

Decision **PROPOSED DECISION OF ALJ WEATHERFORD**

(Mailed 5/8/2012)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authorization to Implement Discounted Rates for Recycled Water Service and Apply Facilities Fees in its Fontana Water Company Division in accordance with a contract with the City of Fontana.

Application 11-06-005
(Filed June 2, 2011)

**DECISION ADOPTING SETTLEMENT AGREEMENT AND
AUTHORIZING DISCOUNTED RATES FOR RECYCLED WATER SERVICE,
APPLICATION OF FACILITIES FEES, AND RECORDATION OF
COST OF FUNDING AND OFFSETS**

1. Summary

This decision adopts a two-party settlement between San Gabriel Valley Water Company (San Gabriel) and the Commission's Division of Ratepayer Advocates. The settlement, documented in the Settlement Agreement included as Attachment A,¹ is supported by the remaining party, City of Fontana (City), and resolves all issues in this proceeding. ~~In connection with~~ To add a new distribution system ~~to~~ that will provide recycled water service, San Gabriel is

¹ Attachment A does not include the exhibits appended to the original Settlement Agreement.

authorized to implement discounted rates for that recycled water service and apply facilities fees, to offset the costs of designing and constructing that distribution system (Project Costs) and any accrued capitalized interest costs, in its Fontana Water Company Division in accordance with a contract with the City. This decision denies the joint motion seeking a waiver of comments and grants the joint motion for waiver of a hearing.

2. Background

2.1. Features of Distribution System and its Regional Setting

The Inland Empire Utilities Agency (IEUA), overlying the Chino groundwater basin in Southern California, has allocated a supply of tertiary-treated effluent (recycled water) to several contracting retail agencies, including the City of Fontana (City). Under its contract with IEUA, the City received an allotment of approximately 12,000 acre feet annually of that recycled water, a portion of which is to be delivered by IEUA directly to the Fontana Water Company Division (FWC) of the San Gabriel Valley Water Company (San Gabriel) for direct non-potable use purposes, such as landscape irrigation. IEUA and the City are negotiating an arrangement for the construction of a regional backbone pipeline² that will convey the City's allotment of the recycled water to connection points of distribution systems, one of which would be facilitated by the authorizations that San Gabriel seeks here in Application (A.) 11-06-005.

² San Gabriel's Vice President, Robert DiPrimo, estimates that the design of the regional project will be completed in May 2012 and that construction of it will start in August 2012. PHC T.R., at 49, ll.2-24.

In its last General Rate Case (GRC) for the FWC,³ San Gabriel presented plans for developing recycled water service. The decision in that proceeding ordered that such an initiative would have to proceed, if at all, by an application, not advice letter, to be filed after San Gabriel and the City had completed a recycled water agreement.⁴

Such an agreement between FWC and the City (FWC-City Contract) was reached on April 26, 2011. Under that agreement, FWC would obtain funding for and plan, design, construct and own a distribution system having a then estimated capital cost of construction of \$6.3 million (now estimated at \$5.7 million) and an estimated capacity to deliver at least 1,000 acre feet of recycled water. FWC would sell and deliver that water within its service area to City-owned parks, school district properties, community facilities, and commercial and industrial customers. In its application here, San Gabriel seeks Commission authorization to implement the FWC-City Contract. In a joint motion, San Gabriel and the protestant, the Division of Ratepayer Advocates (DRA), seek Commission approval of a Settlement Agreement dated October 12, 2011, resolving outstanding issues among the parties here in connection with San Gabriel's application.⁵

³ A.08-07-009.

⁴ D.09-06-027, O.P. 8: "If, after it reaches an agreement with the City of Fontana, San Gabriel Valley Water Company decides to provide recycled water service, it shall do so through an application."

⁵ Date last signature was affixed.

2.2. Procedural History

The Application in this proceeding was filed on June 2, 2011. On July 6, 2011, DRA timely filed a Protest. A Prehearing Conference (PHC) was held before Administrative Law Judge (ALJ) Gary Weatherford on July 12, 2011, to determine parties, identify issues, consider the schedule, and address other matters as necessary to proceed with this application. Assigned Commissioner Timothy Alan Simon issued a Ruling and Scoping Memo on August 26, 2011 that categorized the proceeding as ratesetting, determined that a hearing was needed, and identified seven issues in need of resolution.

