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

In the Matter of the Application of CALIFORNIA WATER SERVICE COMPANY (U60W), a California corporation, for an order (1) authorizing it to increase rates for water service by \$94,838,100 or 16.5% in test year 2017, (2) authorizing it to increase rates by \$22,959,600 or 3.4% on January 1, 2018, and \$22,588,200 or 3.3% on January 1, 2019, in accordance with the Rate Case Plan, and (3) adopting other related rulings and relief necessary to implement the Commission's ratemaking policies.

Application 15-07-015
Filed July 9, 2015

**CITY OF BAKERSFIELD'S BRIEF REGARDING RECOVERY OF COSTS
RELATED TO THE SOUTH BAKERSFIELD WATER TREATMENT PLANT**

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Date: September 2, 2016

Intervenor City of Bakersfield (“City” or “Bakersfield”) submits the following brief in opposition to the California Water Service Company’s (“CWS” or “Cal Water”) request to recover previously incurred costs in connection with the South Bakersfield Water Treatment Plant (“SBWTP”) as part of CWS’s application for a general rate increase in its 23 districts, and in particular its Bakersfield district.

The City submits this brief pursuant to the schedule adopted by Administrative Law Judge Burcham at the August 17, 2016 status conference in this proceeding. The City will submit separate, additional comments with regard to the proposed settlement agreement for this proceeding, and the joint motion asking the Public Utilities Commission (“Commission”) to approve the settlement, prior to the deadline set by ALJ Burcham for such comments.

I. INTRODUCTION

CWS provides water service to more than 170,000 residential and commercial customers in Bakersfield. Bakersfield is a Charter City, and represents the interests of all residents and businesses located within the City’s boundaries.

Bakersfield filed a Motion for Party Status in this proceeding on September 15, 2015. The Commission granted Bakersfield’s Motion for Party Status during the course of the September 21, 2015 Prehearing Conference for this proceeding.

As part of its General Rate Case, CWS seeks to recover from its ratepayers \$4,676,312 in past design costs, amortized over a 10-year period, for the never-built SBWTP. CWS incurred these costs between 2008 and 2011, and carried the costs through two prior rate cycles without approval or authorization from the Commission.

CWS did not seek Commission approval for the construction of the SBWTP and; therefore, did not have authorization to incur expenses related to the project or to otherwise proceed with the project. The City never approved or agreed to participate in the planning,

design or construction of the SBWTP. CWS incurred approximately \$4.6 million for the design cost of the treatment plant, despite the fact that the project was never “used and useful” and will not be “used and useful” because the availability of surface water in the south Bakersfield area is limited. Not only did CWS forge ahead with a project that has not been reviewed and authorized by the Commission, but CWS imprudently incurred \$4.6 million to design a surface water treatment plant at a location where surface water has limited availability.

Moreover, CWS has determined that it is no longer “feasible” to construct the SBWTP. This means that the \$4.6 million CWS expended to design a project that is not necessary, practical or feasible will not provide any benefit to ratepayers in Bakersfield. The City’s ratepayers should not pay for CWS’s lack of planning and foresight.

To allow CWS to recover such unauthorized previously incurred costs from ratepayers for a project never scrutinized and authorized by the Commission, amounts to impermissible retroactive ratemaking. CWS’s gamble in incurring unauthorized costs for the failed SBWTP should not be borne by its ratepayers, who will receive nothing in return, but rather by its shareholders.

The City therefore respectfully requests that the Commission deny CWS’s request to recover any costs related to the SBWTP.

II. BACKGROUND

CWS first “conceived” the SBWTP in 2007 as an additional project to treat surface water for Bakersfield customers and ratepayers.¹ In this rate case, CWS seeks to recover costs of

¹ CWS, Duncan, A.15-07-015 Reporters’ Transcript (“RT”), p. 472:8-13.

\$4,676,312 incurred between 2008 and 2011 for primarily project design and engineering studies in connection with the SBWTP.²

Although CWS was the “primary driver” of the SBWTP, it initially hoped to pursue the project in partnership with Bakersfield.³ CWS and the City, however, never signed any agreement with regard to the SBWTP, and the City never agreed to advance, expend or share in any costs related to the SBWTP.⁴ At most, the City would have entered into an agreement with CWS to supply water to the SBWTP following its construction.

After expressing some initial support for the SBWTP, in late 2011, the City withdrew its support for the SBWTP and declined to further support or participate in the project.⁵ CWS initially anticipated that it might still build the SBWTP, despite the City’s withdrawal of support and the water quality, design and cost-issues associated with the transmission of surface water to the proposed treatment plant.⁶ CWS later determined that, without the City’s support, “it didn't make sense” for CWS to pursue the project, as CWS “could get the same effect or same impact by expanding one of [its] existing treatment plants,” and the SBWTP “became not feasible for

² CWS-14, p. 51; CWS, Duncan, RT, pp. 471:12-22, 472:8-13, 483:24-25 [last charge incurred in May 2011]; CWS-109:2. Costs were incurred for exploring alternatives for providing a surface water supply, costs benefit analyses, treatability studies, pilot testing and for preliminary design costs.

