

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



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Application of California-American Water Company (U210W), California Water Service Company (U60W), Golden State Water Company (U133W), Park Water Company (U314W) and Apple Valley Ranchos Water Company (U346W) to Modify D.08-02-036, D.08-06-002, D.08-08-030, D.08-09-026, D.08-11-023, D.09-05-005, D.09-07-021, and D.10-06-038 regarding the Amortization of WRAM-related Accounts.

Application 10-09-017  
(Filed September 20, 2010)

**OPENING BRIEF OF APPLICANTS  
CALIFORNIA WATER SERVICE COMPANY (U60W),  
GOLDEN STATE WATER COMPANY (U133W),  
PARK WATER COMPANY (U314W), AND  
APPLE VALLEY RANCHOS WATER COMPANY (U346W)**

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## SUMMARY OF RECOMMENDATIONS

1. Amortization periods for WRAM/MCBA under-collections should be shortened. Applicants continue to request 12-month amortization for balances up to 5% of a ratemaking unit's last adopted revenue requirement and 18 months for balances exceeding that percentage. As an alternative considered reasonable by DRA, Applicants propose that WRAM/MCBA under-collections above 15% should be recovered through surcharges equal to or less than 10% of the last authorized revenue requirement by setting the amortization period between 19 and 36 months, at the smallest duration consistent with the 10% limit but not exceeding 36 months.
2. Utilities should submit their annual reports on their WRAM/MCBA balances by November 30 of each year, well in advance of their related advice letter filings.
3. Utilities' requests for amortization of WRAM/MCBA balances should be submitted on or before March 31 of each year.
4. The Commission should clarify that a utility may request amortization of its WRAM/MCBA balances by a Tier 1 advice letter.
5. The trigger to amortize WRAM/MCBA balances should be 2% of a utility's last authorized revenue requirement, but utilities should be allowed to choose whether to amortize balances under 2% or carry them forward until the next annual filing or the next general rate case.
6. An under-collection should be amortized by a surcharge on quantity charges, but an over-collection should be amortized by a surcredit on the service charge.
7. Water utilities should be allowed discretion to apply "FIFO" accounting for determination of revenue recognition of balances in their WRAM/MCBA accounts.
8. Under-amortized or over-amortized amounts from previously authorized surcharges or surcredits should be included in annual WRAM/MCBA filings.

9. The Commission should allow accelerated amortization of unrecovered portions of 2009 and 2010 under-collections, calculated to complete such amortization in 2012.
10. DRA's proposals to create a Phase 2 of the present Application to focus on districts with under-collections over 15% and to open a rulemaking to review performance of conservation rate pilot programs and WRAM/MCBA mechanisms are without merit.

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APPLE VALLEY RANCHOS WATER COMPANY (U346W)**

Pursuant to Rule 13.11 of the Commission’s Rules of Practice and Procedure and the schedule established by Administrative Law Judge (“ALJ”) Walwyn at the conclusion of evidentiary hearings on September 29, 2011, Applicants California Water Service Company (“Cal Water”), Golden State Water Company (“Golden State”), Park Water Company (“Park”), and Apple Valley Ranchos Water Company (“AVR”), collectively referenced as “Applicants” herein, respectively submit their joint Opening Brief on issues presented in the above-captioned proceeding. Those issues consist of the nine issues enumerated in the Application that initiated this proceeding as well as five areas of disputed fact that were specified in the Assigned Commissioner and Administrative Law Judge’s Ruling and Scoping Memo (“Scoping Memo”), which was filed and served June 8, 2011, in this proceeding. The only active parties in this

proceeding at this time are Applicants and the Commission's Division of Ratepayer Advocates ("DRA").<sup>1</sup>

## I.

### SUMMARY OF APPLICANTS' POSITION

The WRAM mechanism authorized for the Applicant utilities "is doing exactly what it was designed to do." Tr. 35:23-25 (Jordan). It is capturing the variation in actual revenues from adopted revenue requirements due to differences between adopted and actual sales. To the extent there are problems with the operation of the WRAM, the most important problem is the inaccuracy of the sales forecasts adopted in the utilities' general rate cases ("GRCs"). There is also a "small problem," which the present Application<sup>2</sup> seeks to address, with the lengthy amortization periods that currently apply for under-collections of revenue, which may be so long that accounting rules prevent booking of sales revenues on a timely basis. This, in turn, creates a financial disincentive to promote sales reductions exceeding a certain percent, tending to defeat the original purpose of decoupling water utility revenues from sales.<sup>3</sup> The long amortization periods presently required also create an inequity in that customers who benefit from reduced usage may not be the same customers who have to pay the resultant WRAM/MCBA surcharges.

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<sup>1</sup> An additional applicant utility, California-American Water Company ("California-American"), has previously filed a motion for leave to withdraw from this proceeding, and was excused by ALJ Walwyn from participating in the recent evidentiary hearings. The present Opening Brief addresses the issues in this proceeding solely as they relate to Applicants and is not intended to propose or imply how such issues should be resolved with respect to California-American.

<sup>2</sup> The Application was received into evidence as Exhibit 1 and was sponsored jointly by witnesses Smegal, Garon and Jordan. Exhibit 1 will subsequently be referred to hereinafter as the "Application."

<sup>3</sup> Tr. 37:20-38:2 (Garon).

There is no need for a wholesale re-examination of the WRAM/MCBA mechanisms at this time. It was certainly not the utilities' intention to initiate such a re-examination by the present Application. Rather, this Application is intended to make relatively modest changes and clarifications to the timing of the annual WRAM/MCBA reports and the way the WRAM/MCBA balances are amortized in order to improve the efficiency of the annual reporting and advice letter process and to eliminate more fully both the disincentive for the utilities to promote water conservation and the intergenerational inequity of lengthy amortization periods.

## II.

### FACTUAL AND PROCEDURAL BACKGROUND

#### A. Development and Adoption of WRAM/MCBAs in the Water Conservation OII

In the Water Action Plan of December 2005 (the "WAP"), the Commission acknowledged that the recovery of costs through sales created a disincentive to "demand side management."<sup>4</sup> In order to help water utilities encourage their customers to conserve water, the Commission recommended various means to strengthen conservation programs and stated its intent to consider decoupling water utility sales from earnings. The WRAM/MCBA mechanism was intended to enable the Commission to modify rate designs to provide customers with an incentive to conserve, but in a manner "revenue-neutral" from a company's perspective.

In furtherance of the conservation goals of the Commission's Water Action Plan, the Commission addressed several significant issues related to conservation rates, WRAMs and

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<sup>4</sup> WAP, at 9.

MCBAs in Investigation (“I.”) 07-01-022<sup>5</sup> and in a series of decisions approving conservation rate designs and adopting the new WRAM/MCBA mechanisms. Each of the various decisions – D.08-02-036, D.08-06-002, D.08-08-030, D.08-09-026, D.08-11-023, D.09-05-005, D.09-07-021 and D.10-06-038 (the “WRAM Decisions”) – addressed aspects of the WRAM/MCBA mechanism, including the theory and practice of decoupling revenue from sales for Class A water utilities, the most appropriate price signals tailored to the each district, and, for some companies, conservation and low-income rate assistance programs.<sup>6</sup> However, the Commission did not specifically consider how to amortize the net balances of the WRAM/MCBAs in a manner consistent with their underlying purposes.

B. Accumulation of Substantial Under-Collections in Applicants’ WRAM/MCBAs

Since the WRAM/MCBA mechanism was adopted in the various WRAM Decisions, water consumption has been significantly lower than “authorized” by the Commission. The result has been high net WRAM/MCBA under-collections in most of the Applicant utilities’ WRAM/MCBA accounts.

In future-planning to implement these necessary surcharges, it became clear to Applicants that a financial accounting standard, generally known as Emerging Issues Task Force (“EITF”) Issue No. 92-7 and now codified as Accounting Standards Codification (“ASC”) 980-605-25) of the Financial Accounting Standards Board (“FASB”), would preclude Applicants from recognizing the full amount of revenues accounted for by the WRAM for a given period. This would result from the effect of currently-employed amortization periods of

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<sup>5</sup> D.08-02-036, at 28 (noting that the “WAP concluded water utilities had a financial disincentive to conserve water and full decoupling of sales and revenues was necessary to remove that disincentive”).

