



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

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In the Matter of the Application of)
VALENCIA WATER COMPANY (U-342-W),)
a Corporation, for an Order Authorizing It to)
Increase Rates Charged for Water Service in)
Order to Realize Increased Annual Revenues of)
\$4,751,000 or 18.78% in a Test Year Beginning)
January 2011, \$1,957,000 or 6.40% in a Test Year)
Beginning January 2012, \$701,000 or 2.16% in an)
Escalation Year Beginning January 1, 2013, and to)
Make Further Changes and Additions to Its Tariff)
for Water Service.)
_____)

Application No. 10-01-006
(Filed January 4, 2010)

**OPENING BRIEF
OF VALENCIA WATER COMPANY**

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**OPENING BRIEF
OF VALENCIA WATER COMPANY**

In accordance with Rule 13.11 of the Commission’s Rules of Practice and Procedure and the schedule established and thereafter extended by Administrative Law Judge (“ALJ”) DeBerry, Valencia Water Company (“Valencia”) hereby respectfully submits its opening brief on issues addressed in its application and in evidentiary hearings held July 19 and 20, 2010, in the above-captioned general rate case (“GRC”) proceeding. This opening brief begins with a summary of Valencia’s position on the contested issues, then recounts the procedural history of this GRC, including a summary of the scope of the two settlement documents (the Settlement Agreement and the Supplemental Settlement Agreement), then addresses the remaining contested issues in detail, summarizes certain non-controversial matters for the Commission’s consideration, and concludes with a statement of the specific relief Valencia requests in this proceeding.

I.

SUMMARY OF VALENCIA’S POSITION ON CONTESTED ISSUES

Because the only active parties to this GRC proceeding, Valencia and the Division of Ratepayer Advocates (“DRA”), succeeded in settling nearly all of the contested issues, only those issues related to the ratemaking treatment of Valencia’s perchlorate contamination settlement proceeds remain in dispute. As Valencia will demonstrate in a detailed discussion below, there is strong support in the evidentiary record and in recent Commission precedent for the Commission to approve Valencia’s proposal for a fair allocation of net proceeds from the perchlorate settlement between Valencia and its ratepayers.

II.

PROCEDURAL HISTORY

In accordance with the Commission’s Rate Case Plan for Class A Water Companies,¹ Valencia circulated its proposed application in November 2009. On December 7, 2009, Valencia received a deficiency letter from DRA, identifying a series of perceived deficiencies in the proposed application. After addressing each of these items and revising the proposed application as appropriate, Valencia proceeded to file its Application on January 4, 2010, including a total of 25 exhibits and other requisite attachments. The application was served on potentially interested parties and was noticed in the Commission’s Daily Calendar for January 13, 2010, initiating a 30-day protest period. The only protest submitted was that of DRA, filed February 4, 2010.

The assigned Administrative Law Judge (“ALJ”), Bruce DeBerry, scheduled and held a prehearing conference on March 2, 2010, which provided a forum for the ALJ and the

¹ *Rulemaking to Consider Revisions to the General Rate Case Plan for Class A Water Companies*, D.07-05-062 (*Rate Case Plan Decision*), Appendix A.

parties to clarify the issues to be addressed in the proceeding and the procedural schedule. Also on March 2, 2010, the parties met and discussed the scope of the proceeding, including especially, Valencia's decision to suspend efforts to pursue the Water Softening Project originally proposed in its Application. Valencia provided DRA a revised version of its GRC revenue requirements model, excluding all aspects of the planned Water Softening Project, on March 4, 2010 and notified ALJ DeBerry of these developments by letter on March 16, 2010. The procedural schedule and the scope of the proceeding were confirmed by Commissioner Bohn's Ruling and Scoping Memo, issued March 26, 2010, and the schedule later was modified by ALJ DeBerry's e-mail ruling circulated May 14, 2010.

On March 29, 2010, pursuant to the Rate Case Plan,² the Division of Water and Audits ("DWA") provided a preliminary "Report on Water Quality Report for Valencia Water Company in Response to Its Application for a General Rate Increase." At the invitation of ALJ DeBerry,³ Valencia submitted comments on the preliminary Water Quality Report on April 5, 2010 and DWA served a revised Report on all parties on April 27, 2010.

Meanwhile, the discovery process began with the delivery of formal data requests by DRA to Valencia. Valencia worked to respond promptly and fully to all DRA data requests. There were no discovery disputes that had to be brought to the attention of the ALJ. As a result of this cooperative and constructive discovery process, DRA was able to timely complete and serve its Report on Valencia's Results of Operations on May 4, 2010.

With the service of rebuttal testimony on May 24, 2010, the parties initiated efforts to settle some or all issues presented in this GRC. Valencia and DRA commenced settlement discussions on June 1, 2010, with ALJ Linda Rochester serving as Neutral ALJ. Settlement discussions continued through June 4, 2010, resulting in the parties' agreement on terms of a settlement agreement that would resolve most of the issues that previously had

² *Rate Case Plan Decision*, at A-4.

³ ALJ's Ruling Providing for Comments on Water Quality Report, issued March 29, 2010.

been contested by DRA while identifying certain issues as still in dispute. Negotiation of the precise language of the Joint Settlement Agreement between Valencia and DRA (the "Settlement Agreement") was completed on July 16, 2010, just before the start of evidentiary hearings. The Settlement Agreement was received into evidence as Exhibit 48.

