

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



**FILED**

11-17-10  
04:59 PM

Application of California-American Water Company (U210W) 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.

A.04-09-019  
(Filed September 20, 2004;  
Amended July 14, 2005)

**CALIFORNIA-AMERICAN WATER COMPANY COMMENTS ON PROPOSED  
DECISION OF ADMINISTRATIVE LAW JUDGE MINKIN AND ALTERNATE  
PROPOSED DECISION OF COMMISSIONER BOHN**

LORI ANNE DOLQUEIST  
SARAH LEEPER

MANATT, PHELPS & PHILLIPS, LLP  
One Embarcadero Center, 30th Floor  
San Francisco, CA 94111  
Telephone: (415) 291-7400  
Facsimile: (415) 291-7474  
Email: ldolqueist@manatt.com  
Email: sleeper@manatt.com

Attorneys for Applicant  
California-American Water Company

Dated: November 17, 2010

## TABLE OF CONTENTS

|  | Page |
|--|------|
| I. INTRODUCTION .....  | 1    |
| II. MODIFICATIONS TO THE SETTLEMENT AGREEMENT OR WATER<br>PURCHASE AGREEMENT WILL JEOPARDIZE THE REGIONAL<br>DESALINATION PROJECT .....                | 3    |
| III. THE PROPOSED MODIFICATIONS DO MORE HARM THAN GOOD.....  | 4    |
| A. The Modifications Increase Risk Without Adding Correlating Benefit .....  | 4    |
| B. Tier 3 Advice Letters Filings are Unnecessary and Harmful to California<br>American Water .....   | 6    |
| C. The Reduced Cost Cap for the California American Water Facilities Will<br>Not Result in Savings to Customers And Will Actually Increase Costs ..... | 10   |
| D. The Commission's Interest Rate for AFUDC Must Not Create a Shortfall .....  | 11   |
| IV. ERROR IN THE APD .....   | 12   |
| V. DRA COST COMPARISON.....  | 13   |
| VI. CONCLUSION.....  | 13   |

**TABLE OF AUTHORITIES**

**Page**

**CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS**

D.06-12-040, *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 .....9

D.08-05-036, *Application of California-American Water Company (U210W) for an Interest Rate of 8.33% for Allowance for Funds Used During Construction (AFUDC) for its San Clemente Dam Memorandum*, 2008 Cal. PUC LEXIS 182 .....11

D.09-07-021, *Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service in its Monterey District by \$24,718,200 or 80.30% in the year 2009; \$6,503,900 or 11.72% in the year 2010; and \$7,598,300 or 12.25% in the year 2011 Under the Current Rate Design and to Increase its Revenues for Water Service in the Toro Service Area of its Monterey District by \$354,324 or 114.97% in the year 2009; \$25,000 or 3.77% in the year 2010; and \$46,500 or 6.76% in the year 2011 Under the Current Rate Design, and Related Matters*, 2009 Cal. PUC LEXIS 346 .....13

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

Application of California-American Water Company (U210W) 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.

A.04-09-019  
(Filed September 20, 2004;  
Amended July 14, 2005)

**CALIFORNIA-AMERICAN WATER COMPANY COMMENTS ON PROPOSED  
DECISION OF ADMINISTRATIVE LAW JUDGE MINKIN AND ALTERNATE  
PROPOSED DECISION OF COMMISSIONER BOHN**

**I. INTRODUCTION**

Pursuant to Article 14 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”), California-American Water Company (“California American Water”) hereby submits its comments on the Proposed Decision of Administrative Law Judge Minkin (“PD”) and the Alternate Proposed Decision of Commissioner Bohn (“APD”). California American Water is grateful for the substantial efforts of Commissioner Bohn and Administrative Law Judge Minkin in guiding this lengthy and complex proceeding to a conclusion, as well as their thoughtful and thorough examination of the issues in the PD and APD. California American Water also appreciates that both the PD and APD

recognize the pressing need for the Regional Project, as well as the aligned goals of all parties and the residents and businesses on the Monterey Peninsula to ensure that a secure supply of water is available before the severe water restrictions imposed by the State Water Resource Control Board’s Cease and Desist Order are fully implemented in 2016.<sup>1</sup>

Nonetheless, California American Water is concerned that the PD and APD make several unnecessary modifications to the agreements between the Settling Parties<sup>2</sup> that will

---

<sup>1</sup> PD, 4; APD, 4.

