 2**  
**SDWBA Loan Status**

Principal from Amendment A-4	\$1,114,919.62
Interest Due through 12/31/01	\$ 165,008.11
Penalty Interest Due through 12/31/01	\$ 49,390.87
Account Balance as of 12/31/01	\$1,329,318.60

Penalty interest, the term DWR uses for late payment penalties, is calculated at 1% monthly on all interest in arrears. Under Amendment A-4, Arrowhead was to have resumed semi-annual payments of \$45,721.77 beginning July 1, 2000, but because the surcharge was discontinued effective April 15, 2000, it has made no additional payments to DWR. As a result, DWR's witness testified that the total amount due to bring the loan current as of January 1, 2002 was \$232,236.92.<sup>13</sup>

#### **Compliance with I.00-03-016**

Ordering Paragraphs 2 through 7 of the OII ordered Arrowhead to take a series of near-term actions to limit any additional harm Arrowhead's accounting practices might be causing. As detailed below, Arrowhead has substantially complied.

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<sup>13</sup> See Exhibits O-8 and O-9. DWR's witness indicated that Table 2 includes an unspecified \$43 correction not reflected in the \$232,236.92 figure.

First, Arrowhead was to file the appropriate tariffs and discontinue billing customers for the SDWBA charge until further order. Arrowhead discontinued SDWBA billing effective April 15, 2000.

Second, Arrowhead was to provide to the Commission accounting documents showing SDWBA surcharge revenues billed, collected and disbursed during 1999. The intent of that order was satisfied by figures in the joint stipulation filed November 6, 2000 by Arrowhead and Water Division.

Third, Arrowhead was directed to “update its Deferred Investment Tax Credit [ITC] account.” When Arrowhead borrowed SDWBA funds in 1981, the Commission by D.92178, Ordering Paragraph 4, required it to “establish and maintain a separate balancing account which shall include all billed surcharge revenue and the value of investment tax credits on the plant, *as utilized*” [emphasis added]. The decision discussion elaborated on the latter qualification: “a balancing account to be credited with revenue collected through the surcharge and *with investment tax credits arising from the plant construction as they are utilized*” [emphasis added]. D.92178 makes no mention of a “Deferred Investment Tax Credit Account,” only this combined balancing account. The staff auditor’s report cites D.92178, Ordering Paragraph 3,<sup>14</sup> as the authority for requiring ITC to be normalized. Rather than normalizing ITC, Ordering Paragraphs 3 and 4 taken together require ITC to be flowed through to ratepayers as it is utilized. The audit report indicates that Arrowhead did not establish such an account.

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<sup>14</sup> “3. As a condition of the rate increase granted herein, applicant shall be responsible for refunding or applying on behalf of customers any surplus accrued in the balancing account when ordered by the Commission.” (D.92178, Ordering Paragraph 3).

Arrowhead argues that it had never had an opportunity to utilize the ITC that was generated because it consistently operated at a loss. Since losses for income tax purposes may be carried forward (“carry-forwards”) as future year deductions and must be used before investment tax credits, any ITC generated would have expired before it could be used. The staff accountant acknowledged that those tax returns he examined showed losses, but he did not necessarily accept Arrowhead’s tax return figures because the IRS had not audited them. Arrowhead’s certified public accountant testified that its SDWBA investment tax credits expired in 1996, and because of its loss carry-forwards, it was exceedingly unlikely that the company had been able to utilize any tax benefit from ITC before then.

We believe that the record supports Arrowhead’s position. While Arrowhead should have been maintaining a balancing account since approximately 1981 showing ITC utilized, it received no benefit from its ITC and ratepayers suffered no losses because of Arrowhead’s failure to track ITC utilized after the present owner purchased the corporation in 1988. All investment tax credits have now expired. There is no longer any ratepayer advantage to reconstructing that account today, and Arrowhead’s scarce financial resources would be better applied in other areas.

Fourth, Arrowhead was to provide a trust or fiscal services agreement acceptable to the Director of the Commission’s Water Division, open a trust account, deposit all SDWBA funds in the company’s possession, and thereafter provide a monthly status report identifying the source of future deposits. According to DWR, Arrowhead executed a new fiscal services agreement with California Bank and Trust Company, Inc., in Sacramento and filed it with DWR on October 24, 2000. DWR approved it on November 9, 2000. The agreement requires Arrowhead to deposit an average of \$7,620.30 per month to meet the

semi-annual principal and interest payments required under the SDWBA loan contract, and an average of \$762.06 per month to create a reserve fund. As of the end of December 2001, the account had a balance of approximately \$1,200. With the SDWBA surcharge having been discontinued, the only deposits being made were small amounts of surcharge funds collected from past due customers and interest on the account, and no payments were being made to DWR.

While its compliance was not in all cases timely, the record shows that Arrowhead has sufficiently complied with Ordering Paragraphs 2 through 7 of I.00-03-016.

### **SDWBA Fund Diversions**

Arrowhead has acknowledged throughout this proceeding that it diverted SDWBA funds to other uses. From its opening statement in the investigatory phase hearing:

Arrowhead Manor Water Company has never hid nor denied that it was forced to use DWR surcharge funds to cover extraordinary purchased water expenses.... In addition, the company owners can demonstrate that they took extraordinary measures... to prevent having to access DWR surcharge monies to solve their cash flow problems. They tried every other source of funds before deciding to use DWR funds to cover purchased water expenses. Each time, it was truly a choice of last resort.

\* \* \*

The Johnsons have co-mingled DWR surcharge funds with operations funds; however, the evidence shows that they did everything in their power to avoid doing so and, short of going bankrupt and/or closing down... there was no other way to keep the water flowing....

It denies, however, closing the trust account established pursuant to its DWR contract and D.92178:

It was at this time [1994-1995] that deposits to the DWR Fiscal Agent Account ended. However, AMWC did *not* close the Fiscal Agent account; in June 1995, the account was closed by the Bank of America and the last dollars in the Reserve Fund were sent to the DWR because the Bank of America went out of the Fiscal Services account business.... [From July 1995 on] there was no Fiscal Agent Account in which to deposit the DWR monies. Instead, they were deposited into a company savings account and accumulated until 1998, when \$50,000 was paid to the DWR.<sup>15</sup>

The March 10, 1995 Bank of America form letter Arrowhead placed in evidence to support this contention indicates otherwise. In it, Bank of America informed its clients that it was pursuing the sale of the businesses in its Institutional Trust and Securities Services Division, and sought to retain its clients' business:

We want you to know that we are seeking experienced trust service providers and encourage you to remain with us until the transaction is complete. During this transition, you will continue to receive the same level of service that is currently being provided. You do not need to take any action. We understand the needs and concerns of our clients, and are dedicated to providing you with consistent and uninterrupted service.

At each step in this proceeding, Arrowhead has consistently attempted to place responsibility for its problems with others. In literally dozens of instances, staff auditors and their supervisors, Water Division managers and staff, the Commission, the company's previous owners and others have all been targets for its allegations of malfeasance, misfeasance or nonfeasance. Assembling the

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<sup>15</sup> Exhibit A-48, emphasis in original.



pieces from the proceeding record, however, provides a more likely explanation for Arrowhead's problems.

In 1988 Lance Johnson and Sally Johnson Hollingsworth purchased Arrowhead with a combination of cash, a promissory note, and long term utility debt. After the purchase, they had payments to the former owners to make and at best limited financial reserves to deal with any unexpected problems that might arise. Although Lance Johnson had management experience with large, municipal water departments, neither of the Johnsons had any experience owning or managing their own company or dealing with legal or regulatory issues. The larger part of Arrowhead's plant was already old and deteriorating when the system was hit with a series of damaging events between 1988 and 1992: several unusual freezes that severely damaged inadequately buried mains and caused hundreds of leaks; and drought conditions that reduced their water supplies and forced them to rely more heavily on purchased water.<sup>16</sup> While they received some rate relief, they weren't sufficiently knowledgeable to pursue additional possibilities and instead went deeper into debt: a personal equity line of credit on their home in 1991 and a Small Business Administration loan in 1993. Arrowhead's representative described in her testimony what happened next:

The Johnsons separated in September, 1993, and Sally Johnson operated the water company office from her new home in San Bernardino from October, 1993, until May, 1995, when she remarried and moved to Colorado. Revenues dropped, mainly due to an enormous amount of accounts receivable as customers took advantage of the office move off the mountain, and expenses increased beyond the rate base in the GRC, approved in February, 1994. During this difficult transition

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<sup>16</sup> See Resolution W-3488, April 11, 1990.

period, the Johnsons both did their best to cope with company issues. However, both field and office efficiency was affected during 1994-5.