On July 28, 2011, ALJ Richard Smith was appointed as a neutral for Alternate Dispute Resolution. On October 13, 2011, a Joint Motion to Approve the Settlement Agreement between the Division of Ratepayer Advocates and San Gabriel was filed, with the settlement agreement (Settlement Agreement) attached. Filed on the same date was a Joint Motion to Waive Comments and Hearing.

On January 12, 2012, ALJ Weatherford issued a ruling setting an additional PHC to review the Settlement Agreement. San Gabriel filed a PHC statement on February 24, 2012, which provided a framework for the discussion that occurred at the additional PHC on February 28, 2012.

3. Application of Standard of Review to Terms of Settlement Agreement

3.1. Standard of Review

At issue is whether this settlement is “reasonable in light of the whole record, consistent with law, and in the public interest.” Rule 12.1(d). The proposing parties have the burden of proof as to whether the settlement should be adopted by the Commission.

The state-wide public interest in promoting the use of recycled water is clear.⁶ The Commission concludes below that the settlement resolves the issues between the parties and, further, is reasonable in light of the whole record, consistent with law, and in the public interest.

3.2. Analysis of Settlement Agreement

3.2.1. Terms and Conditions of the Settlement Agreement (Attachment A)

The settling parties agree that the Commission should grant the authorization sought by the application for San Gabriel to:

- * Implement a contract rate negotiated with the City for the delivery and sale of recycled water for beneficial uses by the City and local school districts;
- * Establish tariff rates for recycled water metered service to other customers in the FWC division as specified in the FWC-City contract;
- * Record all Project Costs and accrued capitalized interest cost in a separately identified Project Work Order;
- * Offset all such recorded Project Costs with facilities fees and any available grants or contributions until all such costs have been offset and reimbursed, with an allowance of San Gabriel's cost of funding such costs recorded as capitalized interest (Allowance for Funds Used During Construction, or AFUDC) until such costs are offset and reimbursed; and

⁶ References to recycled water occur in the Commission's Water Action Plan 2010 (October 2010), at 4, 7, 16, 22, and 31.

- * Record all such facilities fees, grants, and contributions as Contributions in Aid of Construction, subject to certain terms and conditions.

Among the additional terms and conditions are provisions precluding Project Costs and accrued capitalized interest cost from being included in San Gabriel's revenue requirement for ratemaking purposes; setting the rate of interest accrued as AFUDC to be the then-current monthly cost for short-term debt and the rate of interest to be accrued as capitalized interest after the recycled water distribution system is placed in service to be San Gabriel's authorized weighted average cost of capital; capping at \$69.3 million the additional investment in company-funded plant to be used during 2011 to 2014 in calculating rate base and revenue requirement for the Fontana Water Company District; subjecting the Project Costs and capitalized interest costs to reasonableness review in the next GRC; and redirecting the facilities fees back to the Sandhill Surface Water Treatment Plant to offset its remaining rate base once there has been a full offset and reimbursement achieved for the recycled water distribution system.

3.2.2. Implementation of the Contract Rates Applicable to the City⁷

The Settlement Agreement calls for the Commission to authorize San Gabriel to implement the FWC-City Contract, under which San Gabriel is to

⁷ The quantity rate of \$400 per acre foot that FWC will charge the City and local school districts is subject to price increases commensurate with applicable increases in IEUA's charges for recycled water. Such increases are to be passed through to the quantity rate paid by the City.

receive up to 1,732 acre feet per year of the City's recycled water allotment at IEUA's cost of delivery, presently \$115 per acre foot. The settling parties represent that the use of that recycled water will avoid the need to pump a corresponding amount of production from deep wells in the Chino Basin that would carry direct cost in groundwater pumping assessments and purchased power greater than \$500 per acre foot.

San Gabriel will deliver that recycled water, to the extent available, to points of use by the City and the local school districts for landscape irrigation for a quantity rate of \$400 per acre foot. One aspect of that contract rate deserves particular discussion because it intersects an equitable issue within the province of the Commission's pending rulemaking on recycled water, R.10-11-014, which is designed to develop guidelines for the planning, evaluation and regulation of recycled water projects. The issue is whether the impact on existing potable water customers of providing recycled water service should be neutral. Without some form of intervention, the customer who switches to recycled water is relieved of that portion of the fixed cost recovery represented by the amount of potable water use it is leaving behind; in short, the fixed cost burden of those potable water customers who remain is proportionately increased.