<sup>6</sup> Decisions 08-06-002, 08-11-023, 09-07-021 and 10-06-038 relate to California-American Water Company, which has been authorized to suspend its participation in this proceeding, and so are of limited relevance to the decision the Commission will reach defining procedures to apply to the WRAM/MCBA mechanisms of the remaining Applicants.

24 and 36 months preventing the utility from actually recovering revenues from ratepayers within 24 months after the end of the relevant fiscal period.

C. Submission of the Present Application and the Relief Requested

The present Application was developed in order to address this unintended financial accounting issue and remove any resulting disincentive for encouraging water conservation beyond a certain percentage reduction. In consultation with DRA, Applicants developed the Application in order to ensure that the balances in Applicants' WRAM/MCBA accounts could be amortized in a manner consistent with the needs of ratepayers and the utilities, as well as the goals of the Commission.

The Application consists of nine proposals to modify the WRAM Decisions. The first request addresses the most significant change – the periods of time over which the WRAM/MCBA balances should be amortized. The WRAM Decisions were silent on the issue of amortization periods, leading the Division of Water and Audits (“DWA”) to apply its staff Standard Practice U-27-W to the amortization requests. Applicants request that, for the WRAM/MCBA balances, shorter amortization periods apply in order to allow the utility to meet the requirements of EITF Issue No. 92-7 and to meet other policy goals discussed below. The remaining eight proposals either modify existing procedures or establish new requirements to improve the process by which Applicants may amortize WRAM/MCBA account balances.

D. Procedural Developments in This Proceeding

During the December 3, 2010 prehearing conference (“PHC”), the parties discussed the applicability of the Commission’s Rule 3.2 and were given the opportunity to brief the issue of whether customers should have been provided notice of the present Application. On December 20, 2010, the Commission issued a ruling directing the water utilities to comply with

the Rule 3.2's notice requirements. By May 23, 2011, each of the Applicants had complied with the ruling and submitted proof of customer notice.

Meanwhile, Applicants developed data addressing possible causes of the high WRAM/MCBA account balances, options for addressing such balances, and related concerns. Additional PHCs were held on January 24 and February 17, 2011 to discuss this material, which Applicants submitted on April 15, 2011.

On June 8, 2011, the Assigned Commissioner and ALJ issued their Scoping Memo, which cited the need for hearings, denied Applicant's April 15, 2011 request for immediate interim authority to implement an immediate surcharge, and set forth five "primary areas of disputed fact" that all parties to the proceeding would be required to address.<sup>7</sup>

On June 23, 2011, California-American filed a motion to withdraw from the present proceeding, stating concern that the delayed resolution of this proceeding had created a direct conflict with the scope of its pending GRC. DRA opposed the motion and requested that the Commission address California-American's Monterey District WRAM in this proceeding as a "temporary solution" until a later comprehensive review could be conducted. No formal action has been taken on California-American's motion to withdraw, but ALJ Walwyn excused California-American from participating in the recent evidentiary hearings.

Pursuant to the schedule adopted in the Scoping Memo, DRA submitted its testimony on August 31, 2011. Applicants submitted Joint Rebuttal Testimony on September 17, 2011. Hearings were held on September 28 and 29, 2011 with ALJ Walwyn presiding. Witnesses for Applicants testified jointly as a panel, as did the two DRA witnesses.

In the course of the first day's hearing, ALJ Walwyn directed each of the Applicants' witnesses to prepare an exhibit overnight that would show the combined impacts

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<sup>7</sup> See Section III of this Opening Brief below for a discussion of these possible areas of disputed fact.

on customer bills of all applicable WRAM/MCBA surcharges through the course of the year 2012 for each ratemaking area under both the current amortization rates and under Applicants' proposals.<sup>8</sup> On the following day, after review of the initial, somewhat inconsistent efforts, the ALJ directed the parties to develop a common template for each of the Applicants to submit a late filed exhibit presenting such data on a consistent basis. Applicants submitted late-filed Exhibits 12, 13 and 14 in accordance with those directions.<sup>9</sup>

### III.

#### POSSIBLE AREAS OF DISPUTED FACT IDENTIFIED IN THE SCOPING MEMO

The Scoping Memo identified five "primary areas of disputed fact that have arisen in this proceeding."<sup>10</sup> In the course of the evidentiary hearing, ALJ Walwyn examined each of the Applicants' witnesses as well as the panel of DRA witnesses with respect to each of these factual areas. The record evidence on each of these topics is summarized below along with Applicants' view as to the relevance of each such topic to the proposals at issue in this Application.

A. Whether failure to grant the relief requested will have a significant impact on the financial health of the applicants

DRA witness Rasmussen testified that failure to grant the relief requested in the Application would not have a significant impact on the financial health of the utilities because the utilities were entitled to full recovery of their WRAM/MCBA balances and could recognize

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<sup>8</sup> Tr. 72:26-74:24 (Statements of ALJ Walwyn). The "overnight" exhibits were received into evidence as Exhibit 5 (Garon), Exhibit 6 (Jordan), and Exhibit 7 (Smegal).

<sup>9</sup> Tr. 230:4-231:10 (Statements of ALJ Walwyn); Response of Applicants Submitting Late-Filed Exhibits 12, 13, and 14 as Directed by Administrative Law Judge Walwyn, filed October 7, 2011.

<sup>10</sup> Scoping Memo, at 5.

the undercollections as deferred revenue.<sup>11</sup> What Ms. Rasmussen does not acknowledge, however, is that “even if it’s revenue, it isn’t cash.”<sup>12</sup> If a water utility is prevented from recovering the full amount of appropriate revenue within the relevant fiscal period and is, therefore, precluded from booking net WRAM/MCBA balances as current revenue, the risk profile and financial strength of the company in the eyes of the investment community (for those companies that are publicly-traded) or lenders (for companies that make private placements with lenders) is impacted – negatively and significantly.<sup>13</sup> Additionally, failure to recognize revenue within a fiscal period could lower the company’s interest coverage ratio to a point where the company would be unable to issue debt.<sup>14</sup>

Moreover, the magnitude of the undercollections in Applicants’ WRAM/MCBA accounts and the current-authorized periods over which they are permitted to amortize those amounts present serious cash flow constraints for the utilities. Applicants pay their fixed supply costs as they become due, but have to wait to recover 70% of those costs in the commodity rate tied up in the WRAM/MCBA. Applicants cannot simply borrow their way out of this scenario because they are required by statute and Commission decisions to pay off their short-term debt every year. The result is that there are very real costs of carrying the undercollections until they can be recovered, which are exacerbated by the lengthy amortization periods currently required.

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<sup>11</sup> Tr. 207:15-208:6 (Rasmussen).

<sup>12</sup> Tr. 82:28-83:2 (Garon); *see also*, Tr. 226:9-19 (Rasmussen).

<sup>13</sup> Application, at 4-5; Tr. 77:8-79:21 (Smegal).

<sup>14</sup> Tr., 82:11-83:12 (Jordan).

B. Whether failure to grant the relief requested will have a chilling effect on conservation efforts of the utilities

While it is conjecture to try to quantify the chilling effect on conservation that might occur if the relief requested herein is not granted, the future results could range from simply dampening a utility's enthusiasm to do more to encourage conservation, to pushing a company to curtail conservation program spending to conserve cash, even if it means refunding conservation dollars at the end of a rate case cycle. Regardless of the extent to which a chilling effect on conservation materializes, if at all, the Commission should avoid undermining the conservation goals that motivated the Commission to develop and approve the WRAM/MCBA mechanism for water utilities. The WRAM is doing what it was supposed to do, but for the "small problem" that amortization periods may be so long that accounting rules prevent booking of sales revenues on a timely basis. The present Application seeks to address this problem and the financial disincentive to promote sales reductions exceeding a certain percentage that it creates.<sup>15</sup>

C. Whether operation of WRAM/MCBA mechanisms has had a disproportionate effect on ratepayers, especially low-income ratepayers

There is no evidence on the record in this proceeding that the WRAM/MCBA mechanisms have disproportionately impacted either low-usage customers or low-income ratepayers. With respect to low-income ratepayers, Applicants are not aware of any consistent pattern of undercollection resulting in any particular customer class.<sup>16</sup>

DRA's analysis supports this assessment in that, to the extent of DRA's consideration of the issue, only district size was found to have any correlation with the

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<sup>15</sup> Tr. 37:5-38:9 (Garon).