It was at this time that deposits to the DWR Fiscal Agent Account ended.<sup>17</sup>

Throughout this difficult period there was another, related factor at work stressing Arrowhead's finances: purchased water expense. In test year 1984, Arrowhead purchased 10 acre-feet of water from Crestline Lake Arrowhead Water Agency (CLAWA) for \$4,800 (\$480 per acre-foot). With leak problems on the old part of the system growing with every passing year, Arrowhead's use and cost of purchased water increased ever more rapidly: to 30 acre-feet and \$19,950 (\$665 per acre-foot) in 1990; to \$33,685 in test year 1993; and most recently to \$132,000 for 115 acre-feet (\$1,150 per acre-foot) in the settlement the Commission approved in its interim D.00-07-036 in this proceeding. The Water Advisory Branch of Water Division has acknowledged the serious threat these rising purchased water costs have posed. In granting a 57.5% interim increase for purchased water, Resolution W-4167 states: "The Branch has reviewed AMWC's request and believes that the increase in purchased water costs the utility has experienced over the last 3 to 4 years [i.e., from 1995 or 1996 through 1999] is a serious threat to the utility's ability to 'make ends meet' and stay in business."

The next section will explain the importance of Arrowhead's purchased water cost as a factor in this proceeding.

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<sup>17</sup> Exhibit A-48.

D.92178 authorized Arrowhead to enter into a specific contract with DWR to borrow SDWBA funds. Together, the decision and DWR contract required Arrowhead to establish and maintain a balancing account to track SDWBA surcharge revenues collected from customers and paid to DWR; to open an account with a financial institution that would serve as a fiscal agent to hold and disburse funds to DWR in repayment of the loan; and to make timely loan payments to DWR as called for in the contract. As a condition of establishing the SDWBA surcharge, the decision put Arrowhead on notice that it would be held responsible for refunding or applying on behalf of customers any surcharge revenues not applied to repaying the loan. Arrowhead acknowledges that it has co-mingled SDWBA surcharge collections with its regular operating revenues rather than depositing them in a trust account; that it has used SDWBA surcharge funds for purposes other than repaying the SDWBA loan; that it has failed to make timely loan payments to DWR as it is obligated to do under the contract; and that it is now unwilling and/or unable to refund to its customers or apply on their behalf those surcharge revenues which were not applied to repaying the loan. In addition, the record shows that Arrowhead caused or allowed its fiscal agent agreement and trust account to be terminated without timely replacement.

The Commission's statement in I.00-03-016 has been tested in this proceeding and found to be accurate; and its admonitions are appropriate to Arrowhead's situation:

Arrowhead apparently rationalizes its position with claims that it had to use surcharge revenues to offset operating losses over the years. This argument is directly contrary to the Commission's longstanding policy and judicial case law which prohibits this form of retroactive rate making. If operating revenues are insufficient to cover operating expenses, it is the

utility's responsibility to request a rate increase to pay for the higher expenses. The diversion of funds from a specially created program for unauthorized purposes violates Commission decisions and mandates. Funds designated for special accounts must be used for the purpose for which they were created. In that way the program's operations and administration can be assessed accurately and the funds channeled properly for use consistent with the program's stated goals. In the present case, Arrowhead is merely a fiduciary conduit for the collection and disbursement of the surcharge revenues under the SDWBA loan contract. Regardless of the physical commingling of surcharge revenues and the utility's operating revenues, surcharge funds have, at no time, belonged to Arrowhead. Use of SDWBA money, other than in the manner prescribed in the loan contract, constitutes a misappropriation of funds.

In the July 2000 evidentiary hearings, ALJ McVicar directed Arrowhead and Water Division, and invited the other parties, to meet and attempt to arrive at a mutually-agreed upon set of figures for the amounts at issue in this proceeding. Arrowhead and Water Division did meet and were able to agree. On November 6, 2000 they filed their joint Motion for Adoption of Stipulation and attached Stipulation, Attachment A to this decision. We have examined their figures in light of the record developed in this proceeding and adopt them for purposes of moving forward. Briefly summarized, Attachment A shows:

Through the first quarter of 2000, Arrowhead had collected from its customers \$321,557 in unremitted SDWBA surcharges, including interest. (Stipulation Appendix A).

Through June 2000, Arrowhead had paid to DWR either directly or through its SDWBA trust account \$800,521. (Stipulation Appendix B).

As of July 1, 2000, Arrowhead owed DWR \$1,114,919.62 in restated loan principal, and \$34,574.01 in delinquent interest penalties. The restated principal has not changed since that time; the delinquent interest penalties are currently due and growing. Interest on the restated principal

amount is 7.4% per annum, or \$41,252.03 semi-annually. (Stipulation Appendix C).

As of August 31, 2000, Arrowhead had a positive purchased water balancing account balance of \$342,812, including interest. (Stipulation Appendix D).

### **Purchased Water Balancing Account**

The largest factor in Arrowhead's A.99-10-027 general rate increase request was its rising purchased water costs. As noted earlier, the Commission by Resolution W-4167 granted Arrowhead an interim \$91,342 (57.5%) rate increase to cover the purchased water component of its overall increase request. That interim increase was made subject to refund depending on the outcome of the GRC in this proceeding, and eventually confirmed in the interim GRC decision (D.00-07-036).

In developing the record for D.00-07-036, it was learned that Arrowhead had received an offset increase for purchased water costs in 1990 and had at that time been ordered to establish a balancing account for purchased water<sup>18</sup> as required by Public Utilities Code Section 792.5.<sup>19</sup> Arrowhead did so, as shown by the fact that it filed an advice letter the following year requesting an additional offset of \$900 annually for purchased water costs and \$2,980 each year for 3 years "to recover an undercollection in the purchased water balancing account."<sup>20</sup> That increase was granted by Resolution W-3560 (May 8, 1991), which again ordered it

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<sup>18</sup> Resolution W-3488, April 11, 1990.

<sup>19</sup> Statutory references are to the Public Utilities Code unless otherwise indicated.

<sup>20</sup> Advice Letter 31, filed March 22, 1991. While AL31 is not in evidence in this proceeding, the same \$2,980 figure can be seen for 1991 through 1994, labeled as "interim increase," in the parties' joint Stipulation filed November 6, 2000.

to maintain a balancing account. Arrowhead apparently received two subsequent increases for purchased water costs<sup>21</sup> with no further mention of the purchased water balancing account.

As described earlier, this was the same period during which Arrowhead's purchased water costs were spinning out of control due to the drought, CLAWA's rising purchased water rates, and Arrowhead's damaged and deteriorating system. Purchased water costs are, in fact, the factor Arrowhead cites for diverting SDWBA surcharge funds: "Arrowhead Manor Water Company has never hid nor denied that it was forced to use DWR surcharge funds to cover extraordinary purchased water expenses...."

In the preceding discussion section, we indicated that we would adopt the figures in the joint Arrowhead and Water Division Stipulation (Attachment A to this decision). We summarized the Stipulation as showing \$321,557 in unremitted SDWBA surcharges, including interest, through the first quarter of 2000, and a positive purchased water balancing account balance of \$342,812, including interest<sup>22</sup> as of August 31, 2000. While coincidental, the near-equality of these figures is striking.<sup>23</sup>

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<sup>21</sup> Resolution W-3826, the test year 1993 GRC, and Resolution W-4167, the 1999 interim purchased water increase discussed here.

<sup>22</sup> For confirmation of the Commission's policy of allowing interest on water memorandum and balancing accounts, see D.94-06-033, the Phase II decision in the Water Risk OIL. Requested recoveries for both memorandum and balancing accounts may also be subject to disallowances should the Commission determine that the amounts tracked were incorrect or unreasonable.

<sup>23</sup> The figures would be more nearly equal if we were to adjust and bring them up to date. Arrowhead discontinued collecting SDWBA surcharges as of April 15, 2000, so the only adjustment needed in the \$321,557 figure would be for interest. The joint Stipulation applies interest to the accumulating balance at the three-month commercial

*Footnote continued on next page*

The parties took opposing positions on whether Arrowhead should receive credit for the undercollection in its purchased water balancing account.

Arrowhead supports full recovery. Peters opposes any recovery. From Peters' brief: "[R]eplenishment of the Purchase Water Account should not fall to the customer base, but be the responsibility of the perpetrator of the loss of vast amounts of water: the company itself." Water Division supports recovery limited to three years:

The Commission should direct a court appointed receiver to collect the under-collection in the balancing account for Purchased Water. [Footnote omitted] The Water Division estimates that for the past three years, which is the period of time allowed under Section 737 of the Public Utilities Code for collecting previously unbilled charges from customers, the under-collection would be \$187,106 as derived in Exhibit RRB-7.

