

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



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In the Matter of the Application of
California-American Water Company
(U210W) for an Order Authorizing the
Transfer of Costs Incurred in 2008 for its
Long-Term Water Supply Solution for the
Monterey District to its Special Request 1
Surcharge Balancing Account.

Application 09-04-015
(Filed April 16, 2009)

REPLY BRIEF OF CALIFORNIA-AMERICAN WATER COMPANY

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I. INTRODUCTION

In accordance with the *Amended Scoping Memo and Ruling of Assigned Commission and Administrative Law Judge*, dated March 10, 2010 (“May 10th Ruling”), California-American Water Company (“California American Water”) hereby files its Reply Brief in the above-captioned proceeding. California American Water will respond to the *Brief of the Division of Ratepayer Advocates Opposing Certain Aspects of the Proposed Reimbursement Agreement*, filed May 21, 2010 (“DRA Opening Brief”). In addition to the issues addressed herein, California American Water supports the Joint Reply Brief concurrently filed today by the Monterey County Water Resources Agency and Marina Coast Water District (both jointly referred to as the “Public Agencies”) to the extent that it responds to the flawed legal arguments offered by the Division of Ratepayer Advocates (“DRA”). In this Reply Brief, California American Water will address affirmative arguments that support the California Public Utilities Commission’s (“Commission”) approval of the Reimbursement Agreement between California American Water and the Public Agencies.¹ California American Water will also briefly address the meritless legal arguments in DRA’s Opening Brief.

¹ California American Water also reiterates its support for the Reimbursement Agreement as stated in the *Opening Brief of California-American Water Company in Support of Reimbursement Agreement*, filed May 21, 2010 (“CAW Opening Brief”). As stated therein, the Reimbursement Agreement provides funding for RDP development costs on

II. DISCUSSION

The Reimbursement Agreement is consistent with the Commission's policy on funding joint projects that will provide benefits to ratepayers. DRA opposes the Reimbursement Agreement because it would allow the Public Agencies to be reimbursed for their administrative, consultant, and legal expenses associated with the Regional Desalination Project ("RDP").² Such opposition contradicts a beneficial Commission policy that allows public utilities to reimburse or co-fund third parties in connection with joint projects. As explained below, the fact that a third party expended funds for a project that will benefit the ratepayers, such as the RDP, does not alter the reasonable and beneficial nature of those projects' expenses.

A. The Reimbursement Agreement Provides Funding that is Reasonable and Necessary for the Development of the RDP

As discussed in more detail in California American Water's Opening Brief,³ the Reimbursement Agreement costs are the type of costs contemplated by the Commission when it authorized California America Water to establish a memorandum account to book costs associated with preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates for the Coastal Water Project, including legal and administrative costs.⁴ The Public Agencies are necessary partners in the

an interim basis, covering costs incurred from March 10, 2010 until the Public Agencies obtain financing for the RDP to meet their ongoing direct RDP-related costs and begin repaying the costs, or December 31, 2010, whichever occurs sooner. The Reimbursement Agreement provides that the funds would be repaid by the Public Agencies, or in the event that the Commission denies the RDP, the costs would be recovered from California American Water's Monterey County District ratepayers. The Reimbursement Agreement originally contemplated payments commencing on February 9, 2010. However, per the March 10th Ruling, California American Water could not track these payments in the memorandum account until the date of that ruling. California American Water subsequently sent a letter to MCWD and MCWRA clarifying that payments would be made beginning March 10, 2010 in accordance with the March 10th Ruling.

² DRA Opening Brief at p.3.

³ CAW Opening Brief at pp. 10-14.

⁴ D.03-09-022, *In the Matter of the Application of CALIFORNIA-AMERICAN WATER COMPANY (U 210 W) for a Certificate that the Present and Future Public Convenience and Necessity Requires Applicant to Construct and Operate the 24,000 acre foot Carmel River Dam and Reservoir in its Monterey Division and to Recover All Present and Future Costs in Connection Therewith in Rates*, 1997 Cal. PUC LEXIS 1279, *2. The Commission confirmed

RDP, and their participation in Commission proceedings and other administrative proceedings is vital to the success of the RDP. The legal and administrative costs that the Public Agencies will incur to participate in such proceedings are no different than the costs incurred by any third party vendor that provides other services to the RDP. DRA does not dispute that a contracted engineering firm may bill for its services to design and construct the RDP. DRA does not dispute the validity of California American Water's own legal and administrative costs that are prudent and necessary to obtain permitting and other regulatory approval for the RDP. DRA's opposition to the provision of adequate funding for the Public Agencies is simply an attempt to pick at the necessary costs of the RDP that may place the viability of the entire project at risk. As discussed in the Motion to Approve Reimbursement Agreement, the Public Agencies will not be able to participate in the development of the RDP without the funding provided by the Reimbursement Agreement, and the project may fail.