<sup>2</sup> The Settling Parties are California American Water, Marina Coast Water District (“MCWD”), Monterey County Water Resources Agency (“MCWRA”), Monterey Regional Water Pollution Control Agency, Surfrider Foundation,

endanger the Regional Desalination Project and imperil the financial health of the company. While California American Water favors the APD, even it, if adopted unchanged, will undermine the viability of the Regional Desalination Project. Therefore, California American Water respectfully urges the Commission to revise the APD as discussed in these comments and the comments of MCWD and MCWRA and adopt the Settlement Agreement<sup>3</sup> and Water Purchase Agreement with no material modifications.<sup>4</sup> To fulfill the requirement of Rule 14.3(b) California American Water adopts by reference the proposed findings of fact and conclusions of law appended to MCWD's comments.

In these comments, California American Water will mainly focus on the APD. The PD contains certain provisions that would prove disastrous for the company and would make the Regional Desalination Project untenable. While aspects of the APD are also problematic, California American Water believes that it can be revised to provide for the successful implementation of the Regional Desalination Project, to the benefit of California American Water, its customers, and the Monterey Peninsula.

MCWD and MCWRA will also be discussing the modifications to the Settlement Agreement and the Water Purchase Agreement that the PD and APD suggest. California American Water supports the comments of its public partners. In these comments, California American Water will focus on several issues that hit particularly close to home for the company. California American Water will also address an error in the APD regarding the Monterey District rate design and concerns regarding the desalination cost comparison recently introduced by the Division of Ratepayer Advocates ("DRA").

---

the Public Trust Alliance, and Citizens for Public Water.

<sup>3</sup> *Settling Parties' Motion To Approve Settlement Agreement [Settlement Agreement Attached]*, Exhibit 1, *Settlement Agreement By And Among California-American Water Company, Marina Coast Water District, Monterey County Water Resources Agency, Monterey Regional Water Pollution Control Agency, Public Trust Alliance, And Surfrider Foundation*, filed April 6, 2010, including the modifications submitted on May 19, 2010 (modifications to the Water Purchase Agreement), June 9, 2010 (addition of Citizens for Public Water as a party to the SA), and *Marina Coast Water District's Notice of Filing of Conformed Copy of Water Purchase Agreement Containing Previously-Announced Revisions Acceptable to the Signatories*, filed August 31, 2010 (collectively, "Settlement Agreement" or "SA").

<sup>4</sup> A material modification is any that would require the approval of the governing board of any of the Parties to the Settlement Agreement and Water Purchase Agreement.

## **II. MODIFICATIONS TO THE SETTLEMENT AGREEMENT OR WATER PURCHASE AGREEMENT WILL JEOPARDIZE THE REGIONAL DESALINATION PROJECT**

The settlement in this proceeding is not a run-of-the-mill compromise. It is carefully crafted to strike a delicate balance amongst numerous stakeholders, including multiple public agencies that are not subject to the Commission's jurisdiction. It also provides an innovative public-private partnership solution to a difficult and lengthy proceeding to determine a long-term water solution for California American Water's Monterey District. While the Commission has the right to condition its approval of the Settlement Agreement on changes being made to the agreement before it, the Settling Parties ask that the Commission not do so because the proposed changes substantially alter the transaction. As noted in today's joint filing, California American Water, MCWD, and MCWRA do not accept the modifications to the Settlement Agreement and Water Purchase Agreement contained in the PD and APD. This means that if the Commission in its final decision adopts some or all of the modifications in the PD or APD, it will jeopardize the Regional Desalination Project.

In considering whether modifications to the Settlement Agreement and Water Purchase Agreement are necessary, the Commission must not overlook the urgent need to move forward with the one project that will allow California American Water to comply with regulatory and legal restrictions on the Carmel River and Seaside Basin. Without the Regional Desalination Project, a solution will be infeasible for the immediate future, and the possibility of a future public-private venture may be forever foreclosed. Failure of the Regional Desalination Project would have devastating consequences for California American Water, its customers, and the Monterey Peninsula.