The Commission should order restitution of the missing [SDWBA surcharge funds]. Part of the restitution can come from the surcharges authorized to recover this under-collection....<sup>24</sup>

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paper rate, which had dropped to very low levels in late-2001. Although Arrowhead diverted \$321,557 when this interest rate is used, the amounts owing to DWR because of Arrowhead's failure to maintain its SDWBA loan payments to DWR since 1995 have grown at the higher 7.4% DWR interest rate, and penalties have been accruing at 1% per month on delinquent interest. Interest on the \$342,812 purchased water balancing account balance, on the other hand, would continue to accrue at the three-month commercial paper rate, and there would be no entries relating to new purchased water costs after approximately August 2000 because all such entries should instead have been made to the purchased water memorandum account ordered by D.00-07-036.

<sup>24</sup> Water Division Brief.

Water Division's reliance on Section 737 is misplaced.<sup>25</sup> Section 737 is the three-year statute of limitations for utilities to backbill "lawful tariff charges," but amounts accumulated in balancing accounts and awaiting Commission action are not lawful tariff charges and do not become lawful tariff charges unless and until the Commission authorizes their recovery in rates through inclusion in the utility's tariffs. The Commission has consistently distinguished rate adjustments associated with recovering or refunding balancing account balances from other backward-looking adjustments, ruling that: (a) balancing account related rate adjustments may look no further back than the date the balancing account was established; and (b) the Commission need not be constrained by the retroactive ratemaking provision of Section 728 in making such adjustments.

Under Section 792.5, not only must the Commission require the utility to establish a "reserve account reflecting the balance, whether positive or negative, between the related costs and revenues..." when it authorizes an offset, but the Commission also "shall take into account by appropriate adjustment or other action any positive or negative balance remaining in any such reserve account at the time of any subsequent rate adjustment." Thus, when a balancing account established pursuant to Section 792.5 is involved, the Commission is required to consider whether an adjustment or other action is appropriate with respect to the

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<sup>25</sup> §737: "All complaints for the collection of the lawful tariff charges or any part thereof, of public utilities may be filed in any court of competent jurisdiction within three years from the time the cause of action accrues, and not after, but if a public utility presents its claim or demand in writing to the person from whom the tariff charges, or any part thereof, are alleged to be due within such period of three years, that period shall be extended to include six months from the date notice in writing is given to the public utility, by such person, or refusal to pay the demand, or any part or parts thereof specified in the notice of refusal...."



balance in the account when it sets rates. The Commission is not required to grant offset adjustments in every instance, rather only when it finds them appropriate.

In Arrowhead's case, the Commission has apparently not considered whether a purchased water balancing account adjustment or other action is appropriate since it granted Arrowhead an increase in Resolution W-3560 in May 1991. We will do so in a following section.

### **Discussion – General Rate Case Phase**

This is our second decision in the rate case phase of this proceeding. Before this A.99-10-027 general rate case was filed we issued Resolution W-4167 granting Arrowhead a 57.5% interim increase for purchased water costs. D.00-07-036 approved a settlement agreement among the parties and granted an additional 30.1% to cover the remainder of Arrowhead's operating expenses. Today's decision grants Arrowhead a final \$ 47,815 (16.8%) general rate increase and completes our consideration of the GRC issues. Table 1 in the Background section above summarizes all of the test year 2000 increases.

We also address here whether to continue the purchased water and contract repair work memorandum accounts D.00-07-036 ordered be established.

D.00-07-036 resolved all issues related to Arrowhead's GRC except the appropriate net revenue allowance. The Commission's policy for determining a fair return for Class C and Class D water utilities is to compare the result using the operating ratio method with that using a return on rate base, and to select the one producing the higher net revenue allowance. This is intended to prevent the artificially low rates that otherwise result when a utility has a very low rate

base.<sup>26</sup> When the last evidentiary hearing was held in January 2002, the most recent recommended return range for Class C water utilities was 12.75% to 13.75% on rate base. The standard operating ratio is 20%. Because the great bulk of Arrowhead's plant is SDWBA-financed and thus not included in rate base and the remainder of its plant is highly depreciated, it has a very low rate base. For Arrowhead, the operating ratio method will be used because it produces the higher net revenue allowance.

We adopt Water Division's suggestion that Arrowhead's return be reduced because of its service and SDWBA problems, to 15% from our otherwise-standard 20%. We do not reduce the return further or eliminate it entirely for two reasons. First, SDWBA surcharge revenues aside, it is clear that the company has suffered grave losses in its operations in recent years. Water Division's own figures<sup>27</sup> showed Arrowhead losing an estimated \$106,000 in test year 2000. This is extraordinary for a small water utility with only \$78,000 in rate base. Arrowhead claims to have suffered a string of operating losses in years past as well, a claim no party tested and one we find credible. Second, as described in the section to follow, we intend to deal separately with Arrowhead's well documented service and SDWBA problems. It would thwart our efforts there to deny a reasonable net revenue allowance in the GRC.

The adopted Summary of Earnings for test year 2000 is Attachment B to this decision. Attachments C, D and E are the new tariff sheets, a comparison showing how typical customers' bills will be affected by the new rates, and the adopted quantities to be used for future ratemaking purposes.

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<sup>26</sup> See D.92-03-093, the Phase I decision in the Water Risk OII.

<sup>27</sup> See Appendix A to the adopted settlement in D.00-07-036.

We will also require Arrowhead to continue until further order using the memorandum accounts for purchased water and contract repair work we ordered established in D.00-07-036. The purchased water memorandum account remains advisable from the standpoints of both the company and its ratepayers because it requires Arrowhead to come in every six months to true up the accumulated under or overcollections.<sup>28</sup> That allows the Commission to catch problems more quickly, and more timely trues up Arrowhead's purchased water cash flow. We retain the contract repair work expense memorandum account because the record shows it has given Arrowhead the incentive and ability to pursue critical leak repairs quickly, which improves service and should save ratepayers money in the longer term. It also serves as a safety net against unexpected major repairs for Arrowhead today and an attractive feature for any prospective system receiver or buyer tomorrow.

#### **Discussion – Corrective Measures**

The final issue to be addressed is stated in the Assigned Commissioner's scoping ruling in the investigatory phase:

If the Commission determines that Arrowhead has failed to meet its obligations in any or all of these three areas [responsiveness to complaints and inquiries; compliance with health requirements; and compliance with SDWBA requirements], what action(s) should the Commission take?

Arrowhead believes that it should be granted a full return in its GRC using a 22% operating ratio; the SDWBA surcharge should be reinstated; the purchased water balance should be used to cancel out diverted SDWBA funds and any

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<sup>28</sup> While not stated in D.00-07-036, as long as it remains in effect the purchased water memorandum account effectively supersedes new entries to Arrowhead's longstanding purchased water balancing account.

excess used to make plant improvements; and the purchased water and contract repair memorandum accounts should be continued. Arrowhead would have the Commission and its staff assist it in its negotiations with DWR to reduce the SDWBA loan principal and forgive penalties; would have staff meet with all potential buyers to help expedite a sale of Arrowhead's system; and would have staff assist it with DHS to expedite approvals for new SDWBA loans.<sup>29</sup>

Water Division advocates reducing or eliminating Arrowhead's return in the GRC; seeking a court-appointed receiver for Arrowhead's system; allowing the receiver to collect from customers the undercollections accruing in the purchased water balancing account for the past three years only; recovering from Arrowhead the diverted SDWBA surcharge funds, less credit for three years worth of purchased water balancing account amounts; making Arrowhead responsible for all SDWBA loan penalties; and continuing the memorandum accounts only until a receiver is appointed.

Peters advocates denying Arrowhead any further rate increase and any recovery of the purchased water balancing account deficit; and placing the system in receivership. He might not object to future rate increases if the system were put under different management.

DWR seeks to persuade the Commission to require immediate reinstatement of the SDWBA surcharge and resumption of payments on all loan principal, interest and penalty amounts; and views receivership as the most appropriate means of achieving those goals.

Wanser favors receivership and objects to rate increases of any type.

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<sup>29</sup> Arrowhead included in its brief new, purportedly factual material not in evidence. That material will be disregarded in this decision.

Pretzinger signed the interim GRC settlement agreement, but did not participate further in either the GRC or the investigation.

We begin with the presumption that the various transgressions for which we find Arrowhead responsible were not due to its owners' dishonesty, but rather to their inability to cope with the challenges inherent in running a small water utility. Lance Johnson and Sally Johnson Hollingsworth through 1995, and Lance Johnson alone after that, were those owners, and both were deeply involved in the management and day to day operations of Arrowhead's water system. The evidence shows that they were the individuals responsible for those transgressions during their tenure, and both are now gone. The record also demonstrates that Arrowhead's water system suffers from, among other things, a lack of as-built plant records. Without adequate records, it is very difficult to locate mains, service connections, shutoff valves and the like to make repairs. By virtue of having lived and worked with the system since 1988, Lance Johnson knew it better than any other individual. Despite his management shortcomings, Arrowhead's water system will be more difficult to operate without him in the near future, not less.