B. The Reimbursement Agreement is Consistent with Commission Precedent

The Reimbursement Agreement provides necessary funding in the form of guaranteed loans to the Public Agencies to develop the RDP. If the development of the RDP progresses, the Reimbursement Agreement provides that the Public Agencies will repay these loans with interest. This proposal to provide financing to a third party for the development of a necessary project is consistent with Commission precedent. The following examples illustrate similar financing or co-funding agreements approved by the Commission.

First, the Commission authorized electric utilities to provide loan guarantee funding for third parties to incur expenses for projects with clear ratepayer benefits. In D.96-08-038, the Commission authorized Pacific Gas and Electric Company ("PG&E"), San Diego Gas and

that California American Water was authorized to track and recover legal and administrative costs in the memorandum account. D.06-12-040, *In the Matter of the Application of California-American Water Company for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project to Resolve the Long-Term Water Supply Deficit in its Monterey District and to Recover All Present and Future Costs in Connection Therewith in Rates. (U 210 W)*, 2006 Cal. PUC LEXIS 422, *31 ("CalAm requests recovery...for project management, legal, administrative and other costs...We authorize CalAm to recover these costs booked in the memorandum account").

Electric Company (“SDG&E”) and Southern California Edison (“SCE”) to provide loan guarantees of \$112.5 million, \$25 million and \$112.5 million, respectively, to the newly formed Independent System Operator (“ISO”) and the Power Exchange (“PX”).⁵ In that proceeding, the Commission sought to assist the energy industry in preparing for the restructuring of the California electric industry by developing computers, software systems, and related services for the ISO and the PX.⁶ The Commission noted that such funding was necessary to ensure that the systems were in place in time to meet the deadline for electric restructuring. While the Commission anticipated that the costs would be recovered in federal rates, it specifically considered the possibility that state ratepayers might ultimately bear those costs. “[S]hareholders of [PG&E, SDG&E and SCE] should not bear cost recovery risks associated with the development of the ISO and PX hardware and software.”⁷ The Commission explained that the costs required to fund the third party development of the projects were reasonable and the loans should therefore be guaranteed by ratepayer funds. With limited exception, the Commission recommended that, “no development costs that may subsequently come before the Commission should be excluded from state rates on the basis that the development cost was incurred unreasonably.”⁸

The Commission recognized in D.96-08-038 that a source of funding was necessary to timely develop the ISO and PX in a manner that would ultimately benefit ratepayers. As such, it approved an agreement that provided loan guarantees to fund the development costs incurred by those third parties. In the current proceeding, the Reimbursement Agreement provides for similar funding to the Public Agencies in order to cover the necessary costs required for the development of the RDP, which will clearly benefit ratepayers. The Reimbursement Agreement

⁵ D.96-08-038, *Joint application of Pacific Gas and Electric Company, San Diego Gas and Electric Company, and Southern California Edison Company For Ex Parte Interim Approval Of A Loan Guarantee And Trust Mechanism To Fund The Development Of An Independent System Operator (ISO) And A Power Exchange (PX) Pursuant to Decision 95-12-063 as modified*, 1996 Cal. PUC LEXIS 857 (“D.96-08-038, 1996 Cal. PUC LEXIS 857”), **21-22.

⁶ D.96-08-038, 1996 Cal. PUC LEXIS 857, at *31.

⁷ D.96-08-038, 1996 Cal. PUC LEXIS 857, at *40.

⁸ D.96-08-038, 1996 Cal. PUC LEXIS 857, at *45.

also follows the structure applied in D.96-08-038 because it recognizes that shareholders should not bear the risk that California American Water may not recover the costs of the loans to the Public Agencies if the Commission does not approve the RDP. In the context of the RDP, it is appropriate for ratepayers to assume the limited risk to guarantee the loans to the Public Agencies because the funding provided by those loans is a necessary and reasonable cost to develop the RDP that will benefit ratepayers.