Evidentiary hearings in this GRC were held July 19 and 20, 2010, at the Commission's offices in San Francisco. Two witnesses appeared for Valencia and two for DRA, each adopting his or her previously circulated prepared testimony, in some cases offering additional direct testimony, and responding to cross-examination. A total of 49 exhibits were received into evidence in the course of the hearing, with accommodation made for two additional late-filed exhibits that were submitted thereafter and received into evidence August 19, 2010 (Exhibit 50, a DRA exhibit correcting two perchlorate-related tables and providing clarification of a file name; and Exhibit 51, a Valencia exhibit updating the balance of Valencia's Water Quality Litigation Memorandum Account as of June 30, 2010).

As the briefing period commenced, the parties continued to discuss possible settlement of the issues presented during evidentiary hearings for which the parties had been previously unable to reach a stipulated result. Settlement discussion continued through August 5, 2010, resulting in the parties' agreement on a Supplemental Settlement Agreement between Valencia and DRA (the "Supplemental Settlement") resolving nearly all of the contested issues presented during evidentiary hearings, except for issues related to the disposition of perchlorate contamination settlement proceeds. In order to allow the parties to finalize the Supplemental Settlement, the parties requested and ALJ DeBerry approved an extension of the briefing schedule. Negotiation of the precise language of the Supplemental Settlement was completed on August 12, 2010. Valencia and DRA filed a Joint Motion for

approval of both the Settlement Agreement and the Supplemental Settlement on August 13, 2010.⁴

As noted above, Valencia and DRA executed two settlement agreements before the filing of opening briefs. Together, the two settlement agreements (the “Settlement Documents”) address “all of the issues that DRA and Valencia have been able to resolve in this proceeding.” Exhibit 48 (Settlement Agreement), ¶ I.1; Supplemental Settlement, ¶ I.1. The Settlement Documents provide for the precise terms of the parties’ agreements.⁵ The specific revenue requirement impacts of the settlement outcome of particular issues will be shown in the Joint Comparison Exhibit that Valencia plans to join with DRA in filing concurrently with reply briefs.

Generally, the Settlement Documents resolve all issues regarding revenues; all issues regarding operation and administrative expenses, including payroll and new employee positions; all issues regarding capital plant additions; all issues regarding rate base, except for the rate base effects associated with Valencia’s receipt of perchlorate contamination settlement proceeds; all issues regarding Valencia’s Water SMART Program, conservation rate design, the associated proposals for a Water Revenue Adjustment Mechanism (“WRAM”) and a Modified Cost Balancing Account (“MCBA”), and a variety of other items, including the use of Valencia’s current adopted rate of return for cost of capital until a final Commission decision is adopted in Valencia’s separate Cost of Capital application (A.09-05-002), filed May 1, 2009.

⁴ After the filing of the Joint Motion, DRA and Valencia acknowledged a typographical error on page 3 of the Supplemental Settlement regarding the start date of the pilot program described therein. Per ALJ DeBerry’s August 23, 2010 e-mail correspondence, the first sentence of Section II. B. of the Supplemental Settlement should read, “[t]he Parties agree that the Water SMART Program, related ratemaking mechanisms (specifically the Water Revenue Adjustment Mechanism and Modified Cost Balancing Account) and associated reporting requirements will constitute a pilot program (the “Pilot Program”) to become effective at the same time as new rates in this GRC cycle, which is scheduled to be January 1, 2011.”

⁵ The Supplemental Settlement defines the widths of quantity rate tiers based on percentages of customers’ total water budgets. The intention of the parties was that Tier 3 would start at 101% of the budget and Tier 4 at 151% of the budget.

III.

CONTESTED ISSUES: RATEMAKING TREATMENT OF PERCHLORATE SETTLEMENT PROCEEDS

This portion of Valencia's opening brief addresses the contested issues related to the ratemaking treatment of perchlorate settlement proceeds. The parties were unable to reach a stipulated result with respect to these issues. Valencia will show that its position is well supported by the evidentiary record and by Commission precedent and should be approved by the Commission.

Exhibit 10, Valencia's "Perchlorate Litigation Summary," presented a narrative summary describing the decade-long saga of perchlorate contamination and litigation in the Santa Clarita Valley, the resolution of that litigation through a complex settlement highly beneficial to the plaintiff water purveyors and their customers, and Valencia's proposed ratemaking treatment of the proceeds derived from the settlement. Exhibit 10 was sponsored jointly by Robert DiPrimio, Valencia's President, and Greg Milleman, Valencia's Vice President of Administration.

A. The Decade-Long Perchlorate Contamination Saga Posed Challenges That Valencia Successfully Met While Protecting Its Customers From Adverse Impacts.

Mr. DiPrimio, who guided Valencia through all stages of the perchlorate challenge, was responsible for portions of Exhibit 10 relating the history of perchlorate contamination affecting Valencia's and other utilities' water supplies in the Santa Clarita Valley. He described the remediation efforts Valencia undertook and the plaintiff's litigation Valencia pursued against parties responsible for the contamination as well as the insurance carriers reluctant to honor outstanding policies, and he explained the extended settlement efforts that ultimately produced very favorable results. Exhibit 10 (DiPrimio/VWC), at 1-9.