In opening this investigation, we stated,

In this investigation, we shall consider whether existing circumstances warrant the filing of a petition pursuant to section 855 of the P. U. Code seeking the appointment of a receiver for the water system or whether further proceedings are needed to consider other remedies.

Every party has stated its belief that the best long-term solution would be the sale of Arrowhead's system to a willing and capable buyer. All except

Arrowhead would support putting the system into receivership<sup>30</sup> if no buyer were forthcoming. Arrowhead's representative has repeatedly stressed the company's strong desire to sell the water system and, as we noted earlier, has held talks with at least four potential buyers in late-2000 and 2001. Despite its optimistic predictions and the extra time it was given in the proceeding to pursue that purpose, Arrowhead was never able to close a deal. It believes the reason is clear: "[T]he zero rate of return has been the single most important deterrent to achieving the primary goal of all Parties, the sale of AMWC to a larger operating company." Nonetheless, it still believes a sale is possible: "We urge the Commission to recognize the advances AMWC has made in the last year and allow us to go forward to improve the system and remove the uncertainties that have prevented us from being able to complete a sale to a larger agency or company. That is our goal." <sup>31</sup>

We also would have preferred a sale to putting Arrowhead's system into receivership. Petitioning the Superior Court for the appointment of a receiver is a serious step, one that sets the Commission and the company on a potentially litigious path demanding scarce resources that would be better used to promote service and facilities improvements. It is not a step we take lightly. Nor could the Commission be assured of finding a willing and highly qualified operator; no party in the proceeding nominated a candidate who seems sure to be both qualified and willing. With no voluntary sale on the horizon, however, we are

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<sup>30</sup> Pretzinger's position is unknown, since he did not participate in the investigatory phase.

<sup>31</sup> Exhibit A-105.

compelled to take the steps we outline below to put Arrowhead's water system on the path to recovery.

First, based on our findings above in the investigatory phase of the proceeding, we conclude that Arrowhead has been unable or unwilling to adequately serve its ratepayers, and that it has been unresponsive to the rules and orders of the Commission. We will direct the Commission's General Counsel to petition the Superior Court of San Bernardino County to appoint a receiver for Arrowhead's water system, in accordance with Section 855.

Second, we note that the Arrowhead water system is in dire need of rehabilitation. To accomplish that, future rates will need to be higher than those we authorize today, and that will remain true regardless of whether the future operator is Arrowhead, a new owner, or a receiver. Our decision to begin strengthening the rate structure now by authorizing a return based on a 15% operating ratio is explained in the general rate case discussion section above. Maintaining artificially low rates to penalize Arrowhead would promote additional rate shock for customers later and make capable buyers less willing to consider a purchase. In addition, any receiver that may be appointed will need a strong cash flow to overcome the neglects of the past decade and longer.

Third, we reinstate a SDWBA surcharge. Our suspension in I.00-03-016 has served its purpose: to halt the diversion and allow time to develop an evidentiary record leading to this order. No party wishes to see DWR's late payment penalties increase further. We expect Arrowhead or its receiver to meet with DWR to attempt to work out a new loan amendment that will recapitalize back interest (but not penalties, which are to remain an Arrowhead obligation not recoverable from ratepayers) and take into account the time necessary for Arrowhead's new surcharge to build up sufficient funds to resume regular payments.

We will assign our Water Division in its advisory role to designate an experienced staff person as a liaison to be in frequent contact with the system's management over the next year, and longer if necessary. The staff liaison should have substantive telephone discussions with company management no less frequently than monthly, and should be receptive to any information Arrowhead's customers, DHS, DWR, and the other parties may wish to convey. We are particularly sensitive to ensuring that Arrowhead complies with our orders regarding its SDWBA loan surcharges, payments and penalties. The Water Division staff liaison should pay particular attention to obtaining *positive confirmation every month* that funds collected by the surcharge are being deposited in the trust account, and that DWR is timely receiving scheduled payments in full. Water Division management will keep us informed and suggest for our consideration any follow-up actions that may be necessary.

As an added level of assurance that surcharge collections will be applied as intended, we will include a provision that causes the GRC increases and SDWBA surcharges we authorize today to expire automatically on February 15, 2003 if not sooner extended. This is 45 days after the January 1, 2003 DWR payment is due. Arrowhead will be authorized to submit an advice letter not sooner than the date the payment is actually made and not later than January 31, 2003 (i.e., 30 days after the payment is due) to reset the clock for an additional six months (i.e., a new expiration date 45 days after the July 1, 2003 payment is due), after which the advice letter extension process is to be repeated for each subsequent payment due date until further order of the Commission. Those advice letters are to become effective upon Water Division's confirmation with DWR that DWR has received the corresponding payment in full. Since the contract is between Arrowhead and DWR, repayment of the loan is Arrowhead's legal obligation; a claim of shortfall in surcharge funds collected



or of funds in the reserve account will not be considered justification for non-payment or partial payment, or for late payment beyond the 30-day grace period Arrowhead's contract with DWR allows before penalties are applied. We will consider in a future decision, perhaps when we authorize a transfer of control of Arrowhead's system, or after a receiver has been appointed, whether to discontinue this provision.

We recognize that these second and third measures mean real and significant rate increases for customers, but bringing the Arrowhead water system into compliance with Commission and DHS orders and the DWR contract requires the funds they will generate. With Lance Johnson gone, control of Arrowhead, and thus its water system, will change. The record does not indicate who is managing the company on an interim basis in Lance Johnson's absence. Whoever ultimately assumes control must not be handicapped going forward.

Fourth, we find that Arrowhead should receive credit for an undercollection in its purchased water balancing account; that Arrowhead should be held liable to its customers for the full amount of past SDWBA surcharge revenues collected from customers and not applied toward the SDWBA repayments for which the SDWBA surcharge was authorized; and that the two amounts are, to the extent they can be determined, approximately equal and offsetting. For our determination that they are equal and offsetting, we rely only in part upon the figures Arrowhead and Water Division present in their November 6, 2000 Motion for Adoption of Stipulation and its attached Stipulation. While we grant the motion, we accept the figures only as a starting point. We note that we have not had the opportunity to apply the same level of scrutiny to the water balancing account figures that they would have received had Arrowhead been submitting claims more frequently. Also, we note that the

three-month commercial paper rate has been applied as the interest rate for both the diverted funds and the balancing account. While that is our standard rate for many purposes and not an unreasonable rate to use here, we also note that SDWBA interest has been accumulating at the 7.4% SDWBA loan rate DWR has applied from 1989 forward, not the three-month commercial paper rate. If we were to apply the 7.4% rate after 1989, the final figure for SDWBA funds diverted would be higher and even more nearly equal to the balancing account shortfall. Thus, we find the stipulated figures are reliable for our purpose here, but given these considerations and how near to equal they are, not sufficiently certain to justify ordering a rate surcharge or surcredit based on any small arithmetic difference there may be between them.

Fifth, we find that Arrowhead alone should be responsible for all penalties, past, present and future, generated under its SDWBA loan contract with DWR. Those are not obligations of Arrowhead's ratepayers and are not reasonably recoverable in future rates. As Arrowhead points out on brief in an attempt to deflect responsibility for its penalties,

This loan is between AMWC and the DWR, not the CPUC. Furthermore, our customers should not be penalized for additional penalties imposed by the agency responsible to protect their interests or by penalties resulting from the Commission terminating the customer surcharge for a two-year period of time.

Arrowhead at one point urged the Commission to require DWR to cancel the penalties, but as DWR's attorney correctly informed Arrowhead's representative in our hearings, "[T]he Commission doesn't have that kind of authority over DWR to instruct us what to do with our loan program." Late in the proceeding, Arrowhead modified its request to having the Commission and its staff assist it in its negotiations with DWR to reduce the SDWBA loan

principal and forgive penalties. While DWR's forgiving Arrowhead's penalties could hasten the company's financial recovery and ultimately benefit DWR by making full repayment of the loan principal and interest more likely, we leave those negotiations up to the contracting parties: "This loan is between AMWC and the DWR, not the CPUC."

Should Arrowhead or its receiver be successful in negotiating a sale of the system before all penalties are discharged, we will expect the sales agreement to include a provision for paying any remaining penalties from the sale proceeds or, if the proceeds are less than the penalties, an explicit acknowledgment from a financially capable buyer that it alone is accepting the obligation for the penalties and that they are not recoverable in future rates.

