

CALIFORNIA PUBLIC UTILITIES COMMISSION
Water Division

TRANSFER OF A WATER SYSTEM OR SEWER
SYSTEM AND SALE OF UTILITY PROPERTY UNDER
PUBLIC UTILITIES CODE SECTION 851

Standard Practice U-24-W

San Francisco, California
October 2006

A--PURPOSE AND SCOPE

1. The purpose of this document is to aid in the preparation and processing of a formal application or advice letter for approval of the sale or transfer of a water or sewer system and to notify the Commission of the sale of used and useful or non-used and useful utility property (facilities and land). It also addresses:

- a. advice letters to acquire non-Commission regulated water systems (NCRWS), and
- b. advice letters to acquire inadequately operated and maintained small water systems (IOMSWs). An IOMSWs is any water system serving less than 2,000 customers that is subject to an outstanding compliance order or citation from the California Department of Health Services (Ref. A, p. 2) and
- c. change of ownership due to probate (Section 853(c) of the Public Utilities Code.)

2. It is designed to assist the applicant in preparing a complete application or advice letter and in complying with statutory requirements. It also discusses the procedure to follow when a small water system is purchased by a municipality, district or a mutual water company. It includes the procedures that must be filed when a utility sells utility property but not the whole system.

B—DEFINITIONS

B—TRANSFER OF AN ENTIRE SYSTEM

3. An application is required to transfer a Commission regulated water or sewer system to another owner, including a city or county, unless the sales price is \$5,000,000 or less in which case the parties can request approval by Tier 2 advice letter.¹ The filing fee for the application is \$75 if the transfer is to another Commission-regulated utility. No fee is required if the sale is to a district, municipality or a mutual water company.²

4. Within 30 days after transfer of ownership due to probate from a decedent to member of the decedent's family of a water system serving less than 10,000 connections, the new owner shall file an advice letter containing:

¹ Public Utilities Code Section 851.

² Resolution No. W-4029, February 19, 1997, "Lucerne Vista Water Company (LVWC), Order Authorizing LVWC to be Exempted from Commission Jurisdiction" involved the sale to the Lucerne Vista Mutual Water Company.

- a. A new tariff cover sheet that includes the new owner's mailing address and contact information.
 - b. A copy of the legal instrument that conveys ownership of the regulated entity.
5. Within five working days from the date of the signing an agreement to acquire a Non-Commission Regulated Water or Sewer System (NCRWS) or Inadequately Operated and Maintained Water or Sewer System (IOMSWWS,) the utility shall file an "information only" filing with the Water Division, describing the system and the details of the proposed acquisition. (Ref. B, p. 1)

C - ADVICE LETTER SUBMITTAL AND CONTENTS

6. Within 30 days after the date of execution of the agreement to acquire a NCRWS, and, for all service area extensions, not less than 30 days prior to providing service in the territory, the utility shall file an advice letter delineating the new service area on an existing service area map or as a new service area map.^{3,4} The map shall be of such detail that it can be determined if a single piece of property is inside or outside the service area. If the map uses a street as the border of the service area, the utility is allowed to serve property on either side of the street.⁵ The new area shall be highlighted or crosshatched. The advice letter shall contain the following information:

- a. If the advice letter is for a service area extension, it should generally follow the format of the advice letter outline in Appendix A and must include the following attachments (Ref B. p. 5):
 - (1) A completed Water Supply Questionnaire (if a letter to the Department of Real Estate is required) or other document demonstrating water availability per Standard Practice U-18.
 - (2) A copy of the developer's application for service or a statement that all owners of parcels of land in the extension area have been served a copy of the advice letter.
 - (3) Documentation showing that the project for which the service area is being extended has sought approval from the local permitting agency and is making reasonable progress toward project completion. The showing of reasonable progress may include demonstration of a comprehensive development plan, site ownership or control, completion of engineering and architectural plans, achievement of financing milestones, or other information that indicates a reasonable likelihood of project completion.

³ General order (GO) 96-B, Section 8.5.4

⁴ Public Utilities Code Sections 1001, 852 and 854 do not require that the utility receive Commission approval before a water utility extends its line plant or service into a contiguous area that is not being served by a utility of like character (ref. D.94-01-046, January 19, 1994, Ordering Paragraph 5). The utility may provide service at tariffed rates or by contract in the contiguous area.

⁵ Letter from Fred Curry to all Water and Sewer Service Utilities, September 26, 2000.

- (4) A letter from the local fire protection agency or other documentation that shows that the fire protection agency is satisfied with the fire flow capability of the system planned for the new area.
 - (5) A system map with supporting computations showing that the system in the new territory is in compliance with the minimum design and water supply standards of G.O. 103.
- b. If the advice letter is for a service area extension that requests permission to provide service outside the service area or at less than G.O. 103 standards, it should resemble Appendix B and must address the following (Ref. C.):
- (1) A showing that the customer cannot be served at G.O. 103 standards at reasonable cost.
 - (2) A showing that the customer is willing to be served at less than G. O. 103 standards.
 - (3) A copy of the title to the property showing that the limitation of service is shown as a deed restriction on the property.
 - (4) An assertion that the area to be served is one in which additional customer growth is unlikely.
 - (5) An assertion that the final installation, including all customer-provided facilities, meets all local permit requirements.
 - (6) Contain a copy of the special contract providing service at less than G.O. 103 standards and delineating the limitations listed above, and a appropriate modification to the utility's tariff sheet listing Contracts and Deviations.
- c. If the advice letter is for an acquisition, it should resemble Appendix C and must include the following attachments (Ref. B, p. 3):
- (1) A copy of the executed purchase agreement.
 - (2) A copy of the notice sent to all affected customers comparing the rates before and for the first year after the acquisition and identifying any costs not fully reflected in the first year's rates. (Ref. A, para.4.03)
 - (3) A copy of the appraisal with all supporting materials and workpapers. (Ref. A, para 2.05)
 - (4) All necessary tariff sheets, including a tariff sheet showing rates.
- For an NCRWS acquisition, the utility may use:
- (a) existing NCRWS rates, or
 - (b) rates for its nearest service territory (with cost justification adequate to show that it is reasonable to apply them to the newly acquired system), or
 - (c) new rates producing revenues lower than either⁶. (Ref A., p. 3; Ref. B, p. 4).
- For an IOMSWWS acquisition the utility may request new rates that:

⁶ For example, the Commission has long held that the basis upon which rates should be set is the original depreciated cost or the purchase price, whichever is lower (D.83676, November 6, 1974)

- (a) collect 100% of fixed costs in the service charge, and
 - (b) receive revenues based on the rate of return permitted a Class C or a Class D water utility. This return may also be earned on 50 percent of the difference between book value and the price paid, and
 - (c) increase rates annually by the latest Consumer Price Index for All Urban Customers (Ref. A, p. 2&3).
- (5) A detailed description of the acquired water system including a list of facilities such as wells, storage, and structures, and a distribution system map showing pipe sizes, fire flow and pressure areas.
 - (6) A list of planned water system improvements, including estimated costs and the rate impact on the acquired and existing customers.
 - (7) An estimated Summary of Earnings before and after the acquisition with and without the estimated costs of improvements in (5) above for the first and fifth year following acquisition.
 - (8) The names and addresses of all utilities, corporations, persons or other entities, either public or private, with which the acquired system is likely to compete, and all cities and counties within which service will be rendered.
 - (9) A list of the franchises and health and safety permits obtained or required to operate the system, including the status of the Technical, Managerial and Financial Capacity certification required from the Department of Health Services.
 - (10) An accounting of the original cost (or estimated original cost) of all acquired plant and depreciation reserve.

7. For a water system the new owner must also obtain the necessary permits from the State Department of Public Health (DPH) or County Departments of Health. The water system must comply with the applicable agencies' requirements and must meet acceptable engineering practices.

8. The Commission does not necessarily hold a hearing on an application for a water system sale, but may issue its decision on an ex parte basis. Hearings may not be required where the application is relatively complete and where there are no parties protesting, or likely to protest, the granting of the application.

9. One important issue with respect to the sale is the sales price. Appendix B contains Commission policy with respect to sales of small (Class D) water systems.

C—SALE OF PART OF A SYSTEM

10. Water companies shall notice the Director of the Water Division and the Director of the Division of Ratepayer Advocates 30 days' in advance by written notice whenever they plan to sell land, buildings, water rights, or all or part of a water system, including facilities or land that is no longer used and useful.⁷ Staff will

⁷ D.06-05-041 O. P. 19

review the notice to assess whether companies are selling off key portions of their asset base. Providing notice will not preclude later review of such sales in a water company's GRC or other proceeding. The notice shall include the following heading in at least 16 point bold type: "Notice under Rulemaking 05-06-040. Commission staff must respond within 30 days." The notice must include the name, address, phone and email address of the potential purchaser(s). If the Commission staff objects to the proposed sale, it may send an objection in any form to the seller and proposed purchaser(s). Mailing of such an objection shall prevent the proposed purchaser from claiming it is a bona fide purchaser of the property at issue until the issues raised in the objection are resolved.

11. Additionally, when utility property that was at any time included in rate base is sold, it must be tracked and the sales records must be kept, even if it is sold to an affiliate. At the same time the water or sewer service company must establish a memorandum account to record the net proceeds from the investment. The proceeds booked to this account can only be used to invest in new utility plan or used and useful land. Any proceeds that are not invested within eight years of the sale, must be returned to ratepayers.⁸

12. Gains and losses on sales of depreciable property shall accrue 100% to ratepayers. Gains and losses on used and useful land shall accrue 67% to ratepayers and 33% to stockholders.⁹ If the asset sold is real property that is no longer used and useful the proceeds shall be reinvested in accordance with the Infrastructure Act (Section 790 of the Public Utilities Code).

13. When property is never in rate base, all gains and losses will accrue to shareholders.¹⁰ However if property or assets are in rate base part of the time, the allocation of gains should be proportional to the amount of time that the asset was rate based divided by the life of the asset when sold (that percentage accrues to ratepayers.) The utility may assert a different allocation, and always has the burden of proving the amount of time the asset was not in rate base.

14. If a water or sewer system sells part of a system that include facilities actively serving customers, to a governmental entity that then serves those customers, all gains or losses accrue to stockholders.¹¹

D—NAME CHANGE

⁸ D.06-05-041, O. P. 17

⁹ D.06-12-043 at 21, change q

¹⁰ D.06-05-041 at 82

¹¹ D.06-05-041, O. P. 10

^{15.} A utility may change its name by filing a new Cover Sheet for its tariff book.
No resolution is required.¹²

¹² Memorandum from Edmund J. Texiera, Deputy Director to Distribution List, March 3, 1983, Subject: Water Management Meeting of March 3, 1983: Percell, Reader/Rosenthal and Texiera

Appendix A

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF
CALIFORNIA

Application of _____)

_____)

doing business as _____)

_____)

to sell and _____)

_____)

_____) (For Commission use
only)

to buy the water system in _____)

_____ County))

_____)

APPLICATION

This application of _____

(seller(s))

whose address and telephone number is _____

_____, (_____) _____

owner(s)

of the water system known as _____

_____ and _____

(buyer(s))

whose address and telephone number is _____

_____ ,

(_____) _____ respectfully shows:

I

That communications in regard to this application are to
be addressed to _____ whose
address _____

(person)

Appendix A

is _____,
(zip code)
telephone number (_____)_____.

Appendix A

II

That the application is made pursuant to Sections 851 through 854 of the California Public Utilities Code and Rules 1 through 7, 15 through 17, 35, 36, 45 through 48 and 88 of the Commission's Rules of Practice and Procedure for authority to transfer the water system operating in the area described as

_____ in or near the
community
of _____, serving

(city)
(number)
customers.

III

The seller(s) was/were granted a Certificate of Public Convenience and Necessity by Decision

(D.) _____, dated _____, in
Application (A.) _____, filed
_____.

OR

Authority to acquire the system was granted to sellers by
D. _____, dated _____, in
A. _____, filed _____. The water
system operates under a franchise granted by

(if applicable)

IV

The water system consists of (brief description):
Land:

Appendix A

Wells Number: _____, Diameter: _____
_____ Depth: _____ Other Source of
Supply: _____

Pumping Equipment: Number: _____ HP: _____ capacity--
GPM: _____ Water Treatment Equipment: _____

Reservoirs and Tanks: Number: _____
Capacity: _____

(gallons)
Water Mains: _____ feet. Services: _____

(number)
Meters: _____ installed, _____ available for
installation: _____ Fire hydrants: _____
Buildings: _____

(number)
_____ Office furniture and equipment: _____

Transportation equipment: _____

Other equipment: _____

V

The original cost of property being transferred is
\$_____, and the depreciation reserve as of _____

(date)

Appendix A

is \$_____, resulting in a net book cost of \$_____. The selling price is \$_____ with these terms for payment:

—.