Tests conducted in 1997 found Valencia's Well V-157, along with three other wells operated by other local purveyors, to be contaminated by perchlorate. The apparent

contamination source was the nearby Whittaker Bermite site, where munitions had been manufactured for a half-century through the late 1980s. In November 2000, Castaic Lake Water Agency, Valencia, and two other retail purveyors (“Plaintiffs”) filed a complaint against the potentially responsible parties, resulting in complex claims and counterclaims that led to a court ruling in July 2003 finding defendants liable for response costs under the Comprehensive Environmental Response, Compensation and Recovery Act (“CERCLA”). An interim settlement and a bankruptcy filing by key defendants occupied the following two years, followed by court-ordered mediation in 2005.

While the mediation was ongoing, perchlorate contamination was identified in another Valencia well, Well Q-2. The defendants and their insurers agreed to pay for all the costs of installing, operating, and maintaining a wellhead treatment that permitted Valencia to bring Well Q-2 back into active service after just six months. Further testing without detection of perchlorate enabled Valencia to remove the treatment system in October 2007, and to continue use of the well without need for wellhead treatment.⁶

Litigation resumed later in 2005, but the Bankruptcy Court approved a settlement between the defendants and their insurers that made insurance proceeds available to settle Plaintiffs’ contamination claims. After further extensive negotiations, settlement of the contamination claims was announced in May 2007, providing up to \$100 million to address the problems affecting the four Plaintiffs’ water systems. Castaic Lake Water Agency assumed the lead role for construction and operation of treatment facilities, and so is designated to receive the majority of settlement funds. Valencia received a total of \$3.5 million under the settlement, including \$2.5 million for past environmental claims and \$1.0 million to close and abandon well V-157 and drill replacement well V-206. Exhibit 10

⁶ Further detail about the operation and treatment of Well Q-2 was provided by witness DiPrimio in Exhibit 10, at 7-8 and Appendix C. No issues have been raised regarding the use of funds provided for perchlorate treatment of Well Q-2.

(DiPrimio/VWC), at 1-4. The settlement agreement and related documents are in evidence as Appendices A and B to Exhibit 10.

Mr. DiPrimio's testimony goes on to describe the history of Valencia's Well V-157, which was constructed in 1962 by Valencia's parent company, essentially contributed to the utility, and removed from service in 1997, when perchlorate was detected. The well's capacity of 1,500 gpm was replaced by the 2,500 gpm Well V-206, which was placed in service in September 2005 along with an increased-capacity connecting pipeline. Investment in the new well and pipeline totaled about \$2.4 million. Exhibit 10 (DiPrimio/VWC), at 5-6.

As Mr. DiPrimio testified, Valencia incurred various legal and consulting costs starting in April 1998 related to the perchlorate lawsuit, related litigation, and settlement negotiations. Valencia expensed these costs in the year incurred, less insurance proceeds received to cover a portion of such costs. Since 1998, these costs and receipts have been recorded in Valencia's Water Quality Litigation Memorandum Account ("WQLMA") Exhibit 10 (DiPrimio/VWC), at 8-9 and App. E.

B. Accounting and Ratemaking Procedures Have Effectively Shielded Valencia's Customers From Risks Borne By Valencia as It Pursued Years of Perchlorate Litigation.

Mr. Milleman sponsored the remainder of Exhibit 10, including a detailed account of the expenses and proceeds (both from insurance and settlement funds) recorded in the WQLMA, an explanation of how gain was deferred for income tax purposes by investing \$3.5 million of settlement proceeds in "similar plant" pursuant to Internal Revenue Code §1033, and an extended discussion of the relative risks borne by shareholders and customers over the years of perchlorate contamination. Exhibit 10 (Milleman/VWC), at 9-17 and Apps. F and G. Mr. Milleman explained that Valencia took the initiative to pursue the party responsible for the contamination, pursuing seven years of litigation and what will likely be decades of on-

and off-site clean-up activities, while fully shielding Valencia's customers from exposure to health and financial risks. He described Valencia's prompt actions to install treatment at Well Q-2, cleaning up the well for future production at no expense to ratepayers, and the broader provisions of the settlement agreement that shield ratepayers from all perchlorate clean-up and treatment costs and provide a \$10 million Rapid Response Fund to address future contamination incidents. *Id.* at 9-13. He explained that new Well V-206, replacing the contaminated and now destroyed Well V-157, offers increased capacity and extended life expectancy, with lower prospective maintenance costs, all to the great benefit of customers. *Id.* at 13-14.

Mr. Milleman provided a detailed analysis of the extent to which Valencia was allowed to recover in rates its costs of responding to the perchlorate contamination challenge. As he explained, Valencia's general rates from 1998 to 2002 included no projected expense for perchlorate litigation or remediation. Valencia's next general rate case, setting rates for the years 2003 to 2007, allowed \$110,000 per year in general rates for perchlorate litigation costs, just 50% of the projected expense, subject to recording in the WQLMA and subject to refund. As Mr. Milleman testified, the amounts allowed were not enough to fund Valencia's actual costs either for perchlorate or non-perchlorate outside service costs. And Valencia's most recent GRC decision, D.07-06-024, excluded all perchlorate litigation expenses from the outside services expense projection.⁷ While Valencia has been permitted to record its perchlorate litigation costs (less revenues allowed in rates and insurance proceeds received) in its WQLMA, recovery of those costs is subject to reasonableness review and has never been guaranteed. *Id.* at 14-16.

On this factual basis, Mr. Milleman concluded that "Valencia's customers bore little, if any, financial risks related to the perchlorate contamination and litigation that

⁷ The differences between the expenses Valencia incurred for perchlorate litigation and the much smaller amounts allowed in rates are quantified and documented in Exhibit 10, App. G.

threatened VWC.” Observing that the investment to construct Well V-206 had increased rate base and costs to customers, he stated Valencia’s belief that a fair assignment of risks for this proceeding is 67% to Valencia and 33% to its customers, with net gain to be shared accordingly. *Id.* at 16-17.