Sixth and lastly, we will order Arrowhead to prepare and submit to the Commission's Water Division within nine months a comprehensive, long-range plan for system infrastructure and operational improvements. The plan is to include cost estimates and identify sources of funding. If low interest rate state funding is not available, we expect the plan to identify realistic, alternative sources. If Arrowhead is unable to obtain financing, we will take that as an additional indication of financial inability or unwillingness to adequately serve its ratepayers. Regardless of its past difficulties, from today forward we expect and will require Arrowhead to engage in a proactive program of infrastructure, service and health compliance improvement measures.

### **Comments on Proposed Decision**

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

Peters supports the proposed decision as written, and urges the Commission to move swiftly to remove Arrowhead's current management.

Water Division also supports the decision as written, but would have the Commission add language stating that any penalties levied by DHS, or by any other state regulatory agency, are Arrowhead's obligations and may not be recovered from its ratepayers. Other than our discussion of penalty interest levied by DWR, this is a new topic not previously addressed in the proceeding record. We note that the rates we approve today do not include recovery of any such penalties, and the Commission would have to approve any future rate increase requests based on the record developed at that time. It is not necessary or helpful to add the statement Water Division seeks.

Arrowhead uses its comments as an opportunity to reargue its position based on new, untested information not in evidence in the proceeding. It does attempt to make two points that, as the rules require, "focus on factual, legal or technical errors in the proposed decision." First, Arrowhead implies that the proposed decision errs by stating that the SDWBA loan contract requires that Arrowhead be held responsible for refunding or applying on behalf of customers any surcharge revenues not applied to repaying the loan. In fact, that provision is not in the SDWBA loan document, nor does the draft decision state that it is. Rather, as the proposed decision notes in two places, it was the Commission's D.92178 (in Ordering Paragraph 3) that imposed that condition in approving the SDWBA loan. Second, Arrowhead submitted figures attempting to show that the SDWBA surcharge rates we approve and set forth in Attachment C are not high enough to generate the revenue Arrowhead will need to make its semiannual payments to DWR. We have evaluated the figures Arrowhead submitted in its comments and found a major error in the number of metered customers it assumed. We have rechecked our figures and they are correct.

Only minor changes to correct typographic errors have been made in the proposed decision.

**Findings of Fact**

1. Arrowhead is a California corporation. The late Lance L. Johnson was its only stockholder.
2. No party in this proceeding has advocated sanctions specific to Lance L. Johnson as an individual.
3. The number of complaints made by Arrowhead customers to the Commission and to DHS since 1990 has been unacceptably high.
4. Arrowhead's customer complaint levels have gone down since 1999, but are still at unacceptably high levels.
5. Arrowhead has frequently failed to return customer complaint calls, to make repairs once a customer did reach the company, and to respond to DHS calls and letters.
6. Arrowhead does have a system for receiving, recording, dispatching and tracking customer complaints, but has nonetheless not been effective in handling and resolving those complaints..
7. Arrowhead has failed to cooperate with the Commission's process and orders involving customer formal complaints.
8. Arrowhead has not been sufficiently responsive to its customers, DHS, and the Commission.
9. More of Arrowhead's customer complaints are due to system leaks than to any other cause. Arrowhead's high incidence of system leaks is a result of the deteriorated condition of the older section of its system.
10. Arrowhead's leak repair performance, and its responsiveness to customers' leak repair complaints, has improved during the past year, due at

least in part to rate relief and the memorandum accounts ordered in the interim decision in this proceeding.

11. The most recent Deficiency List from the DHS October 2001 Annual Inspection of Arrowhead's system listed approximately 30 current health-related deficiencies.

12. DHS has cited Arrowhead numerous times for failure to comply with various health-related regulations and requirements. Arrowhead has still not complied with the requirements of at least four of those citations.

13. Many, but not all, of Arrowhead's health-related deficiencies cannot be corrected without a large infusion of construction financing. Arrowhead has not been able to obtain the needed financing.

14. Financial hardship is not an acceptable reason for noncompliance with health-related requirements.

15. Arrowhead has not complied with applicable health-related orders of the Commission and regulations and orders of the Department of Health Services.

16. After Lance Johnson purchased Arrowhead in 1988, Arrowhead received no benefit from its ITC arising from SDWBA plant construction, and ratepayers suffered no losses because of Arrowhead's failure to track ITC utilized in a balancing account. All investment tax credits have now expired. There is no longer any ratepayer advantage to reconstructing that account today, and Arrowhead's scarce financial resources would be better applied in other areas.

17. Arrowhead has executed a new fiscal services agreement and opened a trust account with California Bank and Trust Company, Inc., in Sacramento. DWR approved that agreement on November 9, 2000.

18. Revenues from Arrowhead's SDWBA surcharge were less than the annual DWR payments in every year from 1985 through 1992.

19. Arrowhead caused or allowed its fiscal services agreement and trust account to be terminated in 1995 without timely replacement. The bank paid the \$1,783 remaining balance to DWR.

20. From 1995 on, with one exception, a \$50,000 lump sum payment Arrowhead made to DWR from company funds in 1998, Arrowhead made no significant payments to an SDWBA trust account or to DWR.

21. Arrowhead's SDWBA surcharge continued to generate revenues for the company between 1995 and 2000. By the time Arrowhead discontinued the surcharge in April 2000 at the Commission's direction in I.00-03-016, Arrowhead had collected \$321,557 more in SDWBA surcharges, including interest at the three-month commercial paper rate, than it had paid out.

22. Arrowhead co-mingled SDWBA surcharge revenues with its regular operating revenues rather than depositing them in a trust account, and used those SDWBA surcharge revenues for purposes other than repaying the SDWBA loan.

23. Arrowhead has been unwilling and/or unable to refund to its customers or apply on their behalf those surcharge revenues which were not applied to repaying the loan.

24. Arrowhead and Water Division have stipulated to a set of figures, Attachment A to this decision, defining certain amounts at issue in the investigation. Their figures are suitable for our purposes in this proceeding.

25. On April 11, 1990 the Commission issued Resolution W-3488 granting Arrowhead an offset increase for purchased water expense, and ordered Arrowhead to establish a purchased water balancing account. Arrowhead did so.

26. The Commission has not since Resolution W-3560 in May 1991 considered whether an adjustment or other action is appropriate with respect to the balance in Arrowhead's purchased water balancing account.

27. Arrowhead has suffered financial losses in operating its water system in recent years.

28. Arrowhead's water system is in need of rehabilitation.

29. Arrowhead's owners since 1988 have been unable to cope with the challenges inherent in running a small water utility.

30. The best long-term solution for Arrowhead's service, health, and SDWBA problems would be the voluntary sale of Arrowhead's system to a willing and capable buyer. If no such sale were forthcoming, the next best solution would be putting its water system into the hands of a capable receiver.

31. Whoever manages Arrowhead's water system will need a strong cash flow to overcome the neglects of the past decade and longer.

32. Penalizing Arrowhead for its service, health, and SDWBA problems by further reducing or eliminating its net return would lead to degraded service, more severe operating problems, greater rate shock for customers in the future, greater problems for any receiver that might be appointed, and a lower likelihood that Arrowhead could transfer its water system to a willing and qualified buyer.

33. It is reasonable to grant Arrowhead a general rate increase which includes a net return derived using a 15% operating ratio.

34. The purchased water memorandum account and contract repair work memorandum account provisions of D.00-07-036 have been beneficial to both Arrowhead and its customers. Both would benefit by extending those provisions.



35. Our order in D.00-07-036 that Arrowhead stop billing SDWBA surcharges has served its purpose: to halt the diversion of SDWBA revenues and to allow time to develop an evidentiary record leading to this order.

36. The longer Arrowhead's SDWBA surcharge is suspended, the greater will be the interest and penalties that accumulate on its SDWBA loan.

37. Both Arrowhead and its customers would benefit by reinstating SDWBA surcharges and resuming SDWBA repayments to DWR, provided that Arrowhead is properly monitored to ensure the funds collected are put to the use intended.

38. The SDWBA surcharges included in the tariffs in Attachment C to this decision are reasonable and necessary to allow Arrowhead to resume making payments on its SDWBA loan, and to accumulate the two-payment reserve fund over the next ten years that Arrowhead's SDWBA contract with DWR requires.

39. The figures Arrowhead and Water Division have agreed to in their Motion for Adoption of Stipulation are sufficiently reliable for our purposes here, but given the considerations discussed in this decision, not sufficiently certain to justify ordering a rate surcharge or surcredit based on any small arithmetic difference there may be between them.