Second, the Commission previously authorized California American Water to recover costs that it reimbursed to a third party public agency for necessary conservation projects in its Monterey County District. In California American Water's 2008 GRC, the Commission noted, "We have previously approved a joint project between Cal-Am and [MPWMD] for conservation programs, which included recovery of [MPWMD's] costs from Cal-Am's customers by a surcharge placed on the customers' bills."⁹ In D.06-11-050, the previous GRC for the Monterey County District, the Commission approved a special conservation surcharge to fund activities undertaken by MPWMD.¹⁰ "We find conservation activity is critical for the Monterey district and the funds being provided by customers... Therefore, it is reasonable and in the public interest to have Cal-Am and MPWMD enter a formal agreement for the conservation funds that Cal-Am provides to MPWMD..."¹¹ The Reimbursement Agreement is analogous to the MPWMD conservation surcharge. Both projects incurred costs for activities that the Commission deemed necessary for Monterey County District customers, and both projects included costs that were incurred by third parties and reimbursed by ratepayers. In fact, the Reimbursement Agreement is more favorable to ratepayers because it provides loan guarantees to the Public Agencies rather than direct payments. As such, there is a high likelihood that the Public Agencies will repay the

⁹ D.09-07-021, *Application of California-American Water Company (U210W) for Authorization to In-crease its Revenues for Water Service in its Monterey District*, 2009 Cal. PUC LEXIS 346, *188.

¹⁰ D.06-11-050, *In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its Monterey District*, 2006 Cal. PUC LEXIS 479 ("D.06-11-050, 2006 Cal. PUC LEXIS 479"), **40-41.

¹¹ D.06-11-050, 2006 Cal. PUC LEXIS 479, *41.

funds with interest, so the ultimate cost to ratepayers is low, especially when compared to the consequences of a “no project” alternative for the Monterey County District.

Third, the Commission addressed joint project funding in relation to the Operational Energy Efficiency Programs (“OEEP”) authorized for the energy and water utilities.¹² In that proceeding, the Commission authorized costs for OEEP projects to improve energy efficiency, also known as the “embedded energy,” of well pumps and booster pumps. Although that particular proceeding involved cost sharing between only Commission-regulated utilities involved in that proceeding, the Commission ordered the electric utilities, and consequently their ratepayers, to fund the bulk of the project costs. This included \$250,000 for administrative and project support costs of the water utilities.¹³ Therefore, electric utility ratepayers provided funding for the administrative costs of third party water utilities. Although the Commission retains jurisdiction over both the energy and water utilities, many electric utility ratepayers that provided this funding certainly do not live within the customer service areas of the OEEP projects. In addition, the Commission had previously approved a similar project to develop partnerships with public water agencies.¹⁴ The Commission’s authorization of electric utilities to fund the OEEP administrative and project costs undertaken by third parties provides another example that is analogous to the Reimbursement Agreement. The OEEP projects ultimately benefited electric ratepayers, and therefore it was appropriate for ratepayer funds to support the joint projects. Similarly, the Public Agencies’ administrative and legal costs related to the RDP will ultimately benefit ratepayers by allowing the development of the RDP. The fact that a third party expended funds for both the OEEP and the RDP does not alter the reasonable and beneficial nature of those projects’ expenses.

¹² D.10-04-030, *Southern California Edison Company's Application for Approval of Embedded Energy Efficiency Pilot Programs for 2007-2008 And Related Matters*, 2010 Cal. PUC LEXIS 113, *1.

¹³ D.10-04-030, 2010 Cal. PUC LEXIS 113, *12.

¹⁴ D.10-04-030, 2010 Cal. PUC LEXIS 113, *5.

C. DRA's Intervenor Compensation Arguments are Irrelevant

The Reimbursement Agreement does not seek intervenor compensation for the Public Agencies. The purpose of the intervenor compensation program is, “to provide compensation for reasonable advocate’s fees, reasonable expert witness fees, and other reasonable costs to *public utility customers* of participation or intervention in any proceeding of the commission.”¹⁵ The term “customer” expressly does not apply to a state, federal, or local government agency.¹⁶ As such, the intervenor compensation laws relied on by DRA are not applicable to this proceeding, and the Public Agencies are not claiming intervenor compensation.¹⁷

D. DRA's Constitutional Arguments are Without Merit

DRA argues that the Reimbursement Agreement would violate the Constitution and the free speech rights of ratepayers because it would forcibly compel them to “associate” with views of other speakers.¹⁸ DRA relies on two U.S. Supreme Court Cases and various Commission decisions to support this argument. Each of these cases and decisions, however, is completely off-point and irrelevant to the issue at hand.