<sup>16</sup> Tr. 93:28-99:26 (Smegal/Jordan/Garon).

magnitude of undercollections in WRAM/MCBA accounts.<sup>17</sup> Although DRA cited an excerpt from a decision as justification for contending that the Commission had concerns that a “severe economic downturn” could have a “disparate impact” on ratepayers, the decision referenced (D.08-06-002) discussed the specific operation of California-American Water Company’s WRAM/MCBA and not the mechanisms generally.<sup>18</sup> Indeed, in response to the ALJ’s inquiry regarding the existence of any impacts on low-income ratepayers, the DRA witness acknowledged that it did not find any changes or trends in the two years worth of data provided that would suggest a disproportionate impact.<sup>19</sup>

Regarding any impacts on low-usage customers, there was a degree of agreement among the parties that more of any surcharge related to an under-collection was likely to be collected from the high water users rather than from low users.<sup>20</sup> Although the parties did not “crunch the numbers” as part of this proceeding to confirm this common-sense conclusion, the decisions adopting the original settlements offer evidence that low-usage customers stood to benefit from the new rate designs by reduced bills. For example, in D.08-08-030, which adopted the settlement between Golden State and DRA, Worksheet 3 of the settlement shows the impact of tiered rates at different usage levels. Customers with usage up to and including 9 ccfs per month were projected to see bill reductions.

If the Commission considers high undercollections to be problematic, it “is not a problem associated with the WRAM mechanism.”<sup>21</sup> Instead, “it is a problem associated with

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<sup>17</sup> Exhibit 3 (Rasmussen), at 20:22-25:13.

<sup>18</sup> Tr. 23:16-29:20 (Smegal/Jordan/Garon).

<sup>19</sup> Tr. 211:3-212:18 (Rasmussen).

<sup>20</sup> Tr. 94:14-95:14 (Smegal); Tr. 211:13-15 (Rasmussen).

<sup>21</sup> Tr. 39:9-13 (Jordan).

how we forecast the adopted sales, and that's where the solution lies.”<sup>22</sup> The unintended effects of faulty sales forecasts are only exacerbated by a 4-year deferral of recovery, in that customers who receive unintentional billing discounts will not consistently be the same customers that have to pay the surcharge to make up for the shortfall recorded in the company's WRAM/MCBA. This intergenerational inequity clearly impacts differently customers differently and is the significant “disparity” that the Commission should seek to remedy in this proceeding.<sup>23</sup>

D. Whether there has been compliance with Commission decisions on the WRAM/MCBA

There have been no allegations of non-compliance with Commission decisions on the WRAM/MCBA in this proceeding. In its testimony, DRA stated that “no clear violations of any WRAM/MCBA decision have been committed.”<sup>24</sup> The companies confirmed this in their responses to examination by ALJ Walwyn during the second day of hearings, stating that, to their knowledge, non-compliance with the WRAM/MCBA decisions was not an issue for their respective companies.<sup>25</sup>

E. Whether municipal water districts and investor-owned energy utilities have experienced similar revenue shortfalls and rate impacts since 2008

Much like the investor-owned water utilities,, municipal water districts have experienced substantially reduced sales since 2008 due to a combination of conservation

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<sup>22</sup> Tr. 39:14-19 (Jordan); *see also*, Tr. 39:20-41:18 (Garon/Jordan). Decreased accuracy in sales forecasting stems, in part, from modifications made in 2004, which were intended to reduce and streamline the workload in general rate cases. The current methodology considers only two variables – temperature and rainfall – and does not permit the utilities to forecast short-term differences in sales resulting from conservation. Tr. 45:10-48:27 (Jordan).

<sup>23</sup> Tr. 101:24-102:23 (Garon).

<sup>24</sup> Exhibit 3 (Rasmussen), at 20 lines 10-11.

<sup>25</sup> Tr., 146:4-13 (Garon/Jordan/Smegal).

activities and economic factors.<sup>26</sup> For example, in April 2011, the San Francisco Public Utilities Commission considered implementing a 47% rate increase to help address its \$54.3 billion revenue shortfall. The Metropolitan Water District of Southern California has implemented a series of rate increases to meet the shortfall necessary to recover its costs since January 2009.<sup>27</sup> Clearly, revenue shortfalls and consequent rate increases due to conservation are not unique to the investor-owned water utilities.

With respect to the investor-owned energy utilities, there appears to have been less volatility in rates since 2008, although there is little evidence on this point.<sup>28</sup> While large-scale undercollections apparently have not accrued during this period in Electric Revenue Adjustment Mechanism (“ERAM”) accounts, this does not imply a failure of Applicants’ WRAM/MCBA mechanisms. Unlike the investor-owned water utilities, the energy utilities have much larger service areas, allowing them to avoid the extreme effects that may occur especially in the smallest water utility districts. The energy utilities also have several tools at their disposal to mitigate the accrual of large potential balances. The energy utilities use sophisticated, multi-factor sales forecasting that includes projections of declines in sales due to conservation, whereas Applicants’ authorized methodology considers only two variables – temperature and rainfall – and does not permit the utilities to forecast short-term differences in sales resulting from conservation.<sup>29</sup> Moreover, the energy utilities are permitted to true-up their sales forecasts on a semi-annual basis, whereas the water utilities are barred from adjusting their sales forecasts except on their three-year general rate case (“GRC”) cycle.<sup>30</sup>

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<sup>26</sup> Tr. 151:8-152:12 (Smegal); *see also*, Exhibit 8 (Applicants’ Data Responses), Attachment 3.

<sup>27</sup> Exhibit 8, *supra*, Attachment 3.

<sup>28</sup> Tr. 34 (9-12); 152:14-156:19 (Smegal).

<sup>29</sup> Tr. 34:14-35:10 (Smegal), 36:3-23 (Jordan).

<sup>30</sup> Tr. 154:22-155:2 (Smegal).

Also, the energy utilities have been allowed to recover ERAM balances over the course of 12 months, an amortization period that avoids for them the EITF Issue No. 92-7 problem discussed in the context of Issues 1 and 5, below. Applicants have stated that they would welcome being allowed the same 12-month amortization that is available to the energy utilities, but were willing to forego that request in the present Application in order to address concerns about high surcharges.<sup>31</sup> In sum, it is clear that the greater resources and flexibility available to the energy utilities to model and forecast their sales have enabled them to mitigate in their ERAMs the extent of under-collections that Applicants have experienced in their WRAM/MCBAs.

#### IV.

#### APPLICANTS' PROPOSED MODIFICATIONS TO THE WRAM DECISIONS

In consultation with DRA, Applicants developed proposals regarding their WRAM/MCBA accounts “to ensure that the balances in those accounts are reported and amortized in a manner that meets the needs of ratepayers, the water utilities, and the Commission.”<sup>32</sup> The Application identified nine issues relating to the operation of WRAM/MCBAs and proposed corresponding modifications to the WRAM Decisions to address the identified concerns.<sup>33</sup>

DRA’s witnesses responded constructively to the Application, agreeing in their testimony with most of the proposed modifications but raising concerns and proposing different measures to address several of the identified issues. In their Joint Rebuttal Testimony, Applicants responded to DRA’s concerns by suggesting alternative approaches to some of the issues while continuing to support their original proposals. In the course of the evidentiary

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<sup>31</sup> Application, at 12-13; Tr. 34:18-20.

<sup>32</sup> *Id.* at 2-3.

<sup>33</sup> *Id.*, Summary, at i-iv.

hearing, it became apparent that there was more agreement than dispute between Applicants and DRA as to how each of the nine issues should be resolved.