In addition to Order 95-10, California American Water is now also subject to a Cease and Desist Order from the State Water Resources Control Board ("SWRCB"). Without a long-term water supply solution, California American Water will have to continue to divert water from the Carmel River to meet customer demand, creating the likelihood of enforcement actions by the SWRCB. Monterey District customers will also face additional fees and other

consequences if California American Water is unable to comply with the ramp-down of water use required under the Seaside Basin Adjudication.<sup>5</sup> Failure to reduce diversions from the Carmel River will also expose California American Water to enforcement actions seeking fines and other penalties under the Endangered Species Act for endangerment to the steelhead trout. The costs to defend against such enforcement actions, and the imposition of fines and other penalties, pose significant additional costs to California American Water's customers if the Regional Desalination Project is not built. In addition to the regulatory repercussions of the failure of the Regional Desalination Project, the economic repercussions for the Monterey Peninsula from draconian water rationing measures that would follow will also be severe. As Mr. Fogelman noted at the oral argument, the failure of the Regional Desalination Project could cost the Monterey Peninsula more than one billion dollars per year and the loss of more than 6,000 jobs.<sup>6</sup>

The Settling Parties cannot accept the modifications in the PD and APD. If the Commission issues a final decision that contains material modifications to the Settlement Agreement or the Water Purchase Agreement, the Regional Desalination Project will fail, and the decades-long process of trying to find long-term water supply solution for Monterey will have been for naught. In order to avoid this fate, California American Water respectfully implores the Commission to modify the APD to adopt the Settlement Agreement and Water Purchase Agreement without material modifications.

### **III. THE PROPOSED MODIFICATIONS DO MORE HARM THAN GOOD**

#### **A. The Modifications Increase Risk Without Adding Correlating Benefit**

As MCWD and MCWRA discuss in their comments, modifications to the Settlement Agreement and Water Purchase Agreement are unnecessary because the Settling Parties anticipated the concerns the PD and APD raise and addressed them in those agreements. Moreover, the modifications to the Settlement Agreement and Water Purchase Agreement

---

<sup>5</sup> Exh. 103, Rebuttal Testimony of David P. Stephenson, dated May 27, 2010 ("Stephenson Rebuttal"), pp. 8-9; Exh. 100, Rebuttal Testimony of Robert G. MacLean, dated May 27, 2010 ("MacLean Rebuttal"), p. 4.

<sup>6</sup> RT 2027:22 – 2028:1 (Fogelman/MCWD).

substantially alter the transaction because they make the Regional Desalination Project and California American Water more risky, thus increasing the overall cost of financing or eliminating the possibility of financing entirely.

The PD and APD recognize that “the Water Purchase Agreement is structured such that Cal-Am essentially commits future cash flows to funding the debt committed to the Regional Project.”<sup>7</sup> In testimony and at the oral argument, California American Water described the implications of its role as the primary source of cash flows to pay debt service and operating expenses:

Bond investors must be confident that California American Water has the financial wherewithal to meet its obligations under the WPA before they will invest in the bonds.<sup>8</sup>

Any modification that increases the risk to California American Water, the ultimate credit supporter for the transaction, will likely cause a corresponding increase in financing costs.

The PD and APD note, “the financing opportunities are integral to the costs ultimately passed onto Cal-Am ratepayers.”<sup>9</sup> The financing costs, which comprise a significant portion of the total project costs, depend upon a number of circumstances related to the project, including the conditions that the Commission imposes on this transaction.<sup>10</sup> The modifications to the Settlement Agreement and Water Purchase Agreement, if adopted, will likely be viewed by investors as increasing the risk of the project, and make it difficult to obtain financing for the project at reasonable rates, thus increasing the total project cost or killing it altogether.

These modifications would also affect the financial performance of California American Water and its risk profile, further weakening its financial condition and increasing the company’s cost of capital. California American Water explained that any increase in the cost of capital resulting from the transaction would affect California American Water customers throughout California as they would pay such increased costs:

---

<sup>7</sup> PD, pp. 89-90, 184-185, Findings of Fact ¶135; APD pp. 91, 185, Findings of Fact ¶137.

<sup>8</sup> Exh. 111, Rebuttal Testimony of James Kalinovich, dated May 27, 2010 (“Kalinovich Rebuttal”), p. 3. RT 2094:15 – 2095:14 (Dolqueist/California American Water).

<sup>9</sup> PD, p. 97; APD, p. 98.

<sup>10</sup> RT 1616:4-10 (Kalinovich/California American Water).

