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EXHIBIT CAW - 33

Response to Questions on Ratemaking

**RESPONSE TO QUESTIONS IN THE NOVEMBER 4, 2013 RULING ON
RATEMAKING IN THE PROPOSED SETTLEMENT AGREEMENT**

**David P. Stephenson
Director of Rates, California American Water**

REQUEST:

California American Water shall provide a detailed description of the ratemaking implications of the proposed Settlement Agreements. For example, the Settling Parties propose that a new memorandum account be established to track \$71.5 million that will be accrued through Surcharge 2, with a subaccount established to track and credit the first \$35.1 million in accrued monies to Cal-Am Only facilities. (Ruling, p. 12)

RESPONSE:

- 1. Interaction of Surcharge 1 and Surcharge 2**
 - a. Settlement provisions governing Surcharge 1 and Surcharge 2 Collections are in Section 12.1 (c) of the Large Settlement Agreement on page 23:**
 - i. California American Water agrees that Surcharge 1 will cease before Surcharge 2 collections begin to allow for a more gradual ramping up of rates that are directly attributed to the MPWSP. To ensure smooth transition from the surcharge 1 collections to the implementation of Surcharge 2, the Parties agree that the rate of collection for surcharge 1 shall increase to 20% at a time of a decision in this proceeding and that it again shall increase to 30% six months later so that it equals the implementation surcharge percentage for Surcharge 2.**
 - b. Basic components of the two surcharges**
 - i. Surcharge 2 will not be on bills until the balance in the Surcharge 1 balancing account is fully collected.**
 - ii. The ratemaking and tracking for Surcharge 1 does not change as a result of the Settlement, except as noted in paragraph (i) above in that the percentage collections for Surcharge 1 will increase to assist in the ramp up to implementation of Surcharge 2.**
 - iii. The ratemaking implications of Surcharge 2 are described in Section 2 below.**
 - iv. Surcharge 2 shall start at a rate of 30% and in accordance with Paragraph 12.1 (d) “California American Water will file a Tier 1 advice letter (AL) quarterly to “true up” these total amounts and propose a new surcharge rate for collection that is estimated to allow for collection of the entire \$71.5 million.”**

2. Memorandum Account and Sub-Accounts to Track Surcharge 2 Collections

- a. Section 6.8(a) of the Large Settlement Agreement provides: “California American Water will establish a memorandum account to track the costs for the desalination facilities and CAW-Only Facilities, as well as to accumulate Surcharge 2 funds in excess of the \$35.1 million that will first be credited against spending on the CAW-Only Facilities as noted later in Section 7.3. The cost of the desalination facilities and the surcharge 2 collections will be tracked separately in the memorandum account.” This memorandum account will have three subsets.**
 - i. Desalination facilities (“Desal Facilities”) (Section 6.8(a) of the Large Settlement Agreement)**
 - ii. Surcharge 2 collections above the \$35.1 million attributable to CAW-Only Facilities (Section 8.8 (a) of the Large Settlement Agreement)**
 - iii. CAW-Only Facilities and Surcharge 2 collections up to \$35.1 million. This subset will have two parts:**
 - 1. CAW-Only Facilities (Section 7.3(a) of Large Settlement Agreement)**
 - 2. Surcharge 2 collections (Section 7.3(a) of Large Settlement Agreement)**
- b. The net balances of part (i) and (ii) will accrue interest at the cost of capital necessary to finance the project. (Large Settlement Agreement, Section 6.8(b))**
- c. The net of parts 1 and 2 of part (iii) will accrue interest at the cost of capital necessary to finance the project. (Large Settlement Agreement, Section 7.3(b))**
- d. Allowance for Funds Used During Construction (AFUDC) in both cases will be accrued to the capital accounts if the capital spend exceeds the Surcharge 2 collections. The AFUDC will be accrued to the Surcharge 2 collection sub accounts if the collections exceed the capital spend. (Large Settlement Agreement, Section 14.4)**

3. Cost Caps

- a. The Parties agree that for purposes of setting a cost cap for the Desal Facilities, \$210.62 million for the 6.4 million gallon per day (“mgd”) option and \$253.36 million for the 9.6 mgd option, shall be used. (Large Settlement Agreement, Section 6.7(a))**