³ CWS, Duncan, RT, pp. 471:26 – 472:3.

⁴ CWS, Duncan, RT, pp. 478:17-27; 482:15-23.

⁵ CWS, Duncan, RT, p. 482:10-23; CWS-109, p. 72:21-22.

⁶ CWS-109, pp. 72: 22-28, 73:8-13; CWS, Duncan, RT, pp. 476:12 – 478:16. A canal intended to bring Kern River water to the SBWTP site was determined not to be a feasible option due to water quality issues to which the Health Department objected. Another option, a raw water transmission pipeline, was also found infeasible cost-wise, without the City’s participation, where the “same effect or impact” could be achieved by expanding one of CWS’s existing treatment plants. (Id.)

Cal Water cost-wise.”⁷

CWS never received advance authorization or approval from the Commission for the SBWTP and the costs incurred in connection with the project.⁸ In the 2009 general rate case, the settlement approved by the Commission specified that CWS should file a separate application for recovery of costs incurred for the SBWTP.⁹ CWS never filed that application.¹⁰ In the 2012 rate case, CWS included the incurred costs of \$4,676,312 in its Plant Held for Future Use Account.¹¹

At the time it filed the current general rate case, CWS determined that the SBWTP was not feasible and that there was not a definite use for the project in the near future.¹² CWS testified during the evidentiary hearing in the current general rate case that “we decided when we filed this rate case that the project was not going to occur within that five-year window for plant held for future use.”¹³

CWS now seeks to recover \$4,676,312.49 in costs incurred for the SBWTP, amortized over a ten-year period, as a Water Treatment Expense.¹⁴

⁷ CWS, Duncan, RT, p. 478:9-16

⁸ CWS, Duncan, RT, p. 474:7-28; ORA-10, p. 17:9-16.

⁹ CWS, Duncan, RT, p. 474:5-28.

¹⁰ CWS, Duncan, RT, pp. 474:21-22, 476:2-3.

¹¹ CWS-14, p. 51; ORA-10, p. 17:1-4; CWS, Duncan, RT, p. 479:2-25.

¹² CWS-14, p. 51; CWS, Duncan, RT, pp. 476:12 – 478:16; 479:9-17; ORA-10, p. 17:4-8 and 16-17.

¹³ CWS, Duncan, RT, p. 479:14-17.

¹⁴ CWS-14, p. 51 “When it became apparent that there would not be a definite use for this project in the near future, Cal Water removed this cost in the calculation of revenue requirement for this proceeding. Cal Water is seeking Commission approval to amortize the costs over a longer period.” *see also* ORA-2, p. 38:23-29:2.

III. ARGUMENT

A. Recovery of Unauthorized Costs for the SBWTP Would Violate the Prohibition Against Retroactive Ratemaking

CWS's request to recover previously-incurred but unauthorized expenses for the SBWTP violates the well established rule against retroactive ratemaking. One of the most "cardinal" principles in the ratemaking process, the rule against retroactive ratemaking is very broad in its application.¹⁵ "Without this rule, the Commission, as well as the people of this state whom it is charged to protect, would be virtually powerless against utility efforts to recover unauthorized expenses from ratepayers. A lowering of the bar against retroactive ratemaking would represent abandonment of the fundamental concept in public utility law that profit is not guaranteed."¹⁶

"It is a well-established tenet of the Commission that ratemaking is done on a prospective basis."¹⁷ It is not the Commission's practice "to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking."¹⁸

¹⁵ D. 92317, 1980 Cal. PUC LEXIS 844, *3

¹⁶ *Id.*

¹⁷ D.92-03-094, 1992 Cal. PUC LEXIS 236, *7-8; *see also Pacific Telephone and Telegraph Co. v. Public Utilities Commission* (1965) 62 Cal.2d 634, 655 ["general ratemaking is legislative in character and looks to the future"].

¹⁸ D.92-03-094, 1992 Cal. PUC LEXIS 236, *7-8. The California Supreme Court has repeatedly affirmed the prohibition against retroactive ratemaking. (*See e.g., Pacific Telephone and Telegraph Co. v. Public Utilities Commission* (1965) 62 Cal.2d 634; *City of Los Angeles v. PUC* (1972) 7 Cal.3d 331.)