A copy of the transfer agreement is attached hereto as Exhibit A.

A copy of the proposed deed to real property is attached hereto as Exhibit B.

VI

Seller(s) desire(s) to dispose of the system because

—.

and buyer(s) desire(s) to acquire the system because

—.

Buyer(s) has/have had the following experience which qualifies him/them to operate the system:

—.

—.

VII

Seller's(s') most recent annual report, for year ending _____, is attached hereto as Exhibit C.

Buyer's(s') financial net worth statement is attached hereto as Exhibit D.

Buyer's(s') occupation is _____ and present employment is _____. Buyer's(s') employment address and telephone number is _____

Appendix A

_____, (____)_____.
Buyer's(s') residential address and telephone number is

_____, (____)_____.

VIII

Buyer(s) propose(s) to adopt the presently filed tariffs of the seller(s), a copy of which sellers) has available to furnish to buyer(s). Buyer(s) agree(s) to be bound by any outstanding Commission decisions and/or directives involving the water system being transferred. Buyer(s) will be furnished the utility's copies of the following or informed of their availability at the Commission's headquarters, 505 Van Ness Avenue, San Francisco, California 94102:

- (a) General Order 96-A, Filing and Posting of Tariff Schedules
- (b) General Order 103, Rules Governing Water Service, Including Minimum Standards for Design and Construction
- (c) Uniform System of Accounts for Class D Water Utilities
- (d) Rules of Practice and Procedure
- (e) Public Utilities Code of the State of California

IX

Seller(s) and buyer(s) warrant that:

- (a) There are no customer deposits to establish credit.
OR
Buyers will refund customer deposits when due.
- (b) There are no main extension advances
OR
All refunds due on main extension advances have been paid on a current basis and none are overdue.
- (c) On main extension advances which will fall due in the
future, buyer(s) agree(s) to pay the refunds when due.

Appendix A

(d) The condition of the system is good.

OR

The system needs modification and repair to bring it
up

to the standards of General Order No. 103 at an
estimated cost of \$ _____. These funds
(are) (are not) available. The work will be
performed

by the (seller(s)) (buyer(s)). Source of Funds is

.

X

Seller(s) and buyer(s) accept joint responsibility for
informing the community of customers about this application
after filing.

WHEREFORE, applicants request an ex parte order
authorizing seller(s) to transfer and buyer(s) to acquire the
water system described and under conditions stated herein and
that seller(s), upon compliance with such an order, be
relieved of any public utility responsibilities related to the
system being transferred.

I and each one of us whose names are shown as application
seller(s) and buyer(s) in the above-entitled matter hereby
declare and say:

That I and each one of us have read the foregoing
application and know the contents thereof; that the statements
are true of my own knowledge, except as to the matters which
are stated on information or belief, and as to those matters
which I believe them to be true.

I and each one of us declare under penalty of perjury
that the foregoing is true and correct. This has been
executed at the place and on the date shown on the signature
line. (Each named applicant must sign.)

Signatures

City and State

Date

Appendix A

Seller: _____

Seller: _____

Buyer: _____

Buyer: _____

///

///

///

///

///

///

///

///

///

///

///

///

///

///

///

///

///

///

Appendix A

NOTE:

The following exhibits must be attached to all applications for transfer:

Exhibit A - Copy of the sale agreement. If there is no written agreement, it should be so stated in the application and other documentation of sale attached, such as bill of sale, escrow agreement or note.

Exhibit B - Copy of the proposed deed to the real property transferred.

Exhibit C - Copy of the last annual report of seller(s) or a copy of the latest available balance sheet and income statement of seller(s).

Exhibit D - Copy of buyer's(s') financial net worth statement, or, if operating as a utility, the latest available balance sheet and income statement.

If the purchase price is more than the net book cost, the following statement must be included in the application, preferably as a letter exhibit signed by the purchaser.

Purchaser is paying \$_____ more than the original cost of net depreciation and contributions. He understands that rates will be based upon the depreciated original cost of the plant, excluding contributed plant, and not on the purchase price.

A check for \$75 must accompany the applications for transfer of the Certificate of Public Convenience and

Appendix A

Necessity, when sold to an individual, as contrasted to a public entity.

Following review of the application by Commission staff the applicant will be notified regarding the adequacy of the information contained in application. The applicant will be provided the text of a notification to be sent each customer. Customers will be given 30 days to make any objections to the Commission, at 505 Van Ness Avenue, San Francisco, CA 94102.

Scoping Memo Information for (New) Applications (Rule 7.1)

A. Category ¹ (Check the category that is most appropriate)

☐ **Adjudicatory** – “Adjudicatory” proceedings are: (1) enforcement investigations into possible violations of any provision of statutory law or order or rule of the Commission; and (2) complaints against regulated entities, including those complaints that challenge the accuracy of a bill, but excluding those complaints that challenge the reasonableness of rates or charges, past, present, or future.

☐ **Ratesetting** – “Ratesetting” proceedings are proceedings in which the Commission sets or investigates rates for a specifically named utility (or utilities), or establishes a mechanism that in turn sets the rates for a specifically named utility (or utilities). “Ratesetting” proceedings include complaints that challenge the reasonableness of rates or charges, past, present, or future. Other proceedings may also be categorized as ratesetting when they do not clearly fit into one category.

☐ **Quasi-Legislative** – “Quasi-Legislative” proceedings are proceedings that establish policy or rules (including generic ratemaking policy or rules) affecting a class of regulated entities, including those proceedings in which the Commission investigates rates or practices for an entire regulated industry or class of entities within the industry.

B. Are Hearings Necessary? ☐ Yes ☐ No

If “yes,” identify the material disputed factual issues on which hearings should be held, and the general nature of the evidence to be introduced.