C. “Rates Paid Subject to Refund” Should Be Returned to Valencia’s Ratepayers.

As noted above, during the years 2003 to 2007, Valencia was allowed to recover in general rates 50% of its projected annual expense of pursuing the perchlorate litigation, subject to refund. Accruing at a rate of \$110,000 per year for those years plus continuing accrual of interest, that amount of “rates subject to refund” stood at \$531,605 as of September 30, 2009, when Valencia submitted its proposed application.

In his rebuttal testimony, Mr. Milleman agreed with DRA that customers are entitled to be returned all the amounts paid through general rates (plus interest) and that the calculation originally proposed in Exhibit 10 would not achieve that result. Mr. Milleman proposed an alternative calculation that simply deducts the “rates subject to refund” from the \$3,645,277 total of settlement proceeds received, leaving “net” settlement proceeds of \$3,113,672 to be further reduced by net litigation expenses to arrive at an amount of “net gain” (\$1,528,276) to be allocated between Valencia and its customers. Exhibit 30 (Milleman/VWC), at 10-11 and Att. 3.

When he testified at hearing, Mr. Milleman confirmed Valencia’s intention to ensure that the “rates subject to refund” should be refunded to customers prior to allocation of net settlement proceeds, but explained that Valencia had only lately realized that this \$531,000 amount was additional to – and not just a part of – the \$3.5 million plus interest that Valencia received from the polluters as part of the perchlorate settlement. Tr. 18:5-11, 19:6-18 (Milleman/VWC). Recognizing that the “rates subject to refund” was a “completely

separate item” from the settlement proceeds, Mr. Milleman revised the calculation presented in Exhibit 30, Attachment 3. In a new table, presented as Exhibit 32, Mr. Milleman presented his revised calculation in a third column that provided for paying back the \$531,000 in “rates subject to refund and separately developing a calculation of net settlement proceeds to be allocated between Valencia and its customers. Valencia proposes to refund the amount of “rates subject to refund” (\$531,605 as of September 30, 2009) by a 12-month credit of customers’ bills. Tr. 19:19-20:4; 20:22-21:2 (Milleman/VWC).

DRA witness Larsen, who was responsible for the perchlorate contamination settlement proceeds issues, noted in his testimony that the “ratepayer contributions” – referring to the “rates subject to refund” – had not been refunded and that the “remaining balance” of settlement proceeds should be used for that purpose. Exhibit 35, at 6-3 (Larsen/DRA); Tr. 223:13-23 (Larsen/DRA). In testimony at hearing, however, Mr. Larsen stated that the “rates subject to refund that Valencia ratepayers contributed to the memorandum account” should be refunded to customers as the “first order of business before any net proceeds are returned either to ratepayers or shareholders.” He agreed that this recommendation was consistent with Mr. Milleman’s revised treatment of the “rates subject to refund” as reflected in Exhibit 32, and that the difference between the two witnesses’ positions relates to allocation or assignment of the remaining net settlement proceeds. Tr. 226:12-227:14 (Larsen/DRA).

D. The Commission Should Determine the Net Proceeds Available from the Perchlorate Contamination Settlement and Allocate them Fairly Between Valencia and Its Ratepayers.

The allocation of proceeds from the perchlorate contamination settlement requires a two-step process. The first step is to assign a portion of those proceeds to reimburse certain costs incurred in obtaining the proceeds. The second step is to determine a fair allocation of the net proceeds between Valencia and its ratepayers.

1. Net proceeds should be calculated by deducting net litigation and settlement costs Valencia incurred in achieving the perchlorate contamination settlement from the settlement proceeds received.

Mr. Milleman testified that approximately \$1.0 million of perchlorate litigation costs (net of insurance proceeds) plus accrued interest accumulated in Valencia's WQLMA should be deducted from the \$3.6 million of settlement proceeds plus interest also recorded in that account, leaving about \$2.6 million in "net gain" to be allocated between Valencia and its customers. He stated that this calculation of "net gain" as settlement proceeds less costs incurred to litigate the matter less income taxes actually paid is consistent with the Commission's determination of net proceeds from a comparable contamination settlement in *Re San Gabriel Valley Water Company*, D.07-04-046. Exhibit 10 (Milleman/VWC), at 18.⁸ Valencia having deferred gain on the settlement proceeds for tax purposes, the net gain is simply the settlement proceeds "less costs to litigate." Mr. Milleman testified that, since all such costs and proceeds have been recorded in the WQLMA, the net gain is the balance remaining in that account. *Id.* at 18. As of September 2009, that number was \$2,591,486. *Id.*, App. F, hand-numbered p. 10-197.

