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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's)
Own Motion to Develop Rules and Procedures to)
Ensure That Investor-Owned Water Utilities Will)
Not Recover Unreasonable Return on Investments)
Financed by Contamination Proceeds, Including)
Damage Awards, and Public Loans Received)
Due to Water Supply Contamination.)

Rulemaking 09-03-014
(Filed March 12, 2009)

COMMENTS OF PARK WATER COMPANY IN REPLY TO PARTIES
OPENING COMMENTS ON THE WORKSHOP REPORT - NOVEMBER 23, 2009

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**COMMENTS OF PARK WATER COMPANY IN REPLY TO PARTIES
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I. INTRODUCTION

Park Water Company (“Park”) hereby files its Reply Comments to Parties Comments on the Workshop Report (“Report”), dated November 23, 2009 in Rulemaking (R.)09-03-014. The Report contains the recommendations of the Division of Water and Audits (“DWA”) on issues raised in R.09-03-014.

Fundamentally, there are two key contested issues. First, does the “conventional cost of capital approach” for governmental loans, as described by the California Water Association (“CWA”) and Park result in a fair treatment of ratepayers. Second, whether all or a large portion of the contamination proceeds awarded to the utility will be flowed through to the ratepayers.

**II. REFERENCES TO RATE BASING GOVERNMENTAL LOANS
INCORRECTLY IMPLIES AN UNFAIR TREATMENT OF RATEPAYERS**

Any implication that the utilities benefit from, and that therefore the ratepayers are treated unfairly by, the conventional cost of capital approach for government loans advocated by CWA and Park is false as explained in Park’s Comments to the Workshop Report. As also explained, while the CIAC or Surcharge methodology allows the utility and ratepayers to avoid the property tax obligation, and resultant rate impact, associated with the asset, there is no indication that such a “benefit” was intended and the “benefit” comes with: likely negative consequences to

ratepayers in their role as property tax payers or recipients of County services; higher initial effective rate increases; and the substantial potential for temporal inequities and cross subsidization of one ratepayer group by another.

On Page 2, of DRA's Report Comments it states that it supports the CIAC or Surcharge methodology (Park refers to this as the "Surcharge" methodology in its Comments to the Report). Neither CWA nor Park has argued that the CIAC methodology is invalid; rather that the conventional cost of capital approach is equally valid and that there are problems with the CIAC methodology. The CIAC methodology allows for cost recovery over the life of the loan, whereas, the conventional cost of capital approach allows for cost recovery over the life of the asset. Recovery of the costs of the asset over the life of the asset does not generate the initial higher increase in effective rates or create the potential for temporal inequity and cross subsidization of ratepayer groups. The conventional cost of capital approach is the predominant form of cost recovery for assets funded by loans. In Park's view, the CIAC (Surcharge) methodology is the exception to the rule and was established for Quincy Water Company ("Quincy") primarily because Quincy did not have the financial wherewithal to make the necessary payments on the loan without the dedicated stream of cash inflow associated with the surcharge. Park is advocating that the Commission provide flexibility in selecting, from either the conventional cost of capital approach or the CIAC methodology, the appropriate approach for the individual utilities circumstances. Park, as described in its Comments to the Workshop report, prefers the conventional cost of capital approach as it reduces overall workload to itself and the Commission, eliminates temporal inequities associated with existing ratepayers subsidizing future ratepayers, and it results in a lower initial cost increase to existing customers. Park understands that small water utilities may need to have the option of using the CIAC methodology but Park prefers not to be burdened by being required to follow the exception to the rule, which is like the tail wagging the dog.

One last observation, the Workshop Report creates a lot of haze around the differences in the two methodologies with the potential for somebody to assume there are substantial financial differences between the two methodologies. The reality is that no ratepayer advocacy group argues that the conventional cost of capital approach, for non-governmental loans, is an unfair

treatment of ratepayers. Logically, the exact same treatment applied to governmental loans will not treat ratepayers unfairly.

III. DRA AND TURN ADVOCATE THAT THE UTILITIES SHOULD RETAIN LITTLE OR NO PORTION OF THE CONTAMINATION AWARDS RECOVERED THROUGH THE UTILITIES EFFORTS

TURN states on page 2, that it “does not believe such specific financial incentives are necessary or appropriate” when it discusses the scenario were a utility is seeking damage awards or settlement from polluters, as TURN views this as part of the utilities “general obligation to serve their customers.” From Park’s perspective this is an unrealistic expectation. The time and effort that goes into a contamination proceed litigation case is likely to be massive, creating long hours and increased stress for key utility employees and increased risk for the utility due to the resulting diversion of attention which the utility will not be compensated for by memorandum accounts. If none of the benefits will accrue to the utility and its shareholders motivation will be lacking; it will negatively affect the Company’s decisions to undertake litigation and it is unreasonable to think that the utility’s employees will give their utmost efforts to the litigation, on top of their other workload, when there is no apparent benefit to the company from making that effort.