First, DRA relies on Justice Blackmun’s dissenting opinion in *Consolidated Edison Company v. Public Service Commission* (1980) 447 U.S. 530, 548 (“*ConEdison*”). DRA acknowledges, however, that the *ConEdison* case expressly did not address the issue of free speech as it relates to the reimbursement of pre-development project costs.¹⁹ DRA’s reliance on Justice Blackmun’s dissent is similarly unpersuasive because it focused on the fact that utility

¹⁵ Pub. Util. Code § 1801 (emphasis added).

¹⁶ Pub. Util. Code § 1802.

¹⁷ It is also worth noting that DRA’s subsequent argument regarding the violation of ratepayers’ Constitutional free speech rights, if given any credence, would encompass the intervenor compensation program. Under DRA’s rationale, any Commission decision awarding compensation to an intervenor, which compensation is funded by ratepayers, would unconstitutionally “associate” the ratepayers with the arguments asserted by the intervenors. As discussed in more detail below, DRA’s argument is without merit, and the Commission should dismiss it as irrelevant to this proceeding.

¹⁸ DRA Opening at p.7.

¹⁹ *ConEdison*, 447 U.S. at 544 (“I write separately to emphasize that our decision today in no way addresses the question whether the Commission may exclude the costs of bill inserts from the rate base”) (J. Marshall concurring).

bill inserts conflicted with New York laws that prohibited recovering costs for political advertising and lobbying in rate base.²⁰ Justice Blackmun went on to note that these lobbying costs differed from service-related costs, such as those contemplated by the Reimbursement Agreement, that are appropriately recovered from ratepayers.²¹ The Reimbursement Agreement is not political speech or advertising; therefore, DRA's reliance on *ConEdison* is inapposite.

Second, DRA also relies on *Pacific Gas & Electric Company v. Public Utilities Commission* (1986) 475 U.S. 1 ("*PG&E*") for the notion that the Reimbursement Agreement somehow impinges on free speech.²² Once again, however, the issue in that case has nothing to do with the current proceeding. In *PG&E*, the court stated: "The question in this case is whether the California Public Utilities Commission may require a privately owned utility company to include in its billing envelopes speech of a third party with which the utility disagrees."²³ The Reimbursement Agreement does not in any way compel ratepayers to associate with any form of speech. Unlike a political flier inserted in a bill, which specifically states a particular message, the reasonable costs incurred by the Public Agencies' to participate in regulatory and court proceedings related to the Regional Desalination Project is a business expense that is necessary for the development of the project. The ratepayers are not forced to agree with any positions taken by the Public Agencies, nor are they forced to fund any political messaging or propaganda.

The Reimbursement Agreement and the administrative, consultant and legal expenses that it would fund are not "speech" as contemplated by the authority DRA cites. Ratepayer funding for these activities is a necessary component of California American Water's business expenses that provide utility service to customers. In addition, the Commission precedent DRA relies on is inapplicable because those decisions all involve costs for lobbying or other political

²⁰ *ConEdison*, 447 U.S. at 551 ("Under the laws of New York and other States, however, a public utility cannot include in the rate base the costs of political advertising and lobbying").

²¹ *ConEdison*, 447 U.S. at 552 ("These [lobbying or political advertising] costs cannot be passed on to consumers because ratepayers derive no service-related benefits from political advertisements").

²² DRA Opening at p.9.

²³ *PG&E*, 475 U.S. at 5 (rejecting the Commission's order because it "impermissibly requires [PG&E] to associate with speech with which [PG&E] may disagree").

PROOF OF SERVICE

I, Maria Domingo, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is MANATT, PHELPS & PHILLIPS, LLP, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On June 4, 2010, I served the within:

REPLY BRIEF OF CALIFORNIA-AMERICAN WATER COMPANY

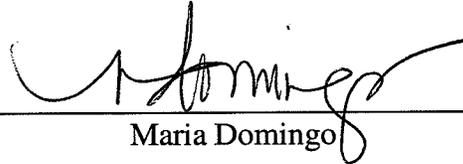
on the interested parties in this action addressed as follows:

See attached service list

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- (BY MAIL)** By placing such document(s) in a sealed envelope, with postage thereon fully prepaid for first class mail, for collection and mailing at Manatt, Phelps & Phillips, LLP, San Francisco, California following ordinary business practice. I am readily familiar with the practice at Manatt, Phelps & Phillips, LLP for collection and processing of correspondence for mailing with the United States Postal Service, said practice being that in the ordinary course of business, correspondence is deposited in the United States Postal Service the same day as it is placed for collection.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on June 4, 2010, at San Francisco, California.



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