With his later proposal, discussed above, to repay \$531,605 in "rates subject to refund," plus accrued interest, directly to ratepayers by a billing surcredit, Mr. Milleman excluded that amount from the disposition of contamination settlement proceeds. This had the effect of increasing the "net expenses" in the WQLMA from \$1,053,791 to \$1,585,396,

⁸ Indeed, Mr. Milleman applied the same procedure for determining net settlement proceeds as the Commission applied in the recent *San Gabriel Valley Water Company* case. While that decision addressed the disposition of revenue derived from several different sources, the relevant item was \$8,559,863 in proceeds from settlement of a contamination claim against the County of San Bernardino, to which an additional \$26,114 of proceeds were added and from which \$208,554 in previously unreimbursed legal costs were deducted, leaving \$8,337,423 of "net proceeds," which the Commission chose to allocate between shareholders and ratepayers by a 33/67 split. D.07-04-046, at 93-99, 124-25 (Findings of Fact 75-79), corrected by D.08-04-005, at 5. The utility's previous \$2,618,291 investment of a portion of the proceeds in replacement plant, which had been accounted for as Contributions in Aid of Construction ("CIAC"), was included in the ratepayers' share, confirming that the Commission's analysis determined the "net proceeds" total *before* assigning any of those proceeds to cover remediation or replacement costs. See, D.07-04-046, at 93, 99-100.

and correspondingly reducing Mr. Milleman's calculation of "net gain" from \$2,591,486 to \$2,059,881. See, Exhibit 32 (Milleman/VWC), cols. 1 and 3, lines J, K and L.

DRA's report, responding to Mr. Milleman's original calculations, proposed that the net proceeds should first be applied to cover the \$2.4 million capital cost of constructing Well V-206, including the pipeline connection. Exhibit 35 (Larsen/DRA), at 6-2. According to DRA, a "true calculation of 'net gain'" would reduce the WQLMA balance of \$2.6 million by the \$2.4 million in "replacement plant," and then would apply the remaining "net gain" to refund to customers the litigation costs already recovered through rates. *Id.* at 6-3. During the hearing, DRA witness Larsen corrected DRA's proposal so as to deduct only \$2.1 million of the Well V-206 project costs, leaving \$500,000 of "net gain" to cover the "rates subject to refund." Tr. 223:13-23.⁹

Valencia witness Milleman testified in rebuttal that DRA's methodology for calculating "net gain" is not consistent with the past Commission practice of calculating "net gain" as total proceeds less any cost to litigate. He criticized DRA's approach as allocating 100% of the proceeds to customers – an extreme position inconsistent with "Commission past practice of allocating 'net gain' based on the relative risks and costs borne by parties." Exhibit 30 (Milleman/VWC), at 8. Certainly, given the updated calculation in Exhibit 32, showing "net gain" of just \$2,059,881, assigning the entire amount of that gain to the cost of Well V-206 would leave no proceeds to allocate between the utility and its ratepayers.

Mr. Milleman's calculation of net gain as total settlement proceeds less costs incurred to litigate the matter less income taxes actually paid is consistent with the Commission's determination of net proceeds in the recent San Gabriel Valley Water Company case, discussed in Footnote 8, above. This approach does not prevent the Commission from taking investments in remediation or replacement plant into account when deciding how to allocate those net proceeds between the utility and its ratepayers. But Mr.

Milleman's approach preserves the Commission's option to allocate net proceeds fairly across a wide range of circumstances.

2. Only the cost of replacing the destroyed well, rather than the entire investment in a new, higher capacity well, should be taken into account in assigning or allocating contamination settlement proceeds.

Entirely apart from the definition of "net gain," Mr. Milleman testified that deducting the entire cost of the new well made no sense. He explained that Well V-206 is a new well with a capacity of 2,500 gpm, replacing a well constructed in 1962 with a capacity of 1,500 gpm. Referring back to his direct testimony establishing the greater value of the new well, he emphasized that DRA's allocation method "completely ignores these facts." He urged the Commission to reject DRA's methodology. At a minimum, if the Commission elects to reduce the "net gain" by an amount invested in the new well, Mr. Milleman explained that the reduction should be limited to reflect the "new to old" assets value and upsized capacity. *Id.*

DRA made no effort to assess the value of Well V-157 when it was taken out of service due to perchlorate contamination in 1997. Instead, DRA simply claims that the entire investment in the new and higher capacity Well V-206 should be treated as the cost of replacing the far older and lower capacity Well V-157.¹⁰ Valencia has shown that this is a spurious claim. What needs to be done is to calculate a value for Well V-157 in 1997.

Well V-157 was 35 years old when it was taken out of service due to perchlorate contamination. Recognizing that Standard Practice U-4-W recommends 20 to 40 years as the average service life for wells but notes that "[p]lant of a particular utility may justify a service life outside of above ranges."¹¹ It is reasonable but conservative to apply a 50-year

⁹ DRA has requested correction of the number "12.1" at Tr. 223:15, so that it would read "2.1". See, electronic message from Darryl Gruen, Staff Counsel, to ALJ DeBerry, August 19, 2010.

¹⁰ On the stand, DRA Larsen acknowledged that the new Well V-206 would be useful for a substantially longer period of time than the old well 157 as long as it was properly maintained. Tr. 228:20-230:27 (Larsen/DRA).

¹¹ CPUC Water Division, "Standard Practice for Determination of Straight-Line Remaining Life Depreciation Accruals," Standard Practice U-4-W, ch. 6, p. 30.

useful life to depreciate Valencia's investment in Well V-157. Accordingly, it is fair to consider that Well V-157 had just one-third of the remaining useful life of the new Well V-206, with production capacity no more than three-fifths that of the new well (1,500 vs. 2,500 gpm). Thus, a rough measure of the relative value of the old Well V-157 would be one-third times three-fifths (that is, one-fifth) of the \$2.4 million investment in Well V-206, which equates to \$480,000. If the Commission concludes that the cost of replacing Well V-157 should be deducted from the contamination settlement proceeds or otherwise allocated to ratepayers, the appropriate estimate of that cost is \$480,000 – not the \$2.6 million cost of the higher capacity and longer lived Well V-206.