¹ See, California Public Utilities Commission Rules of Practice and Procedure, Article 7, especially Rule 7.1. (http://www.cpuc.ca.gov/PUBLISHED/RULES_PRAC_PROC/66013.htm)

Are Public Witness Hearings Necessary? ☐ Yes ☐ No

Public witness hearings are set up for the purpose of getting input from the general public and any entity that will not be a party to the proceeding. Such input usually involves presenting written or oral statements to the presiding officer, not sworn testimony. Public witness statements are not subject to cross-examination.

C. Issues—List here the specific issues that need to be addressed in the proceeding.

D. Schedule (Even if you checked “No” in **B.**, above) Should the Commission decide to hold hearings, indicate here the proposed schedule for completing the proceeding within 12 months (if categorized as “Adjudicatory”) or 18 months (if categorized as “Ratesetting” or “Quasi-Legislative”).

The schedule should include proposed dates for the following events as needed:

_____	Prehearing Conference
_____	Hearings
_____	Briefs due
_____	Submission

_____	Proposed decision (90
_____	days after submission

_____	Final decision (60 days
_____	after proposed decision is mailed)

Appendix A

Docket Office Note: The above information should be set forth either in the text of the application or, if this form is used, it should be inserted into the application packet after the signature(s) of the filer, but immediately prior to the commencement of any exhibits.

- I. End of Scoping Memo Information for (New) Applications
- II. Doc 280540 Rev. June 2007

Decision 00-01-018 January 6, 2000

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Gerald V. Wedel and Linda J. Wedel, doing business as Pine Mountain Water Company (U-258-W) for Authority to Sell and Del Oro Water, Co., Inc. (U-61-W) for Authority to Buy the Pine Mountain Water System in Tulare County.

Application 99-07-016
(Filed July 13, 1999)

Application of Pine Flat Water Company , a California Corporation (U-257-W) for Authority to Sell and Del Oro Water, Co., Inc. (U-61-W) for Authority to Buy the Pine Flat Water Company Water System in Tulare County.

Application 99-07-017
(Filed July 13, 1999)

O P I N I O N**III. Statement of Facts****1. Pine Mountain Water Company**

Pine Mountain Water Company (Pine Mt.) was granted a Certificate of Public Convenience and Necessity (CPCN) by Decision (D.) 70198 issued January 11, 1966 to operate a public utility water system to serve Pine Mountain, a mountain area approximately 45 miles from the Town of Porterville in Tulare County. By D.89266 issued August 22, 1978, the system's sale to Gerald V. Wedel was authorized. Today Pine Mt. serves 84 unmetered customers through 11,800 feet of four-and six-inch transite mains. Pine Mt. also sells water on a metered basis to adjacent Pine Flat Water Company (Pine Flat). Pine Mt. operates from four wells and a 64,000-gallon reservoir.

Commission Resolution W-4037 issued April 9, 1997 authorized Pine Mt. to file an advice letter incorporating the Summary of Earnings, \$21,079 Rate Base, and 13.25% Rate of Return set forth in the Resolution. Pine Mt. filed its Advice

Letter (AL) No. 12 thereafter, and its last general rate increase became effective April 19, 1997.

2. Pine Flat Water Company

About 1911, the Meyers Land Company, as part of its land sales operations, constructed a water system at Pine Flat, an area approximately 45 miles southeast of the Town of Porterville in Tulare County. The intention, not implemented, was to eventually form a mutual. Meyer's daughter, Helen M. Curtis, by 1936 the owner of the system, donated it to the Pine Flat utility organized by K.H. Morse. In 1949, the company obtained a CPCN from the Commission by D.42920. In the 1970 period, Gerald V. Wedel, part owner, became president. Today, Pine Flat serves 206 metered customers through 27,200 feet of two-inch standard screw mains, obtaining its water from three wells, five springs, and purchases from Pine Mt. It has five steel storage tanks with a total capacity of 84,374 gallons.

Commission Resolution W-4039 issued May 21, 1997 authorized Pine Flat to file an advice letter incorporating the Summary of Earnings (set forth in that Resolution) and rate schedules (also set forth in the Resolution). While not explicitly so stated in the Resolution's Ordering Paragraphs, the latter schedules were derived from use of an Operating Ratio Method of Return adopted in view of the small \$2,116 rate base (the result of depreciating the aging plant). The "margin" (or rate of return) was set at a very generous 20% of the total expenses listed in the Summary of Earnings. Pine Flat subsequently filed AL No. 14, and its last general rate increase became effective December 24, 1997.

3. Del Oro Water Co., Inc.

Del Oro Water Co., Inc. (Del Oro), a California corporation since 1963, has provided public utility water services under the regulatory jurisdiction of the

Commission, and presently directly serves approximately 5,000 customers in Butte County, and through wholly-owned subsidiaries serves another 1,300 customers in Shasta and Humboldt Counties.

IV. The Present Situation

The Wedels desire to sell their two water systems because they want to discontinue doing business as regulated public utilities.

Del Oro is interested in acquisition of the Pine Mt. and Pine Flat systems because it believes they can be profitably and efficiently consolidated with the regulated systems Del Oro already owns and operates.

Accordingly, the captioned applications have been filed to effectuate a sale and transfer of both Pine Mt. And Pine Flat to Del Oro. The selling price for Pine Mt. is \$37,500. The original cost is stated as being \$54,833 with a depreciation reserve of \$34,205, resulting in a net book cost of \$20,628. The selling price for Pine Flat is \$27,500, with the original cost being \$67,439 with a depreciation reserve of \$65,858, resulting in a net book of \$1,581. In both proposed acquisitions Del Oro agrees to refund all customer deposits when due. No refundable main extension advances are overdue, and those falling due in the future will be paid. While both applications state that the condition of the systems is good, we note that in the instance of Pine Flat, the Commission's 1997 Resolution W-4039 found that the existing mains were over 70 years old and the Resolution provided that Pine Flat should replace 3,500 feet of 2-inch mains with 6-inch mains. This has not been done.

Pursuant to Rule 6.1(a) of the Commission's Rules of Practice and Procedure, by ALJ Resolution 176-3020 issued July 22, 1999, the Commission preliminarily determined that the captioned applications are ratesetting matters that do not require a hearing.

On August 4, 1999, each application was timely protested by the Ratepayers Representation Branch of the Water Division (RRB), merely stating RRB's belief that a hearing might be necessary.