40. Arrowhead should receive credit for an undercollection in its purchased water balancing account. Arrowhead should be held liable to its customers for the full amount of past SDWBA surcharge revenues collected from customers and not applied toward the SDWBA repayments for which the SDWBA surcharge was authorized. The two amounts are, to the extent they can be determined, approximately equal and offsetting.

41. It would be unreasonable to allow Arrowhead to recover in rates any late payment penalties imposed by DWR.

42. To achieve full compliance with service and health requirements, Arrowhead will need a comprehensive, long-range plan for system infrastructure and operational improvements.

43. The revised rates authorized in this decision are reasonable, and the rate increases are justified.

44. Requiring the GRC increases and SDWBA surcharges we authorize today to expire automatically 45 days after each SDWBA loan payment is due if DWR not has received payment in full by 30 days after the due date, as described in the body of this order, will provide needed assurance that SDWBA surcharges are applied as intended.

45. The summary of earnings presented as Attachment B to this decision and the quantities included in Attachment E are reasonable for ratemaking purposes.

### **Conclusions of Law**

1. The Commission's G.O. 103 requires Commission-regulated water utilities to comply with the laws and regulations of the state or local Department of Health Services. Arrowhead's failure to comply with DHS requirements constitutes failure to comply with the orders of this Commission.

2. Arrowhead is in compliance with Ordering Paragraphs 2 through 7 of I.00-03-016.

3. D.92178 required Arrowhead to establish and maintain a balancing account to include SDWBA surcharge revenues and the value of ITC it was able to utilize on SDWBA plant. Ordering Paragraphs 3 and 4 of D.92178 required ITC on SDWBA plant to be flowed through to ratepayers as it was used.

4. D.92178 authorized Arrowhead to enter into a specific contract with DWR to borrow SDWBA funds. Together, the decision and DWR contract required Arrowhead to establish and maintain a balancing account to track SDWBA surcharge revenues collected from customers and paid to DWR; to open a trust

account with a financial institution that would serve as a fiscal agent to hold and disburse funds to DWR in repayment of the loan; and to make timely loan payments to DWR as called for in the contract. As a condition of establishing the SDWBA surcharge, the decision put Arrowhead on notice that it would be held responsible for refunding or applying on behalf of customers any surcharge revenues not applied to repaying the loan.

5. By abandoning the use of its SDWBA trust account and later closing that trust account without replacing it; by failing to deposit all of its SDWBA surcharge collections into the trust account and failing to make the necessary semi-annual loan payments to DWR; and by applying the SDWBA surcharge collections from customers to uses other than repaying loan principal and interest, Arrowhead violated the Commission's requirements set forth in D.92178 and the DWR contract the Commission approved in that decision.

6. The three-year statute of limitations set forth in Section 737 for utilities to backbill lawful tariff charges does not apply to amounts accumulated in balancing accounts and awaiting Commission action, because those amounts are not lawful tariff charges and do not become lawful tariff charges unless and until the Commission authorizes their recovery in rates through inclusion in the utility's tariffs.

7. Section 792.5 requires the Commission to consider whether an adjustment or other action is appropriate with respect to the balance in Arrowhead's purchased water balancing account when it sets Arrowhead's rates.

8. Arrowhead has been unable or unwilling to adequately serve its ratepayers, and has been unresponsive to the rules and orders of the Commission. The Commission's General Counsel should be directed to petition the Superior Court of San Bernardino County to appoint a receiver for Arrowhead's water system, in accordance with Section 855.

9. Arrowhead should be authorized to resume collecting an SDWBA surcharge, provided that Arrowhead is properly monitored to ensure that the funds collected are put to the use intended.

10. The Commission is not a party to Arrowhead's SDWBA loan contract with DWR.

11. Arrowhead's SDWBA loan contract with DWR does not contain provisions allowing Arrowhead to delay or miss payments because Arrowhead for any reason has insufficient funds available.

12. All penalties imposed by DWR on Arrowhead for failure to make timely loan payments are Arrowhead's obligations under its DWR contract. They are not incurred to benefit ratepayers and should not be recovered from ratepayers.

13. The Commission lacks jurisdiction over DWR.

14. Arrowhead should be required to prepare and submit to the Water Division a comprehensive, long-range plan for system infrastructure and operational improvements, as described in the body of this decision.

15. Inability to obtain financing for needed improvements is an indication that a water utility is unable to adequately serve its ratepayers.

16. Arrowhead should be authorized to file the revised tariffs in Attachment C to this decision.

17. This order should be made effective today so that Arrowhead can implement a program of infrastructure, service and health compliance improvement measures as soon as possible.

**O R D E R**

**IT IS ORDERED** that:

1. The November 6, 2000 Motion for Adoption of Stipulation filed by Arrowhead Manor Water Company, Inc., (Arrowhead) and Water Division is granted. The Stipulation, Attachment A to this decision, is adopted for the purposes described in the body of this decision.
2. Arrowhead is authorized to file in accordance with General Order 96 Series and make effective on not less than five days' notice the tariff sheets in Attachment C to this decision. The revised rates shall apply to service rendered on and after their effective date. The corresponding existing sheets shall not be canceled, but shall remain in Arrowhead's tariffs for use if and when the new sheets expire.
3. The general rate case increases and Safe Drinking Water Bond Act (SDWBA) loan surcharges authorized in this order shall expire automatically 45 days after each semi-annual California Department of Water Resources (DWR) loan payment is due, if not extended. Arrowhead is authorized to submit an advice letter not sooner than the date the payment is actually made and not later than 30 days after the payment is due to reset the expiration clock for an additional six months (i.e., a new expiration date 45 days after the next semi-annual payment is due), after which the process shall be repeated for each subsequent payment due date until further order of the Commission. Those advice letters shall become effective upon Water Division's confirmation with DWR that DWR has received the corresponding semi-annual payment in full.
4. The full current balance due to Arrowhead from past undercollections in its purchased water balancing account is hereby offset against the full current balance of SDWBA surcharge revenues Arrowhead has collected from customers

and did not apply for the purpose intended. As a result, Arrowhead's purchased water balancing account balance shall be reset to zero; and its debt to customers for having diverted SDWBA surcharge revenues is discharged. This ordering paragraph does not relieve Arrowhead of any obligation to DWR arising under their SDWBA loan contract, including its obligations to repay principal, interest, and penalty amounts. This ordering paragraph also does not convey to Arrowhead a right to retain for itself any amounts currently in its SDWBA trust account.

5. Arrowhead shall continue to maintain until further Commission order the purchased water memorandum account and the contract repair work memorandum account required in Decision (D.) 00-07-036. The previously established conditions and procedures relating to those accounts shall continue to apply.

6. The summary of earnings presented in Attachment B to this decision and the quantities included as Attachment E are adopted.

7. The requirement set forth in D.92178, Ordering Paragraph 4, to track the value of investment tax credits on SDWBA construction as utilized is canceled. Arrowhead shall comply with Ordering Paragraph 3, Ordering Paragraph 4 as modified, and Ordering Paragraph 5 of that decision.

8. The Commission's General Counsel is directed to petition the Superior Court of San Bernardino County to appoint a receiver to assume possession of and operate Arrowhead's water system, in accordance with Public Utilities Code Section 855.

9. Within nine months of the effective date of this decision Arrowhead shall prepare and submit to the Commission's Water Division a comprehensive, long-range plan for system infrastructure and operational improvements. The plan shall include cost estimates and identify sources of funding. If low interest rate

state funding is not available, the plan shall identify realistic, alternative sources.

If Arrowhead is unable to obtain financing, that may be taken as an additional indication that it is financially unable or unwilling to adequately serve its ratepayers.

10. Application 99-10-027 and Investigation 00-03-016 are closed.

This order is effective today.

Dated July 17, 2002, at San Francisco, California.

LORETTA M. LYNCH

President

HENRY M. DUQUE

CARL W. WOOD

GEOFFREY F. BROWN

MICHAEL R. PEEVEY

Commissioners



# ATTACHMENT A

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF  
CALIFORNIA**

Application of Arrowhead Manor  
Water Company for a General Rate  
Increase.

A.99-10-027

Investigation on the Commission's own  
motion into the operations, practices,  
and water quality of the Arrowhead  
Manor Water Company and to  
evaluate whether the utility properly  
handled its Safe Drinking Water Bond  
Act Surcharge Revenues

I.00-03-016

**STIPULATION**

1. The parties to the Stipulation ("Parties") are the Ratepayer Representation Branch ("RRB") of the Water Division and the Arrowhead Manor Water Company ("AMWC").
2. The Parties agree that no signatory hereto nor any member of the staff of the Public Utilities Commission assumes any personal liability as a result of the Stipulation. The Parties agree that no legal action may be brought in any state or federal court, or in any other forum, against any individual signatory representing the interests of the Parties, RRB, or its attorneys, or the RRB itself regarding the Stipulation. All rights and remedies are limited to those available before the California Public Utilities Commission.
3. The Parties acknowledge that RRB is charged with representing the interests of customers of public utilities in the State of California, as required by Public Utilities Code Section 309.5, and nothing in the Stipulation is intended to limit the ability of RRB to carry on that responsibility.