Alternatively, the Commission might value the loss of Well V-157 based on the terms of the settlement agreement that resolved the perchlorate litigation, whereby Valencia received \$2.5 million for past environmental claims and \$1.0 million to resolve Valencia's claims "for V-206 Replacement Well, including, but not limited to, construction and installation of VWC's well V206 and associated pipelines, and permanent closure and abandonment of VWC's well V157."¹² On this basis, the Commission might assign a value of \$1.0 million to the replacement of Well V-157. Certainly no higher valuation of the cost of replacing Well V-157 can be justified.

3. Valencia's net perchlorate contamination settlement proceeds should be allocated 67% to shareholders and 33% to ratepayers.

The description in Exhibit 10 of the perchlorate contamination that affected Valencia's operations and the vigorous and persistent efforts Valencia undertook to wring fair compensation out of the responsible parties should make clear to the Commission that Valencia, as a company, made a substantial commitment of company resources and bore substantial risks to achieve that result. Valencia's risk of loss due to perchlorate

¹² Exhibit 10 (DiPrimio/VWC), at 4 and App. A, at 26-27 (hand-numbered pages 10-52 to 10-53).

contamination and its initiative and success in pursuing the polluters justify allowing Valencia to retain most of the net proceeds gained by those efforts.

As noted above, Mr. Milleman testified that “Valencia’s customers bore little, if any, financial risks related to the perchlorate contamination and litigation that threatened VWC.” Observing that the investment to construct Well V-206 had increased rate base and costs to customers, he stated Valencia’s belief that a fair assignment of risks for this proceeding is 67% to Valencia and 33% to its customers, with net gain to be shared accordingly. *Id.* at 16-17.

Mr. Milleman refuted DRA’s contention that customers funded the cost of Well V-206 – noting that Valencia invested the funds to design and construct the well, and that the investment was only included in rate base two years after the well was placed in service. Exhibit 30 (Milleman/VWC), at 8-9. Mr. Milleman also showed that while 34% of the utility’s litigation costs were recovered in rates, subject to refund, the company faced a risk of not recovering 66% of its overall litigation expense – thus supporting the allocation of net settlement proceeds he proposed. *Id.* at 9. During the evidentiary hearing, DRA counsel had no questions at all for Mr. Milleman regarding his recommended allocation of perchlorate litigation settlement proceeds.

Exhibit 32, column 3 shows the detail of Valencia’s proposal. Settlement proceeds received total \$3,645,277. Deducting net litigation expenses of \$1,585,396 from that amount leaves “net gain” of \$2,059,881. Valencia proposes to allocate 67% of that net gain, \$1,373,240, to the utility and 33% of that net gain, \$686,628, to ratepayers, with the latter amount to be accounted for as CIAC.¹³ In addition, the \$531,606 of rates paid subject

¹³ Both Valencia and DRA proposed that any portion of the perchlorate contamination settlement proceeds allocated to ratepayers (as distinguished from the refunding of “rates subject to refund” through a surcredit) should be accounted for as CIAC, thereby benefiting ratepayers through a corresponding reduction in Valencia’s rate base. See, Exhibit 1, ch. 8 (Milleman/VWC); Exhibit 10 (Milleman/VWC), at 19; Exhibit 35 (DRA/Larsen), at 6-3.

to refund, plus interest, would be returned to ratepayers by a 12-month surcredit on their bills.

4. The Commission may wish to assign and allocate the balance in Valencia's WQLMA as of June 30, 2010.

The discussion above regarding Valencia's proposals to assign a portion of the perchlorate contamination settlement proceeds to allow Valencia to recover its litigation and settlement costs recorded in the WQLMA and to allocate the remaining proceeds on a 67%/33% basis between Valencia and its ratepayers, respectively, was based on proceeds, expenses, and interest accruals recorded in the WQLMA as of September 30, 2009. Witness Milleman for Valencia suggested that the Commission may wish to assign and allocate funds recorded in the WQLMA as of a more recent date, and suggested June 30, 2010 as an appropriate date for that purpose. DRA witness Larsen did not oppose that suggestion.¹⁴ Valencia provided the relevant calculations, as of June 30, 2010, in a revised version of Exhibit 32, submitted to ALJ DeBerry and the service list on August 5, 2010.

IV.

OTHER REQUESTS FOR RELIEF

While nearly all the issues initially contested by DRA are addressed and proposed for resolution in the Settlement Documents, numerous other aspects of Valencia's application were approved or were not expressly commented on by DRA's report and so did not receive attention in the settlement process. To the extent these matters are elements of Valencia's proposed revenue requirement calculations, they will be reflected in the Comparison Exhibit that will be submitted concurrently with the parties' reply briefs. Certain other requests for approvals remain outstanding and are addressed below.

¹⁴ Tr. 22:5-9 (Milleman/VWC); Tr. 227:15-24 (Larsen/DRA).

A. ESCALATION YEAR RATE ADJUSTMENTS

Pursuant to the Rate Case Plan,¹⁵ Valencia’s Application requests step rate adjustments for escalation years 2012 and 2013. Therefore, Valencia requests that the Commission authorize escalation year rate adjustments for 2012 and 2013 in the manner provided by the Rate Case Plan and prior Commission decisions. Specifically, Valencia requests that it be authorized to file Tier 1 advice letters by November 16, 2011, and November 16, 2012, to be effective January 1, 2012, and January 1, 2013, respectively, to implement such escalation year rate adjustments.¹⁶

B. BALANCING AND MEMORANDUM ACCOUNTS

Valencia maintains several balancing and memorandum accounts that the Commission has authorized over the years. In its Application, Valencia made certain requests with respect to new and existing balancing and memorandum accounts, as detailed in this section.