On page 3 of TURN’s Comments on the Report it states that “Rather than use the cost of capital proceeding to address any such incentive, the Commission should consider providing the utility and its shareholders with some small portion of any net proceeds...” Likewise DRA, on page 5 of its Comments on the Report, states that “If Net Proceeds are to be Shared on a Case-by-Case Basis, the IOU portion Must be Small...” these opinions are based upon their belief about ratepayer versus shareholder risks and their opinion that ratepayers bear all risk. The utilities have of course a different belief about who has borne what share of the risk, believing that shareholders bear a substantial portion of risk.

These differences are the key to the Parties' positions on the issues of determining the appropriate basis for flowing through portions of the contamination proceeds to the ratepayers and the appropriate ratemaking approach to accomplish that.

Ratemaking Approach

CWA, identifies in Section E (starting on page 9) of CWA's Comments, a misconception in DWA's analysis regarding the awarding of contamination proceeds. Park believes this misconception is creating confusion in this proceeding that would not be evident if a factually correct construct was used. For example, TURN, Section II (starting on page 3) of their Comments is titled "The Report Needs to Better Explain Why Plant Funded By Commission-Awarded Proceeds Should End Up In Rate Base...." In Section E, CWA does an excellent job in identifying this factually correct construct. Once it is understood that the contamination proceeds have been awarded to the utility, via litigation or settlement, some of the confusion should begin to clear. For clarity we will ignore any expenses (e.g., litigation costs, income taxes, on-going O&M costs associated with new assets, etc.) with these proceeds and assume that the utility uses 100% (say \$1,000,000) of the proceeds for a treatment facility. As this utility plant is placed in service \$1,000,000 will be recorded into utility plant (a category which increases rate base). Any portion of the \$1,000,000 that the Commission decides should be "shared" with the ratepayers (in this example \$600,000), the utility would record \$600,000 as CIAC (a category which decreases rate base). Therefore, rate base has increased by \$400,000 consistent with the portion that is not shared, the portion "allocated" to the utility. The accounting is consistent with the Uniform System of Accounts for Water Utilities ("USOA") as prescribed by the CPUC and consistent with generally accepted accounting principles ("GAAP"). This ratemaking approach is clear and accomplishes the sharing identified by the Commission. There is a clear line of sight to the portions shared by the ratepayers and utility.

While the reasons may vary somewhat TURN, CWA, Fruitridge Vista Water and Park all oppose using an adjustment to Return on Equity as the ratemaking approach for dealing with contamination proceeds. DRA is the only Party to the proceeding to favor this approach. The line of sight to the utility's "share" is no longer clear. A cynical viewpoint regarding DRA's position would be that this is supported because, given the uncertainties and latitude involved in

the process of determining ROE, this ratemaking approach would provide little likelihood that utilities would receive any significant “incentive” through increase in ROE and therefore would have a high likelihood of resulting in a larger than reasonable share of the contamination proceeds being awarded to the ratepayers. From Park’s perspective it has an equally high likelihood of discouraging, if not eliminating altogether, any contamination litigation being undertaken by the utilities and would result in little or no contamination awards to be shared with the ratepayers.

Appropriate Basis for “Sharing” Contamination Proceeds Awarded to the Utility

All the Parties agree that whatever ratemaking approach is used in must be done on a case-by-case basis. From Park’s viewpoint, this is appropriate for many reasons, but most importantly the varying circumstances surrounding the litigation or settlement. These circumstances will impact greatly the expenses incurred in the litigation process, potential income tax effects of the award, and the replacement or additional plant, including added O& M costs, to return the system to a condition generally equivalent to its state before the contamination event.

DRA, page 6, states, “Before the Commission determines how proceeds are to be shared, DRA supports an ex-ante listing the factors that should be considered in the evaluation process to give all parties guidance in assessing and analyzing any future proceedings addressing cost allocations.” Generally, Park supports this idea; however, the immediate concern is that this critical element has been obscured by the breadth of the issues in this proceeding and that the Commission would benefit greatly by directing the parties to address this issue separately in a subsequent comment period.

IV. CONCLUSION

For the reasons set forth above, Park respectfully requests that the Commission adopt Park’s positions with respect to the issues discussed in the comments above.

Dated February 2, 2010, at Downey, California.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of “Comments of Park Water Company in Reply to Parties Opening Comments on the Workshop Report – November 23, 2009” on all known parties to R.09-03-014 by transmitting an e-mail message with the document attached to each party named in the official service list.

Executed on February 2, 2010 at Downey, California.

/s/ Ellen M. Zimbalist

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R.09-03-014
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Comments on the Workshop Report – November 23, 2009

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