A. ISSUE 1: Amortization Periods for WRAM/MCBA Balances Should Be Shortened.

From the outset of this proceeding, it has been recognized that the most significant change requested by Applicants relates to the amortization periods for under-collections reflected in the WRAM/MCBA accounts.<sup>34</sup> The problem arises from the lack of consideration in the Water Conservation OII and in the WRAM Decisions of how to amortize the net balances of the WRAM/MCBAs in a manner consistent with the underlying purposes for which they were created. In the absence of specific direction in the WRAM Decisions, DWA staff have applied the rules specified in Standard Practice U-27-W and other existing rules, prohibiting amortization of surcharge balances less than 2% of annual revenues unless in a GRC and requiring amortization periods of 24 months for balances between 5% and 10% of annual revenues and 36 months for balances above 10%.<sup>35</sup>

Since adoption of the WRAM/MCBA Decisions, Applicants' water sales have generally been significantly lower than the sales levels adopted in GRC decisions, resulting in high net WRAM/MCBA under-collections. As a result, Applicants' annual advice letter filings pursuant to the WRAM/MCBA Decisions have had to provide for substantial surcharges on customer bills in order to accomplish the WRAM/MCBA Decisions' goal of revenue neutrality. The lengthy amortization periods required by existing Commission procedures have caused significant cash flow and accounting problems.

The cash flow problem arises from the fact that the conservation rate designs the Commission has approved for Applicants provide for recovery of approximately 70% of

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<sup>34</sup> See, *id.* at 3.

<sup>35</sup> See, Application, at 5 and n. 22.

Applicants' fixed costs through increasing block quantity rates and overestimation of sales results in under-recovery of the revenues intended to cover those fixed costs. Because those under-recoveries are of long duration, Applicants' have had to finance their revenue deficiencies through funds borrowed at costs greatly exceeding the short-term commercial paper rates allowed for accruing interest on their massive WRAM/MCBA balances.

A financial accounting problem complicates the situation. It has recently become clear that a financial accounting standard, Emerging Issues Task Force ("EITF") Issue No. 92-7,<sup>36</sup> may preclude Applicants (and other water utilities) from recognizing for financial accounting purposes the full amount of revenues that WRAM is supposed to ensure within a given time period. EITF Issue No. 92-7 may preclude utilities from booking *any* net WRAM/MCBA balance as current revenue in a fiscal period if the utility will not actually recover *all* those revenues from ratepayers within 24 months after the end of that fiscal period.<sup>37</sup> Due to the 24 and 36 month amortization periods applied under administrative procedures currently applied by DWA staff, this situation threatens the financial strength of the water utilities and undermines a key purpose for the Commission's adoption of the WRAM/MCBA revenue decoupling mechanism – to eliminate the utilities' disincentive to encourage water conservation.<sup>38</sup>

Applicants believe that the modified time periods for amortizing WRAM/MCBA net under-collections proposed in the current Application will enable the utilities to recognize revenue on a timely basis. While Applicants would have preferred the 12-month amortization periods the Commission has allowed the energy utilities with respect to their Revenue

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<sup>36</sup> EITF Issue No. 92-7 has been codified as Accounting Standards Codification ("ASC") 980-605-25 of the Financial Accounting Standards Board ("FASB"). Application, at 3.

<sup>37</sup> Application, at 3-4, 10-12; *see also*, Tr. 77:12-24 (Smegal).

<sup>38</sup> Application, at 3-4; *see also*, Tr. 77:24-78:17 (Smegal).

Adjustment Mechanisms, Applicants appreciate the concern about high surcharges and, as result of discussions with DRA, requested authorization for an amortization period of 18 months for account balances exceeding 5% of a ratemaking unit's last adopted revenue requirement.<sup>39</sup>

In addition to the cash flow and financial reporting problems, the use of long amortization periods presents a problem for customers. With 3-year amortization, recovery will actually take four years because the advice letter filing to implement a surcharge only comes in the year after the under-collection accrues. As a result, there are “intergenerational inequities,” due to customers having bills lower than what the Commission anticipated for a period of time. “Those customers who had that benefit of the lower bill may now be gone and other customers [are] making up the shortfall.”<sup>40</sup> In addition, amortizing under-collections over periods longer than 12 months results in a “pancaking” of surcharges, and multi-year amortization periods result in an accumulation of multiple surcharges that is difficult for customers to understand.<sup>41</sup> Eliminating much of the “pancaking” of surcharges, amortization within 18 months “takes away a lot of problems for the customers as well as for the utility.”<sup>42</sup>

In its prepared testimony, DRA supported giving the utility discretion to amortize surcharge balances less than 5% of revenue requirement over 12 months and supported reducing the amortization period for surcharge balances between 5% and 15% of revenue requirement to 18 months, but proposed to retain the current requirement that surcharge balances above 15% be amortized over a 36-month period.<sup>43</sup> DRA discounted Applicants'

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<sup>39</sup> Application, at 17-18.

<sup>40</sup> Tr. 43:15-44:1 (Garon).

<sup>41</sup> “After four years you can have as many as seven surcharges.” Tr. 44:1-18 (Garon).

<sup>42</sup> Tr. 44:17-24 (Garon).

<sup>43</sup> Exhibit 3 (Rasmussen), at 5 lines 6-16.

concern about EITF Issue No. 92-7 preventing the recognition as current revenue of WRAM/MCBA balances subject to lengthy amortization periods, by noting that Applicants have the option, for financial accounting purposes, of recognizing their WRAM/MCBA under-collections as deferred revenue. DRA considered “GAAP guidance alone” to be an insufficient reason to adjust the amortization periods for WRAM/MCBA accounts.<sup>44</sup>

DRA acknowledged that it had not previously opposed Applicants’ request for shortened amortization periods, noting that “DRA generally does not oppose an 18 month amortization period as it reduces the interest added to an undercollection, and provides better intergenerational equity.”<sup>45</sup> DRA was concerned to discover that several of the districts with high under-collections also have fewer than 10,000 customers and include three of Cal-Water’s subsidized Rate Support Fund districts, which suggested to DRA a concern about affordability. This, together with a concern about California-American Water’s Monterey District, was the basis for DRA’s proposal to maintain a 36-month amortization period for under-collected balances above 15% of annual revenues.<sup>46</sup>

In joint rebuttal testimony, Applicants maintained their original proposal to allow recovery of all under-collections above 5% of annual revenues over an 18-month amortization period. Applicants emphasized that any under-collected WRAM/MCBA balance for a given year reflects revenue that customers would have paid the previous year but for the commitment to implement conservation pilot initiatives and the lack of adopted sales forecasts accurately reflecting actual sales. Applicants noted that the consequent surcharges effectively take the place of higher rates that should have been in effect during the year the under-collection was

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<sup>44</sup> *Id.* at 15 line 17 to 16 line 23.

<sup>45</sup> *Id.* at 5 lines 20-25.

<sup>46</sup> *Id.* at 5 line 25 to 6 line 22; *see also, id.* at 23 line 1 to 25 line 13..

incurred, and that the longer the amortization period for a surcharge, the greater the intergenerational inequity among ratepayers.<sup>47</sup>

Applicants further noted that DRA's dismissal of "GAAP guidance" and reference to "deferred revenue" as another accounting option for the utilities were at odds with the careful balance of incentives developed through the Conservation OII and the utility/DRA settlements that established conservation pilot programs, including full decoupling WRAM/MCBA mechanisms. They noted that the Commission's intent in approving those programs, as also reflected in the Water Action Plan adopted in December 2005, "was to remove the utilities' disincentive to encourage conservation."<sup>48</sup>

Applicants' rebuttal testimony called attention to several anomalous outcomes and financial uncertainty that could result from DRA's recommendation to increase amortization periods. In particular, as a WRAM/MCBA balance begins to approach the 15% benchmark, under DRA's proposal the utility would have to evaluate whether the balance may exceed 15% by year-end, resulting in a 36-month amortization that would bar reporting the year's WRAM balance as "current revenue." Considering the risk of having to restate earnings, DRA's 36-month amortization rule could cause utilities to under-report revenues for ratemaking areas whose WRAM/MCBA under-collections might approach the 15% benchmark, which in turn would tend to reinstate a disincentive to promote water conservation that the revenue decoupling mechanism was intended to remove.<sup>49</sup>

Applicants presented a counter-proposal in their rebuttal testimony, premised on DRA's willingness to accept a 10% revenue increase implicit in ERA's proposal to amortize

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<sup>47</sup> Exhibit 3 (Garon/Jordan/Smegal), at 2-3.