1. The Commission Should Authorize Recovery of the Balances of Valencia’s Existing Purchased Power and Purchased Water Balancing Accounts by Tier 1 Advice Letter.

With Commission authorization and implementation of a Modified Cost Balancing Account (“MCBA”), Valencia will no longer need to maintain its existing purchased power and purchased water balancing accounts (the “Existing Accounts”). In the Supplemental Settlement Agreement, Valencia and DRA agreed that the Commission should authorize Valencia to file a Tier 1 advice letter to amortize the December 31, 2010 balances in the Existing Accounts even if the balances in the Existing Accounts are less than 2% of recorded

¹⁵ *Rate Case Plan Decision*, at A-18 to A-20.

¹⁶ For an appropriate form of ordering paragraph for this purpose, the Commission may wish to refer to *Re San Gabriel Valley Water Company*, D.09-06-027, Ordering Paragraph 4.

revenues.¹⁷ Please see Section E.4 of the Supplemental Settlement Agreement for a detailed description of the proposed disposition of the Existing Accounts.

2. The Commission Should Authorize Allocation of the Balance of Valencia's WQLMA Consistently With the Disposition of Perchlorate Contamination Settlement Proceeds.

In Section III of this opening brief, referencing Exhibits 30 and 32 (Milleman/VWC), Valencia has identified perchlorate contamination settlement proceeds plus accrued interest totaling \$3,645,277, has proposed to assign \$1,585,396 to recover litigation/settlement costs and accrued interest recorded in Valencia's Water Quality Litigation Memorandum Account ("WQLMA"), and has proposed to allocate the remaining \$2,059,881 on a 67%/33% basis to Valencia and its ratepayers, respectively. These amounts were calculated based on amounts recorded in the WQLMA as of September 30, 2009.

Therefore, the Commission should authorize Valencia to;

- a. Reduce (credit) the WQLMA for Valencia's perchlorate litigation expenses of \$1,585,396 with an offsetting reduction (debit) of \$1,585,396 to the settlement proceeds to cover Valencia's costs of the litigation.
- b. Reduce (credit) the WQLMA by \$2,059,881 by recording as CIAC the ratepayers' share of net proceeds and recording as equity the share Valencia is allowed to retain.
- c. Leave the WQLMA open to capture any on-going costs and revenues associated with water contamination claims and litigation.

If the Commission prefers to assign and allocate the WQLMA balance as of June 30, 2010, reference should be made to the revised version of Exhibit 32 that Valencia provided to ALJ DeBerry and the service list on August 5, 2010, and the numbers in the above items a. and b. should be adjusted accordingly.

¹⁷ See, Tr. at 182-83 (Bilir/DRA).

3. The Commission Should Direct Valencia to Present the Net Amount of the Various Amortizations of Balancing Account, Memorandum Accounts and “Rates Subject to Refund” as a Single Line Item on Customer’s Bills.

As described above in Section IV. B. 1. and in Section III. C., Valencia has several accounts for which it has proposed refunding to, or charging, its customers through surcredits and surcharges. If the Commission approves these requests, for the sake of administrative convenience, it should direct Valencia to combine all these items into a single net amount to be amortized over a twelve- month period. If the net amount is a customer refund, it should be amortized based on the service charge. If it is an additional charge to customers, it should be amortized based on the commodity charge.

4. Valencia Withdrew Its Request For Two New Memorandum Accounts.

Over the course of this proceeding, Valencia voluntarily withdrew its proposals for two new memorandum accounts. Valencia withdrew its request for a Water Treatment Chemicals Memorandum Account as part of its voluntary withdrawal of the Groundwater Softening Project originally proposed in its Application. Also, as stated in its response to DRA Data Request JRC-1, dated April 1, 2010, Valencia withdrew its request for a 2011 GRC Intervener Memorandum Account.

C. COMPLIANCE FILINGS

Valencia made several important compliance filings in connection with this GRC Application, for which Valencia seeks the Commission’s approval. Among these were materials addressing water supply and quality, Valencia’s Water Management Program, proposed tariffs and an advice letter filing for a future employee position.

1. Valencia Requests a Finding of Compliance With Applicable Water Quality Standards.

In accordance with the Rate Case Plan,¹⁸ Valencia's Application included a detailed discussion of water supply and water quality issues. This discussion included a showing of Valencia's compliance with California Department of Public Health ("DPH") safe drinking water standards since its last GRC in 2007.¹⁹

Also pursuant to the Rate Case Plan,²⁰ ALJ DeBerry arranged for the Division of Water and Audits ("DWA") to provide a water quality report. The preliminary report on water quality prepared by DWA's water quality expert, concluded that Valencia "is in compliance with the drinking water quality [standards] for water supplied to its customers" and "has not violated any standards for either the federal or state water quality during the last three years, 2007, 2008, and 2009."²¹ Pursuant to a ruling issued by ALJ DeBerry, the DWA water quality report was circulated for comment. Valencia was the only party to file comments on the DWA report, mainly proposing clarifications and stylistic revisions to the report. The DWA report and Valencia's comments were identified and received into evidence as Exhibit 46 and Exhibit 47, respectively.