A duly noticed prehearing conference (PHC) was held on October 22, 1999 before assigned Commissioner Henry M. Duque and Administrative Law Judge (ALJ) John B. Weiss in San Francisco. The assigned Commissioner and the ALJ considered the applications, the RRB protests, and the response of Del Oro at the PHC. Noting Del Oro's past demonstrated capabilities in managing, operating, and maintaining the diverse water public utilities serving over 6,000 customers in various parts of California, the assigned Commissioner and the ALJ concluded no hearing was required regarding Del Oro's capabilities.

Applying the proposed purchase prices reflecting premiums to rate base as required pursuant to Pub. Util. Code § 2718 et seq., and substituting these in the respective Summaries of Earnings applied to Pine Mt. And Pine Flat in each's latest rate proceeding, the Commissioner and ALJ concluded that prospective resulting rate impacts were neither unfair nor unreasonable in view of the Legislature's intentions in promulgating Pub. Util. Code § 2718 et seq., and did not warrant further investment of Commission resources as would be necessitated by a hearing. By the Joint Ruling of the assigned Commissioner and the ALJ issued October 29, 1999, RRB's request for hearing was denied.

v. Discussion

With exceptions not relevant here, historically the Commission has applied the concept of original cost less depreciation in the determination of rate base value to be used in ratemaking. But by the provisions of the Public Water Systems Investment and Consolidation Act of 1997 (Pub. Util. Code §§ 2718 et seq.), the Legislature has provided that henceforth the Commission "shall" use the standard of fair market value (as set forth in § 1263.320 of the Code of Civil

Procedure¹) when establishing the rate base value for the distribution system of an acquired water corporation.

In promulgating the 1997 Act, the Legislature clearly was well aware that incentives, both financial and operational, would be necessary to induce larger, well established water corporations to take over smaller, less well-established water corporations facing needs to replace or upgrade their systems to meet the increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards. These incentives must ultimately be reflected in rates. The benefits of well run, well-financed water utilities to ratepayers do not come without cost. And unless the potentially resulting rate impact is clearly unfair and unreasonable, the intention under Pub. Util. Code §§ 2718, et seq. was that the Commission “shall” approve the proposed acquisitions. But if the resulting potential rate impact was unfair and unreasonable, the Legislature left the Commission authority under Pub. Util. Code §§ 851 and 852 to deny the applications. The Commission lacks discretion to condition approval of an acquisition upon valuation, below fair market value, of the resulting rate base of the distribution systems of an acquired system (see Interim Opinion Regarding Applicability of Pub. Util. Code § 2718 et seq. to the proposed merger (D.99-09-030 issued September 2, 1999) in the Joint Application of Cal-Water Service Co. and Domingues Water Company et al. in Application (A.) 99-02-004).

When the prospective rate impact indicated from application of “fair market” value purchase price as the new rate base is not so great as to be clearly unfair or unreasonable to the ratepayers, considering the future benefits they will

¹ The relevant portion of Section 1263.320 states:

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

receive by virtue of being served by larger, well-managed utilities better able to meet the present and future requirements of federal and state laws and regulations, we see no reason to expend the Commission's limited resources on preparation of staff reports and hearings. To do so and thereby delay and increase the cost of desirable acquisitions for form's sake would only serve to discourage would be acquisitions, and ignore the clear intention of the Legislature when it enacted Pub. Util Code §§ 2718 et seq.

In these applications the proposed purchase prices in each instance meet the fair market value definition of Civil Procedure Code § 116275 for their designation as the new rate base value for prospective ratemaking in each proceeding. These purchase prices (or "fair market" values) clearly do not approach, much less exceed, the reproduction costs (as defined in Evidence Code § 820) for even that portion of each utility's distribution system represented by their existing water distribution pipes (as set forth in each utility's 1998 Annual Reports). This obviates any need to consider Pub. Util. Code § 2720(2)(b) issues.

After concluding that the agreed-upon sales price is the fair market value of the companies, we must now determine if the substitution of the fair market value rate base instead of the current book value results in estimated rate increases that might be considered unfair or unreasonable. In the Pine Mt. instance, application of the "fair market" value purchase price as the new rate base in the 1977 Summary of Earnings set forth in Resolution W-4037, the utility's most recent rate proceeding, would produce an earnings requirement (using the same 13.25% rate of return) only \$2,176 higher, so that the rates authorized by Pine Mt.'s AL No. 12 would increase approximately 13%. We find nothing inherently unfair or unreasonable in that.

Pine Flat, on the other hand, operates on the Operating Ratio Method of Return. Assuming it were to continue under that method, the proposed purchase price would have no impact at all on prospective rates. If the operator received Commission authorization to move back to the Rate Base Method of Return, the proposed purchase price would then become the new rate base. The effect of applying that new rate base to the 1997 Summary of Earnings set forth in Resolution W-4039, the utility's most recent rate proceeding, would produce an earnings requirement less than that under the Operating Ratio Method. Thus, the resulting rates would be slightly less than those authorized under Resolution W-4039 and AL No. 14 for Pine Flat.

Upon payment to the Commission of the Public Utilities Reimbursement Fees collected to the date of the consummated sales and transfers, the Wedels and Pine Flat can be relieved of further public utility obligations with regard to the Pine Mt. and Pine Flat systems.

Finally, pursuant to provisions of California Health and Safety Code (CH&S) § 116525(a), any person or entity operating a public water system must have a permit to operate that system from the Department of Health Services (DHS), and a change in ownership of a public health system requires the prospective new owner to apply to and satisfy DHS' requirement that the new owner "possesses adequate financial, managerial, and technical capability to assure the delivery of pure, wholesome, and potable drinking water" (CH&S Code § 116540). Accordingly, apart from authorization from the Commission for Del Oro acquisition of Pine Mt. and Pine Flat, Del Oro must also apply to DHS for reissuance of the existing permits of Pine Mt. and Pine Flat.