In *In the Matter of the Application of Southern California Water Company*, the Commission determined that it could not allow the recovery of revenue requirement deficiencies related to costs associated with the company's move to its new headquarters and lease of its old headquarters (costs of ownership) due to retroactive ratemaking concerns.¹⁹ The Commission noted that there are several established procedures available for a utility to recover its costs for new plant additions prior to formal action to recognize those expenditures in rates.²⁰ "Either the cost can be estimated in a rate case prior to construction and rates authorized prospectively, or the Commission can grant advance authorization for the utility to book these costs into a memorandum or balancing account for later recovery after any necessary review of the reasonableness of the costs."²¹ Southern California Water Company, however, failed to avail itself of any of these procedures, and such costs were non-recoverable.²²

CWS never sought Commission review and approval for the SBWTP. Instead, CWS began to incur costs associated with the SBWTP in 2008 without prior Commission authorization to incur such costs in general, or for later rate recovery. CWS failed to comply with the required regulatory procedures for the recovery of prior costs and expenses from its ratepayers, and the Commission must reject CWS's request to recover the unauthorized and unapproved approximately \$4.6 million in costs related to the SBWTP.²³

¹⁹ D.92-03-094, 1992 Cal. PUC LEXIS 236, *7-8; *see also* D.92-08-046, 1992 Cal. PUC LEXIS 570 *3-6 [Order Denying Rehearing of D.93-03-094].

²⁰ *Id.*

²¹ D.92-08-046, 1992 Cal. PUC LEXIS 570 *3-6.

²² D.92-03-094, 1992 Cal. PUC LEXIS 236, *7-8; *see also* D.92-08-046, 1992 Cal. PUC LEXIS 570 *3-6.

²³ *See id.*

B. Shareholders of a Utility, and not Ratepayers, Should Absorb the Risk of Failed Projects

Bakersfield ratepayers should not have to bear the costs of CWS's failed and abandoned SBWTP. The project was never, and will never be, "used and useful" in providing any service to ratepayers of the Bakersfield District.

Generally, utility shareholders, and not ratepayers, must ordinarily bear the cost of abandoned projects.²⁴ "The Commission's general principle is to only allow recovery in rates of the reasonable and prudently incurred costs for investments that are found to be used and useful in providing service to ratepayers."²⁵ The utility bears the burden of proof of reasonableness, not only with respect to the planning and conduct of a given project, but also regarding the cancellation of projects.²⁶

CWS seeks to recover all of the costs and expenses it incurred in connection with the abandoned SBWTP from its ratepayers, even though the ratepayers of the Bakersfield District

²⁴ See D.06-11-050, 2006 Cal PUC LEXIS 479, *75 ["The instances of the Commission granting a utility rate recovery for abandoned plant are rare and only done in extraordinary circumstances."].

²⁵ D.06-11-050, 2006 Cal PUC LEXIS 479, *75.

²⁶ *Id.* at *77. In a series of decisions, the Commission laid out the criteria for determining whether it is appropriate for a utility's ratepayers to share in the costs of abandoned projects. (D.06-11-050, 2006 Cal PUC LEXIS 479, *75-79 citing D.84-05-100, D.89-12-057 and D.96-09-039.) The Commission found that in periods of great uncertainty for utility planners, it could be appropriate for ratepayers to bear some of the costs incurred for a project which is ultimately canceled if the utility demonstrates that it has exercised reasonable managerial skill in (1) identifying, assessing, and to the extent possible, quantifying the risks relevant to its ability and obligation to maintain adequate and reasonable service ("identifying relevant risks"), (2) analyzing projects such that the choice of project reflects an overall strategy to minimize costs, consistent with quality and dependability of service ("analyzing particular projects"), and (3) frequently reviewing its project commitments and overall supply strategy ("reevaluations"). (*Id.*) CWS has not made that showing, or attempted to make that showing, in this proceeding.

have not and will not receive any benefit from the abandoned project. The shareholders of CWS are not being asked to bear any of the cost of the abandoned project.

As indicated, the Commission has stated in prior decisions that the application of the exception allowing rate recovery for abandoned projects is rare and only applied in time periods when the uncertainty for utility planners is so high that shareholders cannot be expected to shoulder all the risk of projects. Ratepayers should not be required to shoulder the entire risk, and subsequent cost, of an abandoned project. CWS has failed to demonstrate the extraordinary circumstances that would warrant shifting any portion of the cost of the failed SBWTP entirely to Bakersfield ratepayers.

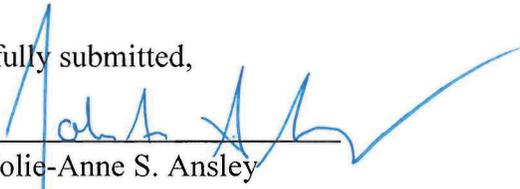
IV. CONCLUSION

For the foregoing reasons, Bakersfield respectfully requests that the Commission deny CWS recovery from its ratepayers any portion of the unauthorized and unreasonable costs related to the SBWTP.

September 2, 2016

Respectfully submitted,

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