<sup>48</sup> *Id.* at 3.

<sup>49</sup> *Id.* at 4-6.

under-collected WRAM/MCBA balances between 5% and 15% over 18 months. While maintaining their original proposal to recover all under-collections above 5% over an 18-month amortization period (thereby best addressing the financial accounting and intergenerational equity issues), Applicants proposed an alternative premised on a 10% annual revenue increase ceiling. Applicants' alternative proposal was that WRAM/MCBA balances above 15% should be recovered through surcharges equal to or less than 10% of the last authorized revenue requirement by setting the amortization period between 19 and 36 months, but at the smallest duration consistent with the 10% limit.<sup>50</sup> This procedure would allow the first 15% of the WRAM/MCBA balance to be collected within the first 18 months, with the remainder collected in subsequent months.

When questioned by ALJ Walwyn, Cal Water witness Smegal explained the choice of a 10% surcharge limit as follows:

We took DRA's testimony that a 15 percent balance could be recovered over an 18-month period to have an effective 10 percent surcharge limit inherent in their proposal. So we are commenting and suggesting a tweak to their proposal. And the reason for that is that there is an oddity that happens between 14.9 and 15.1 percent balances. And that is for a 14.9 percent balance under DRA's proposal the amounts would be recovered at a 10 percent level over 18 months and for . . . a 15.1 percent balance, those amounts would be recovered at a 5 percent surcharge amount over 36 months.

And so what we are suggesting is if DRA believes the customers would be comfortable, or if it is their position that that is a reasonable amount to limit the surcharges at, 10 percent, that we could extend the surcharge proportionately so that that 10 percent was the target number. And so if it were a 16 percent or 17 percent balance it would be extended just enough months so that that surcharge would remain at or below 10%. So we were keying off of DRA's recommendation there.<sup>51</sup>

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<sup>50</sup> *Id.* at 6-8.

<sup>51</sup> Tr. 157:27-158:27 (Smegal).

In her testimony at hearing, DRA witness Rasmussen acknowledged that the highest surcharge percentage allowed under DRA's proposal would be 10% of the utility's revenue requirement (in the case of an 18-month amortization of a 15% under-collection), and she viewed a 10% surcharge as reasonable to amortize a large WRAM under-collection.<sup>52</sup> Ms. Rasmussen went on to indicate familiarity with Applicants' counter-proposal providing for amortization of WRAM under-collection balances of between 15% and 30% over the least number of months consistent with having the surcharge not exceed 10% of revenue requirement and concluded that "the proposal is reasonable."<sup>53</sup>

ALJ Walwyn offered a different approach. At the conclusion of the first day's hearing, she suggested that "we put a percentage cap on the WRAMs and we combine all the years' balances as one and we go forward with some understanding there's never more than a 10 percent WRAM impact on a bill." Tr. 103:14-19 (Statement of ALJ Walwyn).

ALJ Walwyn's proposal has superficial appeal but would create more problems than it solves. There is no theoretical or practical justification for it and it would exacerbate rather than alleviate the accounting, financial, and intergenerational equity problems created by the present, already excessive amortization periods required by application of Standard Practice U-27-W.

ALJ Walwyn characterized the combined magnitude of multiple years' WRAM/MCBA surcharges as a "rate shock issue."<sup>54</sup> That is not, however, an accurate description, because only the current year's surcharge is a new charge, increasing the customer's total bill. Prior years' surcharges will have been in place for approximately 12 or

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<sup>52</sup> Tr. 199:17-200:19 (Rasmussen).

<sup>53</sup> Tr. 200:20-202:3 (Rasmussen).

<sup>54</sup> Tr. 1-4:1-8 (Statement of ALJ Walwyn).

24 months before the current year's surcharge is added to the bill. This why DRA has proposed to set a cap – effectively a cap set at 10% of the last authorized revenue requirement – on any year's WRAM/MCBA surcharge. The present year's surcharge is the *incremental* charge, and it is the magnitude of that *incremental* charge that could present a rate shock issue.

Lengthening amortization periods to keep new charges at no more than 10% of the last authorized revenue requirement – except in the very unlikely case where an under-collection exceeds 30% of revenue requirement, in which case the maximum, 36-month amortization period would result in surcharges exceeding 10% -- is an effective, balanced protection against rate shock.<sup>55</sup>

While missing the mark for addressing “rate shock,” the idea of placing a cap on the total of all currently effective WRAM/MCBA surcharges presents very serious problems. These problems are evident from an examination of late-filed Exhibits 12, 13, and 14. As noted above, those exhibits show the combined impacts on customer bills of all applicable WRAM/MCBA surcharges through the course of the year 2012 for each ratemaking area under both the current amortization rates and under Applicants' proposals – displaying separately the effects of the faster amortization proposed for 2011 under-collections and of those effects

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<sup>55</sup> The possibility of a surcharge exceeding 10% of revenue requirement was addressed by Golden State witness Garon, who discussed a hypothetical 40% under-collection balance that, under either DRA's or Applicants' alternative proposals would be recovered by a 36-month amortization and so would require a surcharge of 13.3%. Mr. Garon noted that “if there is a 40 percent balance, there's a reason for a 40 percent balance. Assume that everyone's done their audit and the true number is 40 percent, whatever drove that 40 percent should be recoverable.” He went on to explain that “the alternative to a 40 percent WRAM is to address the issue that's causing the 40 percent WRAM” – which could be a supply cost issue or a poor sales forecast – and noted that “the factors that are causing these balances are still going to impact the customer's bill through some mechanism, whether it's the WRAM, whether it's the sales forecast in a GRC that's trued up or whether it's an offset to supply cost.” Tr. 168:5-25; 169:4-25 (Garon); *see also*, Tr. 170:14-171:19 (Jordan).

combined with the effects of Applicants' proposal also to accelerate the ongoing amortization of prior years' surcharges.<sup>56</sup> The exhibits provide the following information:

- Exhibit 12 shows that for Golden State:
  - Under existing amortization schedules, two of Golden State's eight districts or regions will have multiple WRAM/MCBA surcharges in place totaling over 10% of revenue requirement for one month of 2012.
  - With the proposed accelerated amortization of 2011 surcharges, four of eight districts or regions will have multiple surcharges in place totaling over 10% of revenue requirement for ten months of 2012.
  - With accelerated amortization of all current surcharges, six of eight districts or regions will have multiple surcharges in place totaling over 10% of revenue requirement for ten months of 2012.
- Exhibit 13 shows that for Park and AVR:
  - Under either existing or proposed amortization schedules, Park will have multiple WRAM/MCBA surcharges in place totaling over 10% of revenue requirement for four months of 2012.
  - Under existing amortization schedules, AVR will have multiple WRAM/MCBA surcharges in place totaling over 10% of revenue requirement for four months of 2012.
  - With the proposed accelerated amortization of 2011 surcharges, with or without accelerated amortization of prior years' surcharges, AVR will have multiple WRAM/MCBA surcharges in place totaling over 10% of revenue requirement for ten months of 2012.
- Exhibit 14 shows that for Cal Water:
  - Under existing amortization schedules, three of Cal Water's 25 districts will have multiple WRAM/MCBA surcharges in place totaling over 10% of revenue requirement for periods of three or nine months of 2012. Three other districts will have surcharges of more than 10% in place for the entire year.
  - With the proposed accelerated amortization of 2011 surcharges, five of 25 districts will have multiple surcharges in place totaling over 10% of revenue requirement for nine months of 2012. Three other districts will have surcharges of more than 10% in place for the entire year.

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<sup>56</sup> See, Response of Applicants Submitting Late-Filed Exhibits 12, 13, and 14 as Directed by Administrative Law Judge Walwyn, filed October 7, 2011.

- With accelerated amortization of all current surcharges, ten of 25 districts will have multiple surcharges in place totaling over 10% of revenue requirement for periods ranging from three to ten months of 2012. Three other districts will have surcharges of more than 10% in place for the entire year.