Findings of Fact

1. Both Pine Mt. and Pine Flat are private investor-owned water public utilities as defined in Pub. Util. Code § 241, and have been subject to the jurisdiction and regulation of the Commission since certification.
2. Del Oro is a private investor-owned water public utility as defined in Pub. Util. Code § 241, subject to the jurisdiction and regulation of the Commission since 1963, and today Del Oro successfully itself or through wholly-owned subsidiaries serves over 6,000 customers in various counties in California.
3. By the captioned applications, Del Oro seeks authorization from the Commission to acquire Pine Mt. and Pine Flat, and the Wedels and Pine Flat seek authorization to sell the systems..
4. Del Oro is a willing buyer; the Wedels' and Pine Flat are willing sellers, and none of the parties are under any necessity to buy or sell.
5. The agreed upon purchase prices for Pine Mt. and Pine Flat each include a premium over the selling entities' rate bases as determined in each sellers' last general rate proceeding in 1997.
6. Given the extensive distribution mains of both the Pine Mt. and Pine Flat systems, the purchase prices, reflecting as they do the respective fair market values, do not exceed reproduction costs as determined in accordance with Evidence Code § 820, and there are therefore no additional purchase price amounts to be considered pursuant to Pub. Util. Code § 2720(b).
7. Application of the fair market value purchase prices as rate bases, and substituting these for the rate bases determined in the Summaries of Earnings for the last general rate proceedings of Pine Mt. and Pine Flat, could result in rate impacts of approximately 13% for Pine Mountain and probably no increase for Pine Flat.

8. Despite the fact that by ALJ Resolution 176-3020 the Commission had preliminarily determined that no hearing was required for either captioned application, the Assigned Commissioner and the ALJ conducted a PHC to consider RRB's protest and Del Oro's response.

9. By a Joint ruling of the Assigned Commissioner and the ALJ issued after the PHC and consideration of the applications, protests, and response of Del Oro, RRB's request of hearings on the applications was denied; the Commissioner and the ALJ having concluded that as Del Oro by past performance had demonstrated its capability to manage, operate, and maintain the two systems, and as no unjust or unreasonable effect on the existing customers of the contracting parties would result from the acquisition, there was no necessity for a hearing.

10. Before Del Oro can operate the Pine Mt. and Pine Flat systems it is required to comply with CH&S § 116540.

11. Payment to the Commission of the Public Utilities Reimbursement Fees due to the date of closing and transfer must be made by the Wedels and Pine Flat before they can be relieved of their public utility obligations with regard to the respective water systems having sold.

12. Transfer of ownership of Pine Mt. and Pine Flat to Del Oro would be in the public interest.

Conclusions of Law

1. In promulgating Pub. Util. Code §§ 2718 et seq., the Legislature recognized the necessity for incentives to induce larger, well-established water corporations to acquire small, less well organized water corporations; one of these incentives is implicit in the legislative language that states that the Commission "shall" use the standard of fair market value to value the rate base of the distribution system

of an acquired public water system and that this standard “shall” be used for ratesetting, even though the result may be higher rates.

2. Nothing in Pub. Util Code §§ 2718 et seq. suggests that the Legislature intended discretionary, rather than mandatory, application of the fair market rate base valuation standard.

3. Pub. Util. Code §§ 2718 et seq. does not undermine or otherwise conflict with the Commission’s obligation to review a water utility sale within our jurisdiction and to authorize that sale only if the Commission concludes authorization is in the public interest.

4. Were the Commission to conclude that application of Pub. Util. Code §§ 2718 et seq. would result in unfair or unreasonable increase in rates, while the Commission cannot require a lower rate base valuation or discriminatory rate of return as a condition of its approval, the Commission’s authority to deny the sale remains undiminished.

5. Application of fair market value purchase prices as rate bases and substituting these for the Summary of Earnings rate base used in the last general rate proceeding for each utility does not result in impacts that are unfair or unreasonable.

6. Public hearing is not necessary.

7. The applications for sale and transfer of Pine Mt. and Pine Flat Water Systems to Del Oro should be authorized as set forth in the order that follows.

8. Upon consummation of the sales and transfers, and payment to the Commission of the Public Utilities Reimbursement Fees collected to the date of the sales and transfers, the Wedels and Pine Flat should be relieved of their public utility obligations with regard to the systems.

9. Before undertaking actual operation of either water system after the sales and transfers, Del Oro should obtain permits to operate the system from the DHS pursuant to the requirements of CH&S § 11650(a)

10. These proceedings should be closed.

O R D E R

IT IS ORDERED that:

1. Within six months after the effective date of this order, Gerald V. Wedel and Linda J. Wedel (the Wedels), doing business as Pine Mountain Water Company (Pine Mt.), and the Pine Flat Water Company (Pine Flat), are authorized to sell, and Del Oro Water Co., Inc. (Del Oro) is authorized to buy the Pine Mt. and the Pine Flat water systems in Tulare County.

2. Within ten days of the actual sales and transfers of the systems, Del Oro shall notify the Commission in writing of the date on which each sale and transfer was consummated, and shall attach on each written notification a true copy of the instrument effecting the sales and transfer.

3. The Wedels and Pine Flat shall make remittance to the Commission of the Public Utilities Reimbursement Fees collected to the date that each sale and transfer is consummated. Upon completion of the sales and transfers, and remittance of the reimbursement fees, the Wedels and Pine Flat shall stand relieved of their public utility water obligations with respect to the Pine Mt. and Pine Flat water systems.

Appendix C

4. Application (A.) 99-07-016 and A.99-07-017 are closed.

This order becomes effective 30 days from today.

Dated January 6, 2000, at San Francisco, California.

RICHARD A. BILAS

President

HENRY M. DUQUE

JOSIAH L. NEEPER

CARL W. WOOD

Commissioners

I abstain.

/s/ LORETTA M. LYNCH

Commissioner

(memo)

State of California

M e m o r a n d u m**Date:** October 11, 1985**To:** The Commission
(for the Commission Meeting of October 17, 1985)**From:** **Public Utilities Commission—San Francisco -**Wesley Franklin, Chief-Water Utilities Br.
M.J. Purcell, Policy & Planning Division**File
No:****Subject:** VI. Speculation in Class D Water Companies

Recommendation: That the Commission issue the attached resolution which would require private parties to justify their intention to pay prices significantly in excess of net book value for purchase of small Class D water companies. By meeting criteria specified in the resolution, applicants would have to demonstrate that the proposed transactions are financially sound. Commission approval would not be authorized for uneconomic sales, that is, sales which are not likely to provide a return from rates on the buyer's investment. Commission approval would also be withheld for sales agreements whereby the buyer would finance the acquisition through the use of long-term debt which would place the company in a high leveraged position. It is intended that this resolution would deter speculation in the purchase and sale of Class D water companies, which in turn would lead to more responsible company management.