Neither DRA nor any other party contested Valencia's assertion of compliance with all DPH standards or DWA's confirmation of Valencia's compliance with federal and state water quality standards. Valencia respectfully requests that the Commission specifically find that Valencia has complied with all federal and state safe drinking water standards during the period since its last GRC in 2007.

¹⁸ *Rate Case Plan Decision, supra*, at A-30.

¹⁹ Application, at 15-16 and Exhibit 9.

²⁰ *Rate Case Plan Decision*, at 25-26 and A-4.

²¹ DWA, "Report on Water Quality Report for Valencia Water Company in Response to Its Application for A General Rate Increase (A.10-01-006)," dated March 29, 2010 (Exhibit 46), at 5.

2. Valencia Requests a Finding That Its Water Management Program Is Adequate.

In accordance with prior Commission decisions establishing the terms of utilities' Water Management Programs²² and requiring them to update and evaluate their Water Management Programs in the context of their GRCs,²³ Valencia submitted its current Water Management Program in the form of the 2005 Urban Water Management Plan ("UWMP") for a group of water agencies (including Valencia) in the Santa Clarita Valley in conjunction with the 2008 Santa Clarita Valley Water Report. These two reports accompanied Valencia's Application as Exhibits 12 and 13, respectively. Valencia's Water Management Program is outlined in the Application, at pages 13-14, 22-24, and more in-depth testimony and analysis of the availability of supplies are provided in Exhibit 9, Water Supply and Quality, sponsored by Valencia witness DiPrimio. In summary, the Water Management Program shows that Valencia's water systems are in good operating condition and its water supply is sufficient to meet expected demand. Accordingly, Valencia respectfully urges the Commission to find that Valencia's Water Management Program as submitted in this GRC is adequate for the Commission's purposes.

3. Valencia Requests Approval of Changes in the Terms of Its Tariff Schedules.

Valencia included with its Application, as Attachment D, a set of its current and proposed tariff schedules. The proposed tariff schedules have been modified over the course of this GRC proceeding to reflect the parties' agreement on various issues. Therefore, Valencia respectfully requests that the Commission specifically approve the changes that Valencia will need to make to its tariffs related to the Water SMART Program,

²² See, *Investigation into Measures to Mitigate the Effects of Drought on Regulated Water Utilities, Their Customers, and the General Public ("Drought Oil")* (1990), D.90-08-055, 37 Cal. PUC 2d 196.

²³ See, *Drought Oil* (1992), D.92-09-084, 45 Cal. PUC 2d 630; *Drought Oil* (1994), D.94-02-043, 53 Cal. PUC 2d 270.

Variance Process and WRAM/MCBA as are more fully described in the Supplemental Settlement Agreement.

Additionally, Valencia requests that the proposed changes to Rule 9 and Rule 11 of its tariffs, as shown on Attachment D to the Application, be authorized. However, Attachment D also indicates changes in the Preliminary Statement in Valencia's tariff to reflect implementation of a 2011 GRC Intervenor Memo Account and a Water Treatment Chemical Memo Account. Because such accounts are no longer being proposed (as explained in Section IV. B. 4. above), these changes in the Preliminary Statement need not be implemented.

4. The Commission Should Authorize Valencia to File a Tier 1 Advice Letter to Include the Salary for a Facility Manager in Rates Once Valencia Has Filled the Position.

Section D.1 of the Settlement Agreement specifies that the salary for a Facility Manager position will be added to rates by a separate advice letter filing made after the position is filled. Therefore, Valencia requests that the Commission specifically authorize Valencia to file this Tier 1 advice letter for this purpose, as provided by the Settlement Agreement.

V.

CONCLUSION

Valencia respectfully requests that the Commission grant the following relief:

- Approve and adopt the Settlement Agreement, submitted as Exhibit 48;
- Approve and adopt the Supplemental Settlement Agreement, submitted as Attachment A to the Joint Motion of the Division of Ratepayer Advocates and Valencia Water Company for Approval of Settlement Agreement and Supplemental Settlement Agreement, filed August 13, 2010;

- Approve the assignment and allocation of perchlorate contamination settlement proceeds as proposed by Valencia in Section III. of this Opening Brief;
- Authorize escalation year rate adjustments effective January 1, 2012, and January 1, 2013, as proposed in Section IV. A. of this Opening Brief;
- Authorize the treatment of balancing account and memorandum account balances as proposed in Section IV. B. of this Opening Brief; and
- Provide the findings and approvals with respect to Valencia's compliance filings as proposed in Section IV. C. of this Opening Brief.

Respectfully submitted,

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August 25, 2010

CERTIFICATE OF SERVICE

I, Jeannie Wong, hereby certify that on this date I served by electronic mail and by hand delivery, the foregoing OPENING BRIEF OF VALENCIA WATER COMPANY on the following persons on the service list for Application 10-01-006:

By electronic mail:

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By hand delivery:

Hon. Bruce DeBerry
Administrative Law Judge
California Public Utilities Commission
505 Van Ness Avenue, Room 5043
San Francisco, CA 94102

Executed this 25th day of August, 2010 at San Francisco, California.

/S/ JEANNIE WONG

Jeannie Wong

CALIFORNIA PUBLIC UTILITIES COMMISSION
Service Lists

**PROCEEDING: A1001006 - IN THE MATTER OF THE
FILER: VALENCIA WATER COMPANY
LAST CHANGED: AUGUST 12, 2010**

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