4. The Parties agree to fully support this Stipulation inasmuch as their negotiations have resulted in the resolution of the following issues raised with respect to the Commission's investigation as shown in the attached appendices:

- APPENDIX A The amount collected from customers by surcharges to repay AMWC's loan it received under the Safe Drinking Water Bond Act (SDWBA), the amounts paid into the trust account where the funds were deposited and payments made directly to Department of Water Resources (DWR) by AMWC, and the amounts unremitted with and without interest.
- APPENDIX B The amount remitted from the trust account and directly from AMWC in repayment of its loan including the year in which paid.
- APPENDIX C The amount that currently is due on the SDWBA loan.
- APPENDIX D The under-collection in the balancing account established by Resolution No. W-3488, dated April 11, 1990.

ARROWHEAD MANOR WATER  
COMPANY

RATEPAYER REPRESENTATION  
BRANCH OF THE WATER  
DIVISION

By \_\_\_\_\_  
LANCE L. JOHNSON  
President  
29135 Hook Creek Road  
P.O. Box 699  
Cedar Glen, CA 92321  
(909) 337-1641

By \_\_\_\_\_  
DANIEL R. PAIGE  
Public Utilities Commission of  
California  
320 West 4<sup>th</sup> Street, Suite 500  
Los Angeles, CA 90013  
(213) 576-7048

APPENDIX A

ARROWHEAD MANOR WATER COMPANY

Computation of SDWBA Surcharge Revenues Collected and Paid to Trust Account and DWR Direct.  
For the Period from 1981 through First Quarter of 2000

( a )	( b )	( c )	( d )	( e )	( f )	( g )
Year	Total Surcharge Collected	Payment To Trust & DWR	Unremitted Surcharge	Interest Rate	Averaged Annual interest (Beg+End)/2xInt%	Unremt.Surch. & Interest Beg+Add+Int
1981	60,234	15,789	44,444	15.34%	3,409	47,853
1982	63,353	85,010	(21,657)	11.90%	4,406	30,602
1983	64,355	116,537	(52,182)	8.88%	401	(21,179)
1984	61,607	62,550	(943)	10.12%	(2,191)	(24,313)
1985	33,956	32,800	1,156	7.95%	(1,887)	(25,044)
1986	49,189	51,300	(2,111)	6.49%	(1,694)	(28,849)
1987	49,844	51,230	(1,386)	6.82%	(2,015)	(32,249)
1988	49,583	21,000	28,583	7.66%	(1,376)	(5,041)
1989	50,463	73,347	(22,884)	8.99%	(1,482)	(29,407)
1990	54,592	47,813	6,779	8.06%	(2,097)	(24,725)
1991	50,981	51,617	(636)	5.87%	(1,470)	(26,831)
1992	52,594	51,071	1,523	3.75%	(978)	(26,286)
1993	60,179	59,144	1,035	3.22%	(830)	(26,081)
1994	49,664	26,447	23,217	4.66%	(674)	(3,538)
1995	57,296	-	57,296	5.93%	1,489	55,247
1996	65,699	301	65,398	5.41%	4,758	125,402
1997	63,512	-	63,512	5.60%	8,801	197,715
1998	58,675	50,000	8,675	5.37%	10,850	217,240
1999	58,139	-	58,139	5.22%	12,857	288,236
2000	15,474	-	15,474	6.03%	17,847	321,557
Total	1,069,387	795,957	273,432		48,125	

# APPENDIX B

## ARROWHEAD MANOR WATER COMPANY

Paid To Department of Water Resources From Trust Account and Direct  
For the Period from 1981 through June 2000

(a)	(b)	(c)	(d)
<u>Year</u>	<u>Paid from</u> <u>Trust</u>	<u>Direct Pay</u> <u>to DWR</u>	<u>Received</u> <u>by DWR</u>
1981	-	-	-
1982	-	16,722	16,722
1983	58,753	25,387	84,140
1984	58,903	-	58,903
1985	58,893	-	58,893
1986	58,899	-	58,899
1987	58,899	-	58,899
1988	58,900	-	58,900
1989	58,893	-	58,893
1990	88,340	-	88,340
1991	29,450	-	29,450
1992	58,896	-	58,896
1993	56,439	2,464	58,903
1994	58,899	-	58,899
1995	1,783	-	1,783
1996	-	-	-
1997	-	-	-
1998	-	50,000	50,000
1999	-	-	-
2000	-	-	-
Total	705,948	94,573	800,521

# APPENDIX C

## ARROWHEAD MANOR WATER COMPANY

### Capitalized Interest and Recomputation of SDWBA Loan Principal

From 1 January 1998 through 1 July 2000

References: Repayment Schedule and Data Requests

Date			Amount Due, Adjustment or Payment	Cumulative Interest Due	Loan Principal	Explanation
Year	Month	Day				
1998	Jan	1	30,680.59	212,992.10	829,205.16	Accrued interest and outstanding principal.
	Apr	28	(50,000.00)	162,992.10		Payment made directly to DWR.
	Jul	1	30,680.59	193,672.69		Annual accrued interest.
1999	Jan	1	30,680.59	224,353.28		Annual accrued interest.
	Jul	1	30,680.59	255,033.87		Annual accrued interest.
2000	Jan	1	30,680.59	285,714.46		Annual accrued interest.
		1	(285,714.46)	-	285,714.46	Accrued interest capitalized.
					<u>1,114,919.62</u>	Restated Loan Principal
2000	Jul	1				Delinquent penalty of \$34,574.01 is not capitalized and remains due and owing.
		1	<u>41,252.03</u>	<u>41,252.03</u>		Semi-annual interest at 7.4%

### Caveat:

Interest accumulates at \$41,252.03 semi-annually and delinquent interest accumulates at a progressive rate.

Above information received over the phone. For official position of DWR data, please obtain from DWR.

APPENDIX D

ARROWHEAD MANOR WATER COMPANY  
Balancing Account for Purchase Water  
For the Period April 11, 1990 to August 31, 2000

<u>Purchase Water</u>	<u>4/11/1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
Recorded	\$ 21,887	\$ 30,949	\$ 31,569	\$ 18,155	\$ 59,327	\$ 60,009
Adopted (\$)	\$ 14,963	\$ 20,525	\$ 20,850	\$ 20,850	\$ 30,907	\$ 33,685
Interim Increase	\$ -	\$ 1,902	\$ 2,980	\$ 2,980	\$ 1,078	\$ -
Contract Work-Repairs						
Under/Over Collection	\$ 6,925	\$ 8,522	\$ 7,739	\$ (5,675)	\$ 27,343	\$ 26,324
Interest	\$ -	\$ -	\$ -	\$ -	\$ 637	\$ 3,478
Balance Account (EOY)	\$ 6,925	\$ 15,446	\$ 23,185	\$ 17,510	\$ 45,490	\$ 75,291
Interest Rate					4.66%	5.93%

<u>Purchase Water</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>8/31/2000</u>
Recorded	\$ 56,220	\$ 76,011	\$ 77,466	\$ 132,895	\$ 98,315
Adopted (\$)	\$ 33,685	\$ 33,685	\$ 33,685	\$ 33,685	\$ 28,259
Interim Increase	\$ -	\$ -	\$ -	\$ 10,686	\$ 38,539
Contract Work-Repairs					\$ (627)
Under/Over Collection	\$ 22,535	\$ 42,326	\$ 43,781	\$ 88,524	\$ 30,890
Interest	\$ 4,683	\$ 6,926	\$ 9,325	\$ 13,005	\$ 18,530
Balance Account (EOY)	\$ 102,509	\$ 151,761	\$ 204,868	\$ 293,392	\$ 342,812
Interest Rate	5.41%	5.60%	5.37%	5.22%	6.00%

(END OF ATTACHMENT A)