This evidence confirms that imposing a cap on the sum of all currently effective WRAM/MCBA surcharges will not permit accelerated amortization of WRAM/MCBA under-collections in districts presently subject to 24-month or 36-month amortization. To the contrary, such a cap, if set at 10%, will require amortizing such under-collections at rates even *slower* than current rules permit. This is evident from the fact, demonstrated by the late-filed exhibits, that every utility has at least one district or region in which even at current amortization rates the sum of surcharges will exceed 10% during 2012. Placing a cap on the sum of currently effective WRAM/MCBA surcharges will serve no useful purpose and will do nothing to alleviate the issues of revenue realization, cash flow impairment, and intergenerational equity that Applicants' proposal to reduce amortization periods would effectively address.

Applicants' witnesses confirmed that imposing a 10% ceiling on the sum of all WRAM/MCBA surcharges on a customer's bill would limit the current year's surcharges to "considerably below 10 percent" and would prevent the utilities from ever being able to recover their WRAM under-collections in some of their districts.<sup>57</sup> While more accurate sales forecasts may eventually diminish the scale of WRAM/MCBA under-collections, each of Applicants' witnesses explained that his company would have to live with the effects of the sales forecasts presently in effect for several years into the future, making it essential to shorten

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<sup>57</sup> Tr. 160:1-161:1 (Jordan/Garon).

amortization periods and making a 10% cap on the sum of several years' surcharges impractical at this time.<sup>58</sup>

The Commission should not be led astray by thoughts of capping the sum of WRAM/MCBA surcharges. Instead, the Commission should approve Applicants' proposal for more rapid amortization of WRAM/MCBA balances or, in the alternative, should approve Applicants' counter-proposal to DRA's which, in the case of WRAM/MCBA under-collections between 15% and 30% of revenue requirement, would allow the most rapid amortization consistent with maintaining a surcharge that does not exceed 10% of the most recently authorized revenue requirement.

B. ISSUE 2: Utilities Should Submit Their Annual Reports on WRAM/MCBA Balances in Advance of Their Related Advice Letter Filings.

Pursuant to settlements adopted in the Water Conservation OII, each of the Applicants currently submits an annual report on the status of its combined net WRAM/MCBA balances by March 31, including data through the previous December 31. Applicants propose to move the date for submission of their annual reports forward to November 30, with data to be provided up to the previous September 30.<sup>59</sup>

Applicants explained that both PG&E and SDG&E file reports on an annual basis in September or October, for amortization to begin the following January. This timing, along with 12-month amortization of under-collections, has helped to ensure that the energy utilities have not had to face the revenue realization problem presented by EITF Issue No. 92-7. Such earlier reporting will decrease the risk for water utilities that full recovery of WRAM/MCBA

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<sup>58</sup> See, Tr. 162:4-17 (Garon); 163:3-13, 166:1-24 (Smegal); 163:14-164:19 (Jordan).

<sup>59</sup> Application, at 20.

balances will extend beyond the 24-month limit set by EITF Issue No. 92-7.<sup>60</sup> The main benefit of earlier reporting, however, is that it will enable DRA to start reviewing the utility's data sooner – providing nine months of the year's data several months in advance of the Tier 1 advice letter that will implement the annual surcharge or surcredit.<sup>61</sup>

Due to the current shortness of time, Applicants propose to implement this revised schedule with the filing of reports in the fall of 2012. In the meantime, they will continue to submit information about their 2011 balances by the March 31, 2012 deadline that is consistent with current practices.<sup>62</sup>

DRA supports this rescheduling proposal.<sup>63</sup> The Commission should approve it.

C. ISSUE 3: Requests for Amortization of WRAM/MCBA Balances Should Be Submitted on or Before March 31 of Each Year.

Currently, Applicants are permitted by the WRAM settlements to request amortization of WRAM/MCBA balances only once a year, and most of the settlements require such requests to be submitted within 30 days of filing their annual WRAM/MCBA reports. In order to provide more certainty and consistency in the administration of these accounts, Applicants propose that requests to amortize net WRAM/MCBA balances accumulated during the previous calendar year should be filed on or before March 31.<sup>64</sup>

DRA supports this proposal.<sup>65</sup> The Commission should approve it.

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<sup>60</sup> Application, at 12-13, 20.

<sup>61</sup> See, Tr. 178:21-179:25 (Garon).

<sup>62</sup> Exhibit 2 (Smegal/Garon/Jordan), at 12.

<sup>63</sup> Exhibit 3 (Rasmussen), at 7 line 7.

<sup>64</sup> Application, at 20; see also, Tr. 179:20-180:11 (Garon/Smegal).

<sup>65</sup> Exhibit 3 (Rasmussen), at 7 line 13.

D. ISSUE 4: It Should Be Clarified That Amortization of WRAM/MCBA Balances May Be Requested By a Tier 1 Advice Letter.

The WRAM Decisions do not specify the appropriate advice letter tier for requesting amortization of account balances, but the Water Industry Rules of General Order 96-B allow requests to amortize balancing accounts by Tier 1 advice letter. Applicants propose to clarify that amortization of net WRAM/MCBA account balances may be requested by a Tier 1 advice letter. This modification will provide clear guidance to the utilities and DWA staff and will diminish the risk of delay in implementing surcharges and surcredits.<sup>66</sup>

DRA supports this proposal.<sup>67</sup> The Commission should approve it.

E. ISSUE 5: The Trigger To Amortize WRAM/MCBA Balances Should Be 2% of a Utility's Last Authorized Revenue Requirement, but Utilities' Should Be Able to Choose Whether to Amortize or Carry Forward Balances Under 2%.

Under the WRAM settlements, Applicants may not amortize the net balance in a WRAM/MCBA account until it exceeds a "trigger" set at 2% or 2.5% (depending on the company) of total recorded revenue requirement for the prior calendar year. For other balancing accounts, the trigger is "2% of annual revenues." WRAM/MCBA balances less than the trigger amount carry over to the next annual filing or can be amortized in the next GRC.<sup>68</sup> Applicants propose to allow amortization of WRAM/MCBA balances on an annual basis regardless of their magnitude, with percentages to be calculated based on the ratemaking district's "last authorized revenue requirement," with the trigger for mandatory filing set at 2%

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<sup>66</sup> Application, at 21; *see also*, Tr. 180:12-21 (Garon)..

<sup>67</sup> Exhibit 3 (Rasmussen), at 7 line 21.

<sup>68</sup> Application, at 21; Exhibit 3 (Rasmussen), at 8 lines 2-11; *see also*, Standard Practice U-27-W (revised May 2008), ¶39; *citing* D.06-04-037, O.P. 2; *but see, id.*, O.P. 3.

for all Applicants, and with utilities allowed to file advice letters to amortize balances under 2% at their discretion.<sup>69</sup>

The EITF 92-7 rule on recognition of revenue presents a problem not only with respect to large under-collections to which long amortization periods apply, but also with respect to small under-collections that are below the 2% or 2.5% of revenues that triggers an amortization advice letter under current rules. If the under-collection remains below the trigger point it may never be collected, and so cannot be recognized as current revenue for financial reporting purposes.<sup>70</sup> Permitting discretionary filings for balances below the 2% trigger also promotes intergenerational equity by decreasing the lag time between recording of a positive or negative amount in a WRAM and applying a corresponding surcredit or surcharge to customers' bills. As noted in the Application, this measure "renders it more likely that the customers from whom the company initially over- or under-collected will actually be the ones to receive the surcredit/surcharge."<sup>71</sup>

DRA supports this proposal.<sup>72</sup> The Commission should approve it.

F. ISSUE 6: Under-Collections Should Be Amortized by a Surcharge on Quantity Charges, but Over-Collections Should Be Amortized by a Surcredit on the Service Charge.

The WRAM Decisions require Applicants to apply over- or under-collections to customer bills as volumetric surcharges or surcredits. At the suggestion of DRA, Applicants propose to modify this requirement to be consistent with procedures governing other balancing accounts pursuant to D.03-06-072 – with under-collections to be amortized by a surcharge on the quantity charge while over-collections are amortized by a surcredit on the *service* charge.

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<sup>69</sup> Application, at 21-22.

<sup>70</sup> Tr. 41:23-42:16 (Smegal); *see also*, Application, at 22.

<sup>71</sup> *Id.*

<sup>72</sup> Exhibit 3 (Rasmussen), at 8 line 21.