I would wager to guess that we would request a higher return on equity to compensate for the additional risk that the company would bear as part of this transaction. There's higher short-term debt costs, higher issuance costs for the debt. So it could have a dramatic impact on customers throughout Cal-Am's service territory.<sup>11</sup>

The Commission must consider whether the modifications in the PD and APD, while intended to protect the interest of California American Water's customers, are worth significantly increasing the financing cost of the Regional Desalination Project or, even worse, making it impossible to obtain financing for the Project at reasonable rates. Furthermore, the modifications to the Settlement Agreement and Water Purchase Agreement could have a negative effect for customers outside the Monterey District. The potential for harm caused by these intended protections far outweighs any possible increased benefit for customers because similar protections are already built into the agreements. California American Water therefore recommends that the Commission revise the APD to adopt the Settlement Agreement and Water Purchase Agreement without material modifications.

**B. Tier 3 Advice Letters Filings are Unnecessary and Harmful to California American Water**

The PD and APD require California American Water to file a Tier 3 advice letter to recover the cost of the water it purchases from the Regional Desalination Project.<sup>12</sup> They also impose a similar Tier 3 requirement on the twice-yearly advice letters to recover the cost of the California American Water facilities.<sup>13</sup> The PD and APD include directions to "process" these advice letters within 120 days, but if Commission staff "has questions about particular aspects of the advice letter filing that cannot be resolved within the 120-day period,"<sup>14</sup> the deadline can be extended indefinitely. The current average time for processing a California American Water Tier

---

<sup>11</sup> RT 1084:20-26 (Linam/California American Water).

<sup>12</sup> PD, pp. 98, 143, 159, 197, 208, 211, 214, Findings of Fact ¶210, Conclusions of Law ¶¶41, 59, Ordering ¶1(h)(i); APD, pp. 100, 143, 159, 198, 209, 212, Findings of Fact ¶214, Conclusions of Law ¶¶42, 60, Ordering ¶1(h)(i).

<sup>13</sup> PD, p. 149-150, 159, 198, 214-215, Findings of Fact ¶214, Ordering ¶1(h)(ii); APD 149-150, 159, 199, 216, Findings of Fact ¶221, Ordering ¶1(h)(ii).

<sup>14</sup> PD, pp. 150, 199, Findings of Fact ¶219; APD, pp. 150, 200, Findings of Fact ¶226.

3 advice letter is seven months. Since the PD and APD require additional documentation,<sup>15</sup> these advice letters could take even longer.

Under the Settlement Agreement, California American Water would recover the costs of Regional Desalination Project purchased water through its existing Modified Cost Balancing Account, as it does in its other districts.<sup>16</sup> The Commission does not subject purchased water costs from other agencies to a Tier 3 level of review and it should not do so here. As the President of California American Water testified, an after-the-fact prudence review of the purchased water costs would subject the company to “an untenable risk. And at that point the project from our perspective . . . may not be feasible for our company to do.”<sup>17</sup> That is because the stream of income for the purchase of water from California American Water forms the basis for repayment of the bonds issued to finance construction of the project. If the flow of the income is at risk of substantial delay or stoppage, then those payments are not a reliable and timely source of repayment of the bonds, and either the interest rates for the bonds will increase to reflect that risk or the financing will not be obtainable.

For the California American Water facilities, the Settling Parties have proposed a process similar to the Commission’s Tier 2 advice letter process, although with a longer review period. California American Water will file the advice letters semi-annually on May 15 and November 15, and the rate increases will become effective as of July 1 and January 1 of the following year, respectively.<sup>18</sup> If the Commission does not process the advice letter in time to ensure the rate increases become effective by the specified dates, the interim rates as filed by California American Water will go into effect on either July 1 or January 1, subject to true up.<sup>19</sup> The proposed process is very similar to the DSIC process already approved by the Commission. The proposed process is appropriate because these are costs that the PD and APD have already

---

<sup>15</sup> PD, pp. 143, 149, 159, 197, 198, 211, 214-215, 216, Findings of Fact ¶¶ 210, 214, Conclusions of Law ¶59, Ordering ¶¶1(h)(ii), 3, 4; APD, pp. 143, 149, 159, 198, 199, 212, 217, Findings of Fact ¶¶214, 221, Conclusions of Law ¶60, Ordering ¶¶1(h)(ii), 3, 4.

<sup>16</sup> SA §§10.3, 10.4.2; Exh. 103, Stephenson Rebuttal, p. 8.

<sup>17</sup> RT 1059:24-27 (MacLean/California American Water).