## ATTACHMENT B



Arrowhead Manor Water Company  
Summary of Earnings  
Test Year 2000

	Utility		Branch		Adopted
	Former Rates	Requested Rates	Former Rates	Recommended (Settlement) Rates	Rates
Operating Revenues					
Metered Rate	\$61,346	\$143,680	\$62,794	\$107,697	\$125,828
Flat Rate	89,453	208,717	84,452	170,970	199,749
Fire Protection	1,271	2,939	1,353	2,570	3,003
Other Water Revenue	<u>2,818</u>	<u>2,818</u>	<u>2,800</u>	<u>2,800</u>	<u>3,272</u>
Total Revenue	\$154,888	\$358,154	\$151,399	\$284,037	\$331,852
Operating Expenses					
Purchased Water	\$150,480	\$150,480	\$130,600	\$132,000	\$132,000
Purchased Power	11,242	11,242	8,430	8,430	8,430
Other Volume Related Expense	180	180	180	260	260
Employee Labor	0	0	7,800	7,800	7,800
Materials	4,000	4,000	2,040	3,000	3,000
Contract Work--Repairs	20,000	20,000	10,400	10,400	10,400
Contract Work--Water Testing	3,200	3,200	2,625	2,625	2,625
Contract Work--DHS	0	0	720	720	720
Transportation Expense	6,051	6,051	5,600	5,600	5,600
Other Plant Maintenance	420	420	1,030	1,660	1,660
Office Salaries	29,508	29,508	25,000	26,000	26,000
Management Salaries	38,900	38,900	28,800	35,500	35,500
Employee Pension & Benefits	7,600	7,600	7,000	5,630	5,630
Uncollectibles	3,500	3,500	757	2,840	2,840
Office Services & Rentals	14,868	14,868	6,000	8,800	8,800
Office Supplies	4,500	4,500	4,420	5,670	5,670
Professional Services	1,000	1,000	2,400	2,400	2,400
Insurance	3,800	3,800	3,800	3,960	3,960
Regulatory Expenses	0	0	230	2,510	2,510
General Expenses	<u>2,312</u>	<u>2,312</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>
Subtotal	\$301,561	\$301,561	\$248,832	\$266,806	\$266,806
Franchise Fee	0	0	0	0	0
Depreciation Expense	9,000	9,000	0	7,000	7,000
Property Taxes	1,022	1,022	1,022	2,960	2,960
Payroll Tax	6,478	6,478	7,528	6,471	6,471
Income Taxes	<u>9,037</u>	<u>9,037</u>	<u>800</u>	<u>800</u>	<u>7,544</u>
Total Deductions	\$327,098	\$327,098	\$258,182	\$284,037	\$290,781
Net Revenue	(\$172,210)	\$31,056	(\$106,783)	\$0	\$41,071
Average Plant	\$102,166	\$102,166	\$264,752	\$264,536	\$264,536
Avg. Accumulated Depreciation	0	0	174,100	177,600	177,600
Net Plant	102,166	102,166	90,652	86,936	86,936
Less: Advances	0	0	0	0	0
Contributions	0	0	10,774	10,774	10,774
Plus: Working Cash	0	0	0	0	0
Materials & Supplies	<u>0</u>	<u>0</u>	<u>2,000</u>	<u>2,000</u>	<u>2,000</u>
Rate Base	\$102,166	\$102,166	\$81,878	\$78,162	\$78,162
Rate of Return	(loss)	30.40%	(loss)	0.00%	(15% Op. Ratio)

(END OF ATTACHMENT B)

## ATTACHMENT C

Attachment C  
Page 1 of 3

Arrowhead Manor Water Company

Schedule No. 1A  
ANNUAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service furnished.

TERRITORY

The unincorporated community of Cedar Glen and vicinity located one mile southeast of Lake Arrowhead, San Bernardino County.

RATES \*

Quantity Rate:

All water, per 100 cubic feet                      \$ 5.24      (I)

Service Charge:	<u>Per Service Connection Per Year</u>			
	<u>Service Charge</u>	<u>SDWBA Surcharge</u>		(T)
		<u>Direct Benefit</u>	<u>Non-Benefit</u>	(T)
For 5/8 x 3/4 inch meter .....	\$ 209.00	\$ 248.52 (I)	\$ 131.28	(I)
For 3/4 inch meter .....	313.50	372.84	196.80	
For 1 inch meter .....	522.50	621.36	328.08	
For 1-1/2 inch meter .....	1,045.00	1,242.60	656.16	
For 2 inch meter .....	1,672.00	1,988.16 (I)	1,049.76	(I)

The Service Charge is a readiness to serve charge, which is applicable to all metered service and to which is to be added the quantity charge computed at the Quantity Rates.

\* Rates on this sheet take precedence over other rates in this tariff. These rates apply to service rendered on and before February 15, 2003. This sheet expires on February 16, 2003 unless extended.

(continued)

\*

Attachment C  
Page 2 of 3

Arrowhead Manor Water Company

Schedule No. 2RA  
ANNUAL RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat rate water service. (T)

TERRITORY

The unincorporated community of Cedar Glen and vicinity, located one mile southeast of Lake Arrowhead, San Bernardino County.

RATES \*

	<u>Per Service Connection Per Year</u>			
	<u>Flat Rate</u>	<u>SDWBA Surcharge</u>		(T)
		<u>Direct Benefit</u>	<u>Non-Benefit</u>	(T)
For a single family residential unit, including premises .....	\$ 580.00 (I)	\$ 248.52 (I)	\$ 131.28 (I)	
For each additional single-family residential unit on the same premises and served from the same service connection .....	387.00 (I)	161.54 (I)	85.33 (I)	

\* Rates on this sheet take precedence over other rates in this tariff. These rates apply to service rendered on and before February 15, 2003. This sheet expires on February 16, 2003 unless extended.

(continued)

Arrowhead Manor Water Company

Schedule No. 4A  
PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service rendered for private fire protection purposes.

TERRITORY

The unincorporated community of Cedar Glen and vicinity located one mile southeast of Lake Arrowhead, San Bernardino County.

RATES \*

Per Service Connection Per Year

For each 4-inch connection or smaller.....	\$ 940.00 (I)	
For each 6-inch connection.....	1,880.00	
For each 8-inch connection.....	3,002.00 (I)	
		(D)

\* Rates on this sheet take precedence over other rates in this tariff. These rates apply to service rendered on and before February 15, 2003. This sheet expires on February 16, 2003 unless extended.

SPECIAL CONDITIONS

(Special Conditions 1 through and including 6 remain in effect.)

(END OF ATTACHMENT C)

## ATTACHMENT D

## COMPARISON OF RATES

A comparison of the present rates and the rates adopted by this Decision are shown below:  
(Does not include SDWBA surcharges.)

	<u>Present Rates</u>	<u>Per Service Per Year Adopted Rates</u>	<u>Increase</u>
<u>General Metered Service:</u>			
Service Charge:			
For 5/8 x 3/4 inch meter	\$ 209.00	\$ 209.00	0.0%
For 3/4 inch meter	313.50	313.50	0.0%
For 1 inch meter	522.50	522.50	0.0%
For 1-1/2 inch meter	1,045.00	1,045.00	0.0%
For 2 inch meter	1,672.00	1,672.00	0.0%
Quantity Rate:			
All water, per 100 cubic feet	\$ 4.03	\$ 5.24	30.0%
<u>Flat Rate Service:</u>			
For a single family residence	\$ 497.00	\$ 580.00	16.7%
For each additional unit	331.00	387.00	16.9%

A comparison of annual bills for a metered customer with a 5/8 x 3/4-inch meter consuming various quantities of water is shown below:

<u>Consumption in Ccf</u>	<u>Present Rates</u>	<u>Adopted Rates</u>	<u>Increase</u>
0	\$ 209.00	\$ 209.00	0.0%
20	289.60	313.80	8.3%
40	370.20	418.60	13.1%
55	430.65	497.20	15.5%
75	511.25	602.00	17.8%
100	612.00	733.00	19.8%
250	1,216.50	1,519.00	24.9%

(END OF ATTACHMENT D)

## ATTACHMENT E



## ADOPTED QUANTITIES

Test Year 2000

### Expenses

1. Purchased Power  
Southern California Edison Company  
Rate Schedule PA-1  
kWh Used 71,950 per year  
Total Charge \$ 8,430 per year  
Average cost per kWhr. \$ 0.1172
2. Purchased Water  
Crestline Lake Arrowhead Water Agency  
Quantity 115 Acre-Feet  
Rate \$ 1,150 per Acre-Foot  
Total Charge \$ 132,000 per year
3. Property Taxes:  
Tax Rate 1.25%  
Total Charge \$ 2,960 per year
4. Service Connections  
  
Metered Customers:  
5/8 x 3/4 inch meter 209  
3/4 inch meter 5  
2 inch meter 1  
Total: 215  
Metered consumption 15,067 Ccf per year  
  
Flat Rate customers:  
Single residence customers 342  
Additional Units 3  
Total 345  
  
Private Fire Service:  
8-inch connection 1

(END OF ATTACHMENT E)