In addition to the benefit of consistency, this change will avoid refunding WRAM/MCBA credit balances disproportionately to customers who use large amounts of water.<sup>73</sup>

DRA notes that Applicants have applied volumetric surcharges/surcredits differently. For example, Golden State initially used its tiered residential rate design to distribute surcharges or surcredits, while Cal Water always has applied WRAM surcharges and surcredits as a flat rate per ccf. DRA does not propose a uniform procedure. DRA recognizes that Applicants' proposal to apply surcharges to the service charge is consistent with Standard Practice U-27-W and underlying decisions, and finds no evidence to deviate from the Standard Practice.<sup>74</sup>

There is no basis in the record for dictating how to assign surcharges to volumetric rates. There are good reasons, however, for bringing the procedure for applying surcredits into line with Standard Practice U-27-W and a consensus favors that result. Accordingly, the Commission should provide for surcharges to be applied to volumetric rates while surcredits are applied to service charges.

G. ISSUE 7: Utilities Should Be Allowed but Not Required to Apply "FIFO" Accounting for Amortized Balances.

The Application noted that the WRAM Decisions do not specify how to account for amortized amounts as the utility receives surcharge revenue or pays out surcredits to customers. The Application proposed that in each ratemaking unit, surcharge revenues or surcredits should be applied first to the oldest net WRAM/MCBA balances. Applicants requested that the Commission explicitly adopt this "First In, First Out" ("FIFO") procedure to assure the

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<sup>73</sup> See, Application, at 22-23.

<sup>74</sup> Exhibit 3 (Montero), at 9 line 2 to 10 line 23.

financial community that recovery of all revenue recognized in a year will be fully collected within the 24 month period required by EITF Issue No. 92-7.<sup>75</sup>

DRA does not oppose use of the FIFO method. However, DRA believed it unnecessary and inappropriate for the Commission to dictate the use of a specific accounting treatment – in this using FIFO to implement EITF Issue No. 92-7. DRA considered this a matter “that should be left to the utilities’ discretion.”<sup>76</sup>

In their rebuttal testimony, Applicants agreed with DRA’s position. Applicants went on to recommend that any reference to FIFO in the Commission’s decision should make clear that FIFO has been considered solely in the context of implementing EITF Issue No. 92-7 on the determination of revenue recognition, and is not relevant to ratemaking determinations such as the calculation of WRAM/MCBA balances, surcharges, and surcredits.<sup>77</sup> Applicants’ witnesses acknowledged that they were agreeing with DRA and that this was a change in Applicants’ position.<sup>78</sup>

The consensus recommendation is that Applicants be given the discretion to use FIFO for determination of revenue recognition under the EITF Issue No. 92-7, but that the Commission should not otherwise address the use of FIFO. Applicants urge that this approach be taken in the Commission’s decision.

H. ISSUE 8: Under-Amortized or Over-Amortized Amounts From Previously Authorized Surcharges or Surcredits Should Be Included in Annual WRAM/MCBA Filings.

The Application observed that the WRAM Decisions do not specify how to handle WRAM/MCBA account balances that have been “under-amortized” or “over-amortized” due

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<sup>75</sup> Application, at 23.

<sup>76</sup> Exhibit 3 (Montero), at 11 lines 12-15, *citing* Scoping Memo, at 11-12.

<sup>77</sup> Exhibit 2 (Smegal/Garon/Jordan), at 8.

<sup>78</sup> Tr. 181:13-26 (Jordan); 181:27-182:2 (Smegal/Garon).

mainly to variations in sales from the forecasts on which amortization schedules were based. For other balancing accounts, the general practice has been to continue a surcharge or surcredit until the amortization period ends and then retain the remaining balance in the account subject to further amortization once the balance again reaches the “trigger” level or a GRC is filed. The Application proposes to give Applicants the option of including any under-amortized or over-amortized amounts from ongoing surcharges or surcredits in their annual WRAM/MCBA filings, while allowing those ongoing surcharges or surcredits to run until the end of their originally intended amortization terms. By this means, the ongoing under- or over-amortization can be rectified on a timely basis.<sup>79</sup>

DRA agreed with Applicants’ proposal “subject to certain refinements.”

Specifically, DRA saw a problem in amortizing under-collected balances over a longer time frame than originally planned, because it could result in over-collections. DRA expressed concern that there appears to be no monitoring to stop surcharge recovery in districts that have fully recovered the prior year authorized WRAM/MCBA balances. DRA noted, as an example, that in Cal Water’s Advice Letter 2029-A “the total over collection on the 2008 WRAM/MCBA reached \$582,451.”<sup>80</sup> DRA does not oppose Applicants’ proposal, but calls for “strict monitoring of the running balances of these prior years’ authorized WRAM/MCBA balances,” with surcharge recovery to be “immediately terminated when such balances have been fully recovered.” DRA also would require utilities with WRAM/MCBA accounts to present documentation of these processes in their next annual reports.<sup>81</sup>

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<sup>79</sup> Application, at 23-25.

<sup>80</sup> Exhibit 3 (Montero), at 12 line 18 to 13 line 6.

<sup>81</sup> *Id.* at 13 lines 7-19; *see also, id.* at 14 lines 3-9.

In their rebuttal testimony, Applicants took issue with DRA’s recommendation that the utilities “immediately stop any ongoing previous year surcharge” once the WRAM/MCBA balances have been fully recovered. They pointed out that the utilities lack the authority to cease applying such surcharges at their own discretion, and that the “strict monitoring” on a real-time basis of account balances, as envisioned by DRA, is not practical. Applicants stressed the complexity of tracking the current levels of WRAM/MCBA accounts, especially when multiple surcharges are concurrently in place, and warned of increased potential for error in the preparation and review of annual WRAM/MCBA advice letter filings.<sup>82</sup>

Applicants questioned the practicality of DRA’s recommendation to strictly delineate amounts recovered for each year’s WRAM/MCBA balance, noting the lag in determining actual collections or payouts on a month-to-month basis and factors that complicate such calculations. Applicants explained that they apply surcharges until an under-collection is substantially recovered and then include the remainder in calculating a new surcharge or surcredit. Insisting on maintaining separate surcharges or surcredits for each WRAM/MCBA year would leave residuals that could not be recovered – an unfair and unjustified result.<sup>83</sup>

In responding to ALJ Walwyn’s questions, Applicants’ witnesses confirmed their rebuttal testimony. Not only do Applicants have no authority to stop collecting a surcharge before it runs its authorized course, they may not know, due to the lag in accounting, when they hit the end of the amortization. As Mr. Smegal testified, “[t]here is no way to know timely when that balance is fully amortized.”<sup>84</sup> Mr. Jordan cautioned against filing advice letters to

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<sup>82</sup> Exhibit 2 (Smegal/Garon/Jordan), at 9-10.

<sup>83</sup> *Id.* at 10-11.

<sup>84</sup> Tr. 182:7-25 (Smegal).

terminate surcharges once full amortization has been confirmed, noting that “the balancing account tracks the over or undershooting, and eventually that’s going to get trued up.”<sup>85</sup> Mr. Garon concluded the discussion by explaining the multiple, multi-year surcharges that would have to be created, in the present context of consistently overstated sales forecasts, to collect residuals of residuals remaining at the ends of amortization periods, as surcharges repeatedly fail to complete the recovery of WRAM/MCBA under-collections.<sup>86</sup>

The one example DRA offered of “over-amortization” turned out to be the result of a misunderstanding. The “over collection” of \$582,451 that DRA noted in Cal Water’s Advice Letter 2029-A with respect to the company’s 2008 WRAM/MCBA turned out not to have resulted from a surcharge that was left in effect beyond the point of fully amortizing an under-collection, but rather related to an over-collection that had not reached the “trigger” point to be reflected in a surcredit.<sup>87</sup> On redirect examination, DRA witness Montero clarified that DRA had come to agree with Applicants on this issue, understanding that the adopted quantity, which is the basis for computing the WRAM surcharge, always differs from the actual – and that difference is what the utilities propose to bring over to the next year’s WRAM surcharge. DRA agrees that “the undercollection because of the difference in sales . . . should be rolled over to the following year. And together with the new WRAM balance, this becomes the base of the new surcharge.”<sup>88</sup>

The evidence clearly establishes that DRA’s initial recommendations for “strict monitoring” of the WRAM/MCBA balances being recovered by each year’s surcharge, with surcharge recovery to be “immediately terminated when such balances have been fully

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<sup>85</sup> Tr. 182:26-183:9 (Jordan).