Background: The effects of speculation in small water company service will be the focus in this memorandum in two contexts: (1) the problems caused when some Class D owners refuse either to provide minimally acceptable water service or to divest their companies at a reasonable price to willing buyers, and (2) the problems caused when inexperienced parties buy Class D water companies at prices set considerably above depreciated rate base, leaving little or no opportunity for the buyers to earn a reasonable return on their investment. These two problems are sometimes related, as an owner who has overpaid for a water company may be reluctant to sell at a price below the acquisition cost.

The problems with the exploitive owner often go on for years. Given enough angry customers who are sufficiently organized, they may form a district or petition a local political subdivision to acquire the utility. In some cases, the public agency pays the owner's asking price and then the costs to make lengthy improvements necessary due to the deterioration of the system. If the customers are insufficiently organized to accomplish a buy out but complain to the Commission, the Commission may enter into extensive litigation trying to get the owner to effectively manage the system or to divest ownership. With very stubborn owners this strategy may have virtually no effect at all. Or the owners may make some minimal improvement to avoid hearings and to justify additional, capital-related rate

Appendix C

increases. In extreme cases, owners have abandoned their systems when the customers stopped paying their bills, due to the poor service, or their systems collapsed, failing to provide water.

When the Commission becomes familiar with these problems it is placed in a reactive position often with few options for a quick or effective fix for the future. This is not to say, however, that rigorous and creative regulation at this point isn't effective in mitigating the problems as evidenced in many cases. In one case, D.83-05-018, the Commission gave an owner 90 days to sell his system to a nearby public district before the Commission would file an action in Superior Court to place a receiver in control of his system. The price he would accept suddenly coincided with net book and he promptly sold. In another case, W-2392 (Meadowbrook Water Company, Inc.), the Commission made an entire rate increase subject to refund in the event the owner failed to make very basic and necessary improvements. Instead of making the improvements the owner pocketed the revenues (just after the customers paid their annual flat rate charge for the coming year) and illegally sold the system at a cocktail party to a friend. The Commission tried negotiation as well as years of hearings to get the system away from the illegal owner (who couldn't manage the system) and to a nearby district. But the bottom line was finally reached when the customers failed to pay their annual charge for the next year (after the Commission had ordered the refund). The illegal owner couldn't subsidize the system and he gave it up.

In another case, a Commissioner personally held hearings almost weekly in Dunsmuir one summer in order to fine the absentee owner of Shasta Retreat Water System (who lived in San Francisco and had to drive up for the hearings) who finally gave in to the regulatory pressure, and sold out to an adjacent company (D.89867). Desertification, i.e., revocation of a utility's authority to operate, as a solution for a poorly managed company, was considered in a current case (San Martin Water Company).

Unfortunately, these options are not available in all situations and, even if they are, it can take an inordinately long time and a considerable drain on Commission resources to effect the ownership change. And, most importantly, a substitution of owners doesn't repay the customers for the poor service they have received.

As a matter of jurisdictional prerogatives, regulation by the Commission and health departments should be designed to prevent this abuse of ratepayers. In exchange for the right of providing monopoly service, water utilities should be licensed regularly and either be penalized or disenfranchised for providing poor service. At present, however, the Commission does not have a program designed to avert the abuse of ratepayers and thus the examples cited above have tended to be reactive, ad hoc solutions applied when customers complain.

At the other extreme, we have also seen inexperienced parties agreeing to pay highly inflated prices for Class D water systems. Often these individuals have limited financial resources aside from the water company. It is not always clear why these transactions take place. Often these sales are made to retirement age individuals who visualize a good income opportunity. Or they believe, naively, that they can improve the systems with little capital and sell them at huge profits. They may anticipate growth in the number of customers which will result in increased revenues (eventually providing a return on the investment). Unfortunately, the Commission has had ample experience with the drawbacks to these sales. If the companies are in poor physical condition and service is inadequate, thereby requiring-extensive maintenance and/or capital improvements the new owners are sometimes unwilling and often unable to respond allowing service to deteriorate further.

Buyers are often willing to pay inflated prices for water companies because they believe they can do much of the maintenance and service themselves for the companies, such as the bookkeeping or repair of mains, and pocket ratemaking allowances for these expenses, thereby increasing their return. However, this may not work if for some reason the operator does have to hire help, thereby losing the allowances.

Although there are exceptions, it is generally the Commission's position neither to interfere with nor to disallow the transaction due to the level of the requested price. If the buyers contact the Commission staff they are warned about any drawbacks to the sale and provided an informal education on the responsibilities of running a utility. On the application form the buyer must acknowledge that rates may be fixed only on depreciated rate base, not the buyer's cost of acquisition.

The majority of applications are approved on an ex-parte basis with minimal staff analysis. The analysis that is performed determines if the buyer has any assets, but no investigation as to the true value of the assets is made. In three cases in which there was serious question about the viability of proposed sales the applications did go to hearing. Staff cross-examined the parties and testified on the problems with the proposed sales. Although the problems varied in each of these cases, they all

involved highly inflated sale prices. In two of the cases, the applications were denied and, in the opinion of staff, much more desirable outcomes have been accomplished. In one of these two cases, a new buyer who is a retired school administrator has bought the system at book value.

A brief description of the second case, D.82-05-011, involving the proposed sale of Descano Park Water Company to Sweet Water Works, Inc. is highlighted here. It is a classic example of speculation and shows the extensive efforts made by staff and the customers to prevent the transfer.

The requested transfer price was \$324,070, representing an amount three times the depreciated ratebase of the system, (approximately \$100,000). The application was forthright in presenting the view of the buyers that they could not derive an adequate income from the water company (in spite of their requesting that the rate base be increased to correspond to the proposed sale price). So they planned to develop a bottled water business at the water company site.