At the February 28, 2012, PHC, San Gabriel stated that the recycled water rate (\$400 quantity rate) that the City would pay upon its shift from potable water to recycled water would result in a "slightly greater increased contribution toward the overall utility costs of operations."⁸ Upon review, we find that the

⁸ Second PHC R.T., at 72, ll.16-20.

opposite would be true.⁹ We do not find the disparity to be a bar to the adoption of the settlement before us, however, because it is uncertain how relevant we will find a neutral-impact-on-potable-rates standard in our rulemaking on recycled water.¹⁰ Among the challenges being dealt with in that rulemaking are the competing considerations the Legislature has set before us concerning water service ratemaking. On the one hand, “any unreasonable difference as to rates” is to be avoided;¹¹ on the other, discounts for recycled water users are expressly allowed, along with the spreading of that impact across all metered customers.¹²

Two factors prompt us to approve the application and settlement here without waiting for the outcome of R.10-11-014. First, potable water customers

⁹ According to analysis done by the staff of the Division of Water and Audits, San Gabriel’s statement at that PHC appears to have been based on the use of the marginal cost of potable water rather than the average variable cost of potable water on which the rate in the FO-1 tariff of FWC is based. San Gabriel overstated the cost of water in rates and thus understated the fixed cost margin contribution. When using the correct cost of potable water in the rate analysis, the fixed cost contribution (\$580) in the potable water rate is shown to be greater than that (\$285) associated with the proposed recycled water rate for the City of Fontana. At this time it is uncertain whether the lower fixed cost margin per acre foot for recycled water as compared to potable water will be fully compensated for through a higher usage volume of recycled water, compared to the City’s historical usage volume of potable water.

¹⁰ R.10-11-014, Order Instituting Rulemaking on the Commission’s own Motion to Consider a Comprehensive Policy Framework for Recycled Water. Three workshops have been conducted as of this writing, with a fourth set for April 30, 2012, and at least one more expected before a staff workshop report is prepared and circulated for comment. Useful power point presentations from the workshops can be accessed at: <http://www.cpuc.ca.gov/PUC/Water/WaterEvents/>

¹¹ § 453, Pub. Util. Code.

¹² § 13580.8(d), Water Code.

will be receiving an offsetting benefit from the recycled water distribution system. The City is supplementing San Gabriel's water supply portfolio by committing a significant portion of its treated waste water allotment to the recycled water distribution system, which increases the reliability of water service for all metered customers. Second, we find there to be an overriding public interest in not delaying San Gabriel's recycled water distribution system in a manner that would place it out of sync with the construction and completion of the regional recycled water trunk line project of the IEUA, upon which San Gabriel's project is dependent.¹³ Certainly, from the perspective of the Commission's 2010 Water Action Plan,¹⁴ the sooner that recycled water is available to displace potable water use in landscape irrigation, the better.

3.2.3. Establishment of Tariff Rates for Other Recycled Water Customers

The settlement directs that the FWC-City contract be implemented. That contract provides for San Gabriel to distribute recycled water, to the extent available, to customers other than the City and school districts pursuant to a proposed Tariff Schedule FO-6 for Recycled Meter Service, at a quantity rate equal to 75% of the Schedule FO-1 quantity rate of potable water service. That

¹³ See discussion in the 2d PHC R.T., at 48-51.

¹⁴ At 16: "To the extent that recycled water is available, the CPUC will require its use, when practicable, as another supply source."

tariff schedule is appended to this decision as Attachment B. This 25% discount falls within the range of discounts offered by retail suppliers of recycled water.¹⁵

3.2.4. Recordation of Project Costs in Project Work Order

The settlement calls for the costs of designing and constructing the recycled water distribution system to be recorded in a separately identified Project Work Order.

3.2.5. Cost Offset by Facilities Fees, Grants or Contributions

The settlement provides that all Project Costs and capitalized interest costs, recorded in the Project Work Order are to be offset by (a) the amounts of facilities fees received pursuant to FWC Tariff Schedule No. FO-FF, CPUC Sheet Nos. 1875W and 1876W, and (b) any available grants or contributions received from other sources for the design and construction of the recycled water distribution system, until all the project costs have been paid.