<sup>18</sup> SA § 9.3.1; Exh. 103, Stephenson Rebuttal, p. 4.

<sup>19</sup> SA § 9.4.2.

determined are reasonable.<sup>20</sup> These are costs that were extensively reviewed in this proceeding and are under the cost cap. Waiting to recover the costs until after they have been incurred is already a substantial safeguard.

California American Water is concerned that the APD made this change without taking into account the affect on working cash. If processing does take an average of seven months and If rates are not adjusted until the Tier 3 advice letters have been processed and the Commission has issued a resolution, it will cause a significant delay between the incurrence of the expense and the recovery of the expense from customers. Based on an annual estimated cost of purchased water of between \$40 and \$80 million, a seven month delay (the current average for Tier 3 advice letters) between when costs are actually incurred and the recovery of those costs from ratepayers results in a working cash necessity of between \$23 and \$47 million. The revenue requirement for an increase in working cash of \$23 to \$47 million is \$2.7 to \$5.6 million.

This is a substantial increase in a revenue requirement that is not provided for in the APD. Not only will this increased working cash cause a significant cash flow issue for California American Water, a cash flow issue that can not be overcome by incurring greater short term borrowings, it is an issue that then again adds more risk to California American Water, thereby possibly affecting not only the cost of debt for this project, but also increasing the overall cost of capital for all of California American Water and customers in every district of California American Water.

Furthermore, under the PD and APD, interest would accrue on the costs of the California American Water Facilities several additional months before California American Water could include those costs in rate base. As shown in Appendix A, even if the 120-day deadline were always met, which seems unlikely, the overall cost of the project would increase by more than \$1 million. Appendix A also shows that if the advice letters for California American Water took as long as California American Water's current Tier 3 advice letters to

---

<sup>20</sup> PD, p. 84; APD, p. 84.

process, costs would skyrocket. The Commission has previously rejected proposals in this proceeding to delay recovery of costs “because ratepayers should not be required to pay unnecessary interest charges on costs that have been approved.”<sup>21</sup> The same principal applies here.

In addition to affecting working cash and increasing the overall cost, modifying the Settlement Agreement to provide for a Tier 3 advice letter process for the California American Water facilities would significantly decrease cash flow right at the time cash flow is most critical. The Commission must consider that the \$107 million dollar project is an enormous investment when compared to the current Monterey District ratebase of \$137 million dollars. Moreover, this will be occurring at the same time California American Water will likely be incurring substantial costs related to the reroute of the Carmel River and removal of the San Clemente Dam. Delay in recovery of costs for a project of this size will substantially hamper California American Water’s cash flow, jeopardizing the financial health of the company.

Decreasing the cash flow right at the time the project begins will likely cause investors to demand higher rates of compensation, thereby driving the costs even higher.<sup>22</sup> Furthermore, placing California American Water’s financial condition at a higher risk will lead to increased financing costs for all California American Water’s investments, which will increase the revenue requirements for which all customers are responsible.

In light of these risks, it is important that the Commission look at the type of costs that it is subjecting to this level of review: (1) purchased water costs and (2) costs for the California American Water facilities that are under the cost cap for the project. The company is not seeking to duck review; the Settlement Agreement provides for review of these costs. The level of possible risk to customers does not justify jeopardizing the Regional Desalination

---

<sup>21</sup> D.06-12-040, *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.

<sup>22</sup> Exh. 103, Stephenson Rebuttal, p. 20.

Project, or the financial health of the company. California American Water urges the Commission to instead adopt the procedures developed by the Settling Parties.

**C. The Reduced Cost Cap for the California American Water Facilities Will Not Result in Savings to Customers And Will Actually Increase Costs**

For similar reasons, California American Water is also concerned with the adjustments to the cost cap for the California American Water facilities. The \$107 million cost cap included in the settlement is midway between the most probable cost estimate and the high-cost scenario.<sup>23</sup> The PD and APD adopt a cost cap of \$95 million and a ceiling of \$107 million. An application is required for costs between the cap and the ceiling. The PD prohibits recovery of costs above the ceiling, while the APD allows for recovery under exceptional circumstances.<sup>24</sup> By lowering the cost cap, both the PD and APD increase risks associated with the project which again, will affect the cost or availability of financing. The PD increases that risk further setting an absolute cost cap that would make the California American Water facilities untenable..