- b. The Parties agree to a cost cap for the CAW-Only Facilities of \$85.04 million (Large Settlement Agreement, Section 7.2(a))**
- c. The cost caps are not absolute. (Large Settlement Section Sections 6.7 (b) and 7.2 (b))**
- d. If California American Water's costs exceed the estimated cost caps set forth above, (but are less than \$223.5 million for the 6.4 mgd option and \$277.8 million for the 9.6 mgd option), it may seek recovery for reasonable and prudent costs above the caps by filing a Tier 2 AL. (Large Settlement Agreement, Section 6.7 (b))**
- e. If the costs for the CAW-Only Facilities exceed \$85.04 million (but are less than \$106.875 million), California American Water may seek recovery for reasonable and prudent costs above the cap by filing a Tier 2 AL. (Large Settlement Agreement, Section 7.2 (b))**
- f. If California American Water's costs exceed \$330.375 million for the 6.4 mgd option and CAW-Only Facilities, and \$384.675 million for the 9.6 mgd option and CAW-Only Facilities, it will file a Petition for Modification with the Commission for recovery. (Large Settlement Agreement, Sections 6.7 (b) & (c) and Sections 7.2 (b) & (c))**

4. O&M Memorandum Account

- a. The Parties agree that California American Water shall be authorized by the Commission to establish a MPWSP Operations and Maintenance memorandum account to track the differences between estimated costs adopted through the Tier 2 AL process and the actual incurred costs during the period of time from the beginning operation of the plant until the time an estimate of such future costs is filed as part of a future general rate case application. (Large Settlement Agreement, Section 8.3 (b))**
- b. California American Water will provide updated operations and maintenance costs to the Commission at least 60 days prior to the time the CAW-Only Facilities become operational. The notification will be made by a Tier 2 AL. This filing will determine the level of costs to be used in setting the initial revenue requirement for the CAW-Only Facilities. (Large Settlement Agreement, Section 8.3 (b) in conjunction with Section 7.3 (c))**
- c. This memorandum account will also track the difference in O&M costs of the Desal Facilities. (Large Settlement Agreement, Section 8.3 (b))**
- d. The Parties agree that California American Water shall be authorized by the Commission to establish a MPWSP Operations and Maintenance memorandum account to track the differences between estimated costs adopted through the Tier 2 AL process and the actual incurred costs during the period of time from the beginning operation of the plant until the time an**

estimate of such future costs is filed as part of a future general rate case application. (Large Settlement Agreement, Section 8.3 (b))

- e. **California American Water will provide updated operations and maintenance costs to the Commission at least 60 days prior to the time the plant becomes operational and delivers water into the distribution system for provision to customers. The notification will be made by a Tier 2 AL. This filing will determine the level of costs to be used in setting the initial revenue requirement for the MPWSP. (Large Settlement Agreement, Section 8.3 (a))**
- f. **In the first general rate case application after at least one full year of operation of the facilities, California American Water will “true up” the difference between the estimated and actual operations and maintenance costs tracked in a memorandum account and seek recovery of all reasonable and prudent differences. (Large Settlement Agreement, Section 8.3 (c))**

5. CAW-Only Facilities and Revenue Requirement

- a. **Once the CAW-Only Facilities are used and useful, California American Water will file a Tier 2 AL to put the balance of the memorandum account (up to the soft cap) into rates by increasing the plant in service by the balance of the CAW-Only Facilities portion of the memorandum account and increase Contributions-In-Aid of Construction by the balance of the Surcharge 2 portion of the memorandum account. (Large Settlement Agreement, Section 7.3 (c))**
- b. **All amounts over the soft cap will remain in the account until the Desal Facilities are placed into service. (Large Settlement Agreement, Section 6.7 (c) and Section 7.3 (c))**

6. Desal Facilities Revenue Requirement

- a. **Once the Desal Facilities go into service, California American Water will file a Tier 2 AL to put the actual costs up to the soft cap, along with the net AFUDC accumulated in the expenditure portion of the memorandum account, into rates. (Large Settlement Agreement, Section 6.8 (c))**
- b. **Once both the CAW-Only Facilities and the Desal Facilities are in rates, all cumulative costs over the soft cap up to the high cap will be filed for recovery through a tier 2 AL, All costs over the high cap will be sought through a Petition for Modification of the initial decision in Phase 1. (Large Settlement Agreement, Section 6.7 (b) and Section 7.2 (b) and Section 14.6)**

7. Examples of Cost Cap Interaction (using 9.6 mgd Facility)

- a. **Example 1 – Cost Cap for Pipeline Exceeding Low Cap but Desal Facilities Not Exceeding Cap:**

- iii. A tier 2 AL filing for the Desal Facilities would be made at a low cap cost of \$253.36 million once in service**
- iv. A Petition for Modification would be filed for recovery of both the excess CAW-Only costs (\$24.96 million) and the Desal Facilities costs (\$26.64 million).**