3.2.6. Recordation of Facilities Fees, Grants and Contributions

3.2.6.1. Cost of Funding as AFUDC

Under the settlement, the funding of Project Costs and any accrued capitalized interest costs are to be recorded as an AFUDC on the unreimbursed

¹⁵ See Response of San Gabriel Valley Water Company to Questions Presented by Administrative Law Judge Weatherford, at 8-9. The approval of a 25% discount in this decision is based on the circumstances of this particular application and is not intended to have precedent value for other proceedings. Rate design issues concerning recycled water are presently under consideration in R.10-11-014.

balance, if any, in the Project Work Order until all of the Project Costs and any interest accrued as capitalized interest are offset and paid.

3.2.6.2. Facilities Fees, Grants and Contributions as Contributions in Aid of Construction (CIAC)

The settlement states that facilities fees and grants and contributions from other sources received to offset Project Costs and accrued capitalized interest costs are to be recorded as CIAC, keeping them out of the rate base. The settlement states that no Project Costs or accrued capitalized interest costs will ever be included in San Gabriel's rate base or otherwise be included in San Gabriel's revenue requirement for ratemaking purposes.

3.2.7. Non-Applicability of California Environmental Quality Act (CEQA)

The settlement takes the position, which we find reasonable, that the actions by the Commission requested in the Application are statutorily exempt from the CEQA.¹⁶ CEQA applies to projects that require discretionary approval from a governmental agency, unless exempted by statute or regulation. It is long established that the act of ratemaking by the Commission is exempt from CEQA review. (See, e.g., D.11-01-034 at 21-22.) As stated in the California Public Resources Code, the "establishment, modification, structuring, restructuring or approval of rates, tolls, fares, or other charges by public agencies" is exempt from

¹⁶ In its Application, at 7, San Gabriel cites Public Resources Code, §21080(b)(8), which provides an exemption from CEQA for the "establishment, modification, structuring, restructuring, or approval of rates, tolls, fares, or other charges by public agencies which the public agency finds are for the purpose of...obtaining funds for capital projects necessary to maintain service within existing service areas."

CEQA.¹⁷ Likewise, the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant impact on the environment is not a "project" subject to CEQA.¹⁸ San Gabriel does not seek and this decision does not grant authority to San Gabriel to build facilities and to the extent the local Recycled Water Master Plan requires a CEQA review, the IEUA did complete the CEQA process as lead agency.¹⁹

3.3. Discussion

As noted above, pursuant to Rule 12.1(d), the Commission will not approve a settlement unless it is reasonable in light of the whole record, consistent with law, and in the public interest.

We have historically favored settlements that are fair and reasonable in light of the record as a whole. Concerning the record in this proceeding, the stipulation of facts in the Settlement Agreement constitutes a clear and succinct description of the facts surrounding the dispute between the parties.

¹⁷ Public Resource Code Section 21080(b)(8).

¹⁸ CEQA Guidelines Section 15378(b)(4).

¹⁹ IEUA filed its Notice of Determination advising of its approval of its Recycled Water Master Plan Final Program Environmental Impact Report (PEIR) on July 28, 2002. See Attachment B of Joint Motion of DRA and San Gabriel for Approval of Settlement Agreement. The City Council of the City, as a "responsible agency" under CEQA, approved an Addendum to the PEIR on July 22, 2008, covering the second-tier project that includes the Project that is the focus of the instant Application. See Attachment D of Joint Motion of DRA and San Gabriel for Approval of Settlement Agreement. Under the FWC-City Contract, the City would be responsible for any further CEQA compliance, if required, for the Project.

According to the parties' joint motion to accept the settlement, the Settlement Agreement represents a compromise of the parties' litigation positions and resolves the issues posed in the assigned Commissioner's Ruling and Scoping Memo.²⁰ We find that the Settlement Agreement reasonably resolves a potentially time-consuming dispute and that each party has made significant concessions to resolve the issues in this proceeding in a manner that reflects a reasonable compromise of their respective litigation positions.