Not enjoying an abundant amount of water themselves, the alarmed customers initiated the paperwork to form a county water district. This was important due to the Commission's policy to prefer mergers of small companies with larger companies or their assumption by public agencies if service would be improved. Staff testimony to deny the proposed sale included the concern that the buyers had no definite plans for operation of the water company and that long-term debt to finance the sale would be greater than 50% of depreciated ratebase. The application was denied. This company continues to be operated by the owner and the final steps for transfer of the system to the county are in place. The adoption of the staff recommendation on leveraging should be applied on an industry wide basis and should discourage the practice of an applicant paying a small amount down and agreeing to carry a burdensome note. "Junk bond acquisitions" carry their own disadvantages and should not be encouraged.

Analysis:

At the present time, there appears to be a presumption with the Commission that most proposed transfers are desirable. Staff, therefore, is placed in a defensive position and has the burden of proof to demonstrate that a sale might not be in the public interest. This is disadvantageous for many reasons and constitutes an unwise resource drain for the Commission. The applicants are in the best position to provide information on the viability and rationale for the sale. They should be required to do so. In the typical permit process the applicant must convince the permitting authority of the need for and likely success of the business venture. That procedure should be followed in these cases.

The purpose of this memo and resolution is not to preclude sales of water companies per se but to suggest guidelines for Commission use in the evaluation of proposed sales between private parties which appear speculative. It is also hoped that owners holding out for unreasonably inflated prices will have an incentive to reconsider their position. Approvals of transfers would be denied only if the terms of the transfer are so financially unsound that the transfer is likely to adversely affect the buyer's financial position and/or the management of the system to the detriment of ratepayers. Staff strongly believes that this would be an appropriate strategy for the Commission inasmuch as its power to approve sales extends to the right, indeed the responsibility, to disapprove sales which are not in the interest of the ratepayers. The standard used in evaluating proposed water company sales at inflated prices (i.e., at a price considerably above net book) should be similar to the standards used in the evaluation of a certificate or license application, which is granted after certain criteria are met, e.g., improving the financial integrity of the system or meeting cost-effectiveness. Staff does not recommend that the Commission set an upper limit on the amount over depreciated rate base which it

would consider appropriate. The financial circumstances vary so greatly among utilities that setting an arbitrary limit would be counter productive. For example, a sale price of \$15,000 for a system with a net book value of \$10,000 might not be burdensome. A sale price of \$300,000 for a problematic system having a net book value of \$200,000, however, might present severe problems if approved.

An inflated price suggests that the market value of the system is not reflected in the system's depreciated historical cost. And the increment of price above that level does not inherently mean the price is imprudent. However, the Commission should actively investigate issues related to above-book pricing. Although there may be many non-financial rewards to running a small water company, which increase its market value, such as experimentation by a retiree etc., staff believes that due to the economic pressures on small water companies tested for reasonableness based upon a measure of the present or future return likely to be provided to the new owner.

This raises the issue of the criteria which may be used to ascertain whether an inflated value of a water company is realistic. The system's new income, both recorded and future, should be determined through an analysis of prior financial history and future operation projections. If the buyer believes that there will be growth (or some other circumstance) occurring which will increase the company's income, then substantial evidence should be provided to determine its reasonableness. For example, to ascertain whether there will be customer growth, the buyer should provide developers' requests for service, applications for or imminent zoning changes or indications that municipal services are being added to accommodate future growth. These matters may still be speculative in nature, but they at least explain the buyer's motivation in valuing the system. Along with evidence of projected growth, the buyer should be required to project utility costs to serve this new development and likely revenues deriving from the growth, to demonstrate that the water company sale price is appropriate if the development does occur.

If it appears that the inflated price does equate with the value of the system, as demonstrated by the evidence provided by the buyer and seller, then the Commission should approve the sale (implying there are no other controversies). Staff believes this policy will encourage more responsible and economic pricing in Class D water company sales. This should reduce prices generally and incentives for speculation specifically. This should improve the Commission's ability to pressure undesirable owners to divest.

Water companies are sold at depreciated historical cost, both to individuals and other utilities, so apparently there is some incentive for such sales. In fact, companies are sold for \$1 in exchange for a release from the obligation of utility service, particularly if the present buyer foresees nothing but deterioration in the system and does not desire to commit capital or other energy to make improvements or foresees Commission action if there isn't improvement in the management of the system. It may be of note to mention here that large water companies rarely pay amounts over net book when acquiring systems. An exception to this was the recent purchase of the Westlake Water Company by California Water Service Company, Inc. for an inflated price. However, this has been justified by the fast customer growth in the system, evidenced by a later rate reduction.

In summary, as a matter of its regulation of small water companies, the Commission should more intensively and actively scrutinize sales transactions involving these companies. A policy requiring the demonstration that such sales are financially sound would discourage investor speculation in these companies and should place ratepayers in a position to obtain better service.

Copy for:

A.

Orig. and Copy

RESOLUTION NO. W-

3285

_____ to Executive Director

POLICY AND PLANNING
DIVISIONVII. RESOLUTION_____

Director
Numerical File
Alphabetical File
Accounting Officer

Date: October 17, 1985

SUBJECT: Resolution for Commission Adoption on Small (Class D) Water Company Sales Policy. This will be Applicable when the Proposed Sale Price is Set Above Depreciated Historical Cost.

WHEREAS: The Commission finds that Class D water companies are often sold at prices substantially in excess of depreciated historical cost due to investor speculation. When an owner cannot realize a profit through rates on the investment, this often results in deteriorating management of the system which affects ratepayers. For this reason, the Commission does not intend to approve water company sales at prices substantially above depreciated premium price. The affirmative burden of providing this evidence is on parties to the transaction. If the Commission is not assured of the financial soundness of the proposed sale, the sale will not be approved, without prejudice. The Commission also no longer intends to approve a sale involving the buyer's issuance of debt which places the company in a highly leveraged position.

The following criteria, among others, should be used to evaluate the potential for future revenues and net income derived from the utility operation that would justify payment in excess of its book value:

A. Provisions of recorded and estimated financial data and results of operations.

- B. A five-year plan for operation of the _____ system including projected system improvements, maintenance schedules and financing.
- C. Provision of an audit to verify the buyer's assets.

- D. Evidence of projected customer growth, including but not limited to: zoning, demands for service by developers, plans for municipal services to accommodate growth, costs of service by the utility to provide service to the projected growth, extent of likely growth and likely revenues derived from this growth.

Executive Director of the
Public Utilities Commission
of the State of California