<sup>86</sup> Tr. 183:23-184:24 (Garon).

<sup>87</sup> Tr. 202:15-206:12 (Montero), referencing Exhibits 10 and 11 (exhibits of Applicants’ counsel).

<sup>88</sup> Tr. 219:4-220:5 (Montero).

recovered,” are impractical and unnecessary. The procedural and practical impediments to keeping precise track, on a real-time basis, of each year’s under-collection balance in the course of its amortization are substantial and the benefit of terminating such surcharges before their amortization terms have been completed has not been demonstrated. The better solution, as Applicants have proposed and DRA now agrees, is to permit Applicants to include any under-amortized or over-amortized amounts from ongoing surcharges or surcredits in their annual WRAM/MCBA filings, while allowing those ongoing surcharges or surcredits to run until the end of their originally intended amortization terms.

I. ISSUE 9: Allow Accelerated Amortization of Unrecovered Portions of 2009 and 2010 Under-Collections Calculated to Complete Such Amortization in 2012.

The Application included a proposal to implement additional surcharges to accelerate the ongoing amortization to recover the 2009 (and in some cases 2008) WRAM/MCBA balances in order to ensure that they would be fully recovered by the end of 2011.<sup>89</sup> DRA considers this request to be moot, since a decision in this proceeding is scheduled for December 2011 – a year later than Applicants originally envisioned. Noting that “some utilities” have included recovery of 2008 and 2009 under-amortized amounts in their advice letters to recover their 2010 WRAM/MCBA balances, DRA would leave any unrecovered 2008 and 2009 balances remaining at the end of 2011 as a matter for the utilities to “discuss with their respective accountants on the appropriate treatment thereof.”<sup>90</sup>

In their rebuttal testimony, Applicants agreed that their request to accelerate amortization of 2008 and 2009 balances was moot, but urged that “recovery can and should be

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<sup>89</sup> Application, at 25-26.

<sup>90</sup> Exhibit 3 (Montero), at 14 line 12 to 15 line 10.

accelerated” for outstanding 2010 balances that Applicants are in the process of amortizing.<sup>91</sup> This would be accomplished by implementing another surcharge to amortize the 2010 balance by the end of 2012, and would not be subject to the 10% “cap” on surcharges to recover 2011 balances discussed above in the context of Issue 1.<sup>92</sup>

DRA’s cavalier proposal to leave longstanding under-collections as a matter for the utilities to discuss with their accountants fails to recognize the serious implications of the continuing risk that one or more of the Applicants may be required to restate its earnings if recovery of revenues booked to the WRAM/MCBA is delayed beyond the 24-month limit set by EITF Issue No. 92-7. The Commission should allow Applicants to catch up with the effects of the over-long amortization periods applied to past years’ WRAM/MCBA surcharges, accelerating those amortizations to achieve full recovery at or about the end of 2012.

## V.

### DRA’S PROPOSALS FOR FURTHER WRAM/MCBA PROCEEDINGS

#### A. DRA’s Proposal to Create a Phase 2 of the Present Application to Focus on Districts With Under-Collections Over 15% Is Unnecessary.

DRA’s testimony includes a recommendation that the Commission institute a second phase to this proceeding in order to create a formal review process for all conservation rate design pilot programs with a “focus on districts that have an undercollection of 15% or greater in the 2011 WRAM/MCBA balances.”<sup>93</sup> The Commission should reject this recommendation, because appropriate procedures already exist to allow the Commission to evaluate the utilities’ compliance with WRAM/MCBA decisions and to consider whether modifications to a company’s WRAM/MCBA mechanism should be implemented.

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<sup>91</sup> Exhibit 2 (Smegal/Garon/Jordan), at 11.

<sup>92</sup> Tr. 184:25-185:12 (Garon); *see also*, Tr. 75:5-20 (Jordan).

<sup>93</sup> Exhibit 3 (Montero), at 20 lines 21-24 and 28 lines 14-17.

Applicants currently engage in a detailed annual review process with both DWA and DRA that evaluates whether the companies are implementing their respective WRAM/MCBA mechanisms correctly. This process involves submission of the annual written report followed by an advice letter, but has also involved oral and written presentations as well as data requests and responses. These ongoing efforts confirm that the WRAM/MCBA balances are correctly calculated in accordance with the currently-adopted WRAM/MCBA mechanisms.<sup>94</sup>

DRA wanted to be able to look at all WRAMs and wanted companies to have similar rules and mechanisms, but acknowledged that there “may not be a chance for that much of a holistic review of all WRAM mechanisms.”<sup>95</sup> Furthermore, substantive changes to the WRAM mechanism should not be considered in a factual vacuum, without the necessary context of each water utility’s sales forecast and rate design. The GRC already provides the forum for a “holistic approach” to evaluating the WRAM mechanism, along with factors, such as sales forecasts and rate design, that contribute to the WRAM/MCBA balance, making a second phase to this proceeding unnecessary and inappropriate.<sup>96</sup>

DRA offers insufficient justification for recommending a second phase for Commission review and concedes that past general rate cases simply had insufficient data to properly evaluate pilot programs – a circumstance that has been ameliorated by the passage of time. DRA has clear direction to address the operation of each utility’s WRAM/MCBA mechanism in its GRCs and DRA has stated its intention to do so.<sup>97</sup>

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<sup>94</sup> Tr. 54:5-55:6 (Garon), 55:8-27 (Jordan).

<sup>95</sup> Tr. 214:12-20 (Rasmussen).

<sup>96</sup> Tr. 56:3-58:6 (Jordan/Garon/Smegal).

<sup>97</sup> Tr. 222:3-223:21 (Rasmussen).

B. DRA’s Proposal for a Rulemaking to Review Performance of Conservation Rate Pilot Programs and WRAM/MCBA Mechanisms Is Without Merit.

DRA also recommends the Commission institute a rulemaking to examine the “past expectations” and “course for moving forward” with WRAM/MCBA programs.<sup>98</sup>

Specifically, DRA proposes to reserve a number of issues explored in this proceeding, some of which have limited relevance to the operation of the water companies’ WRAM/MCBA mechanism, namely, the recent experience of the municipal water districts and investor-owned energy utilities; the disproportionate effect, if any, of the WRAM/MCBA mechanisms on ratepayers, including low-income ratepayers; review of the reasonableness of the WRAM/MCBA mechanisms; and whether conservation rate design pilot programs should be continued.

For the same reasons that it is inappropriate and unnecessary to adopt DRA’s proposal to create a Phase 2 of this proceeding, the institution of a rulemaking to review the functioning of the Class A water companies’ WRAM/MCBA mechanisms should be denied. The company GRC is the proper forum for the Commission to “fully review the performance of the conservation rate design pilot programs and review of the WRAM/MCBA mechanisms,” as urged by DRA.<sup>99</sup> To the extent that the issues DRA cites above as requiring more in-depth consideration are relevant to a particular company’s GRC, they will be addressed, and in the context of the company-specific circumstances within which the WRAM/MCBA operates. Institution of a generic proceeding would create a competing and duplicative avenue for resolution of WRAM/MCBA-related issues. DRA’s proposal is without merit and should be rejected.

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<sup>98</sup> Exhibit 3 (Montero), at 26-27 and 28 lines 17-20.

<sup>99</sup> Exhibit 3 (Montero), at 26 lines 17-19.

VI.

CONCLUSION

For all the reasons presented in this opening brief, Applicants respectfully urge the Commission to address the nine issues identified in the Application and to resolve them in the manner proposed in this brief. In particular, Applicants urge the Commission to grant the more rapid amortization of WRAM/MCBA under-collections that Applicants have proposed, at least in the alternative version also supported by DRA. Applicants recommend that the Commission look to each water utility's GRC as the appropriate venue to conduct a holistic review of the functioning of that utility's WRAM/MCBA mechanism in the context of its sales forecast and its conservation rate design, and accordingly recommend against extending the present application proceeding into a second phase or opening a duplicative proceeding to evaluate WRAM/MCBA mechanisms on a generic basis.

Respectfully submitted,

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