Further, we find that nothing in the Settlement Agreement contravenes any statutory provisions or prior Commission decisions, and that it provides sufficient information for the Commission to discharge its future regulatory obligations with respect to the parties and their interests and obligations. The Settlement Agreement does not contradict current Commission rules, and it does not constitute a precedent regarding any principle or issue in this proceeding or any pending or future proceeding. This is particularly important in light of the pending rulemaking addressing a number of unresolved issues surrounding our regulation of recycled water service by investor-owned recycled water retailers.

The Settlement Agreement is in the public interest. It is consistent with the Commission's well-established policy of supporting resolution of disputed matters through settlement, it reflects a reasonable compromise, and it avoids the time, expense, and uncertainty of evidentiary hearings and further litigation. We find that the benefits to the public outweigh any potential value of continued litigation and its associated cost.

²⁰ At 3.

In summary, we find the Settlement Agreement is reasonable in light of the record as a whole, consistent with law, and in the public interest. It resolves all issues before the Commission in this proceeding. Accordingly, this decision adopts the Settlement Agreement.

4. Comments on Proposed Decision

The proposed decision of the assigned ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code. The proposed decision denied the joint motion to waive comments and comments were allowed accordingly under Rule 14.3 of the Commission's Rules of Practice and Procedure. No comments were filed. Non-substantive editorial changes were made by the assigned ALJ.

5. Categorization and Need for Hearing

The categorization of this proceeding in the Ruling and Scoping Memo was ratemaking and it was anticipated there that this proceeding would require evidentiary hearings. Because no hearings are now required as a result of the settlement, the hearing determination is changed to state that no evidentiary hearings are necessary.

6. Assignment of Proceeding

Timothy Alan Simon is the assigned Commissioner and Gary Weatherford is the assigned ALJ in this proceeding.

Findings of Fact

1. The settlement resolves all of the issues between two of the parties, San Gabriel and DRA, and is supported by the remaining party, the City.
2. The overall result of the settlement lies between the initial positions of the settling parties.

3. The settling parties, although they do not comprise all of the active parties, fairly represent the affected interests.
4. The settlement authorizes implementation of a recycled water contract that will allow San Gabriel to provide customers within its FWC with adequate reliable service at reasonable rates.
5. The Commission's approval of the settlement facilitates the raising of funds for a capital project that is necessary to maintain service within an existing service area.
6. The settlement provides the Commission with sufficient information to carry out its future regulatory obligations with respect to the parties and their interests.

Conclusions of Law

1. Evidentiary hearings are not needed.
2. The settlement does not violate any statute or Commission decision or rule.
3. Pursuant to Public Resources Code § 21080(b)(8), this decision is exempt from CEQA as it will facilitate the raising of funds for a capital project that is necessary to maintain service within an existing service area.
4. The settlement is reasonable in light of the whole record, consistent with law and in the public interest.
5. The settlement should be approved.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement attached hereto as Attachment A, is approved and adopted.
2. San Gabriel Valley Water Company shall record in a separately identified Project Work Order the design and construction costs of the recycled water distribution system covered by Application 11-06-005 and any accrued capitalized interest costs, and these costs will be subject to a reasonableness review in the Company's next general rate case presently scheduled to be filed in January 2013.
3. San Gabriel Valley Water Company shall offset all Project Costs and any accrued capitalized interest costs recorded in the Project Work Order by (a) the amounts of facilities fees received pursuant to Fontana Water Company Tariff Schedule No. FO-FF, CPUC Sheet Nos. 1875W and 1876W and (b) any available grants or contributions received from other sources for the local recycled water distribution system project, until all the Project Costs and any accrued capitalized interest costs have been offset and reimbursed.
4. San Gabriel Valley Water Company shall record the cost of funding of Project Costs and any capitalized interest costs as an allowance for funds used during construction on the unreimbursed balance, if any, in the Project Work Order until all of the Project Costs are offset and reimbursed.
5. San Gabriel Valley Water Company shall record facilities fees and grants and contributions from other sources received to offset Project Costs and accrued capitalized interest costs as contributions in aid of construction. No Project Costs or accrued capitalized interest costs, shall ever be included in San Gabriel Valley

Water Company's rate base or otherwise be included in that company's revenue requirement for ratemaking purposes.

6. The joint motion seeking a waiver of comments is denied and the joint motion for waiver of a hearing is granted.

7. Any remaining unresolved motions or requests are denied.

8. No evidentiary hearings are necessary.

9. Application 11-06-005 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

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