Unlike a general rate case, which forecasts future project costs for inclusion in rates, the estimated cost cap will not result in any increase to rates unless California American Water actually incurs costs for the California American Water Facilities. Regardless of the level of the cost cap, California American Water will only seek recovery of the costs that it actually incurs and records. The reduced cost cap will not result in savings to ratepayers; it will only result in an increased overall cost for the construction of the California American Water Facilities and an additional costly proceeding before the Commission. Moreover, as California American Water explained, setting a cost cap too low will actually raise the overall cost of the facility because contractors will be less willing to take on the risk associated with a cost cap that is likely to be exceeded.<sup>25</sup>

---

<sup>23</sup> SA §8.1.4.

<sup>24</sup> PD, p. 213, Ordering ¶1(a)(ii); APD, p. 214, Ordering ¶1(a)(ii).

<sup>25</sup> RT 1605:11-12, 1620:25-28 (Kalinovich/California American Water).

**D. The Commission's Interest Rate for AFUDC Must Not Create a Shortfall**

The PD revises the AFUDC interest rate for the California American Water facilities and reduces it to 2.46%.<sup>26</sup> In contrast, the APD recognizes that California American Water should "charge and collect actual carrying costs."<sup>27</sup> While the APD uses a lower rate than the Settling Parties do, it allows the rate to be trued up to reflect actual carrying costs.<sup>28</sup>

California American Water has demonstrated that it will have to issue long-term debt and use equity to finance the California American Water Facilities, as there is no ability to use short-term debt.<sup>29</sup> The short-term line of credit is and will continued to be tied up with California American Water's other financial commitments, including its outstanding memorandum and balancing account balances and the line of credit in the Water Purchase Agreement. Although the PD claims that this interest rate will "compensate Cal-Am for its carrying costs,"<sup>30</sup> in reality using a 2.46% interest rate for AFUDC will guarantee a multi-million dollar shortfall for California American Water. As shown in Appendix A, the 2.46% interest rate would create a shortfall of approximately \$2 - \$3.2 million dollars.

The PD cites D.08-05-036, in which the Commission recognized the policy objective of matching the regulatory costs with actual costs and found that "Authorizing a carrying cost less than that would not reflect the risks or actual project costs."<sup>31</sup> In D.08-05-036, the Commission addressed the costs related to the San Clemente Dam that California American Water is currently tracking in a memorandum account and noted that as such, they would be subject to later reasonableness review.<sup>32</sup> The PD justifies its harmfully low interest rate by

---

<sup>26</sup> PD, p. 214, Ordering ¶1(f).

<sup>27</sup> APD, p. 148.

<sup>28</sup> APD, p. 148.

<sup>29</sup> Exh. 103, Stephenson Rebuttal, p. 18.

<sup>30</sup> PD, pp. 148, 158, 211, Conclusions of Law ¶60.

<sup>31</sup> D.08-05-036, *Application of California-American Water Company (U210W) for an Interest Rate of 8.33% for Allowance for Funds Used During Construction (AFUDC) for its San Clemente Dam Memorandum*, 2008 Cal. PUC LEXIS 182 ("D.08-05-036, 2008 Cal. PUC LEXIS 182"), \*12.

<sup>32</sup> D.08-05-036, 2008 Cal. PUC LEXIS 182, \*12. California American Water also addressed this issue in its April 22, 2010 Petition to Modify D.06-12-040 to address the AFUDC interest rate for the Coastal Water Project Memorandum Account.

incorrectly claiming that there is “no reasonableness review” of the California American Water facilities.<sup>33</sup>

As part of this proceeding, the cost estimates for the California American Water facilities have been exhaustively reviewed, analyzed, and litigated. Unlike most costs tracked in a memorandum account, the costs of the California American Water facilities are supported by detailed estimates and extensive testimony.<sup>34</sup> Moreover, to the extent that they are below the cost cap, these are costs that the PD and APD have determined are reasonable. Finally, the Tier 2 advice letter process the Settling Parties propose provides the opportunity for the Commission and other interested parties to review the costs after they have been incurred by California American Water and they will be subject to true up.

It is critical that the Commission authorize California American Water to recover its actual carrying costs for the project, to avoid affecting its ability to earn a fair return and ensure that it is able to attract capital at reasonable rates for all California American Water customers. Using the 2.46% rates percent ignores the reality that limiting the AFUDC rate to a level lower than California American Water’s actual cost of the financing could adversely impact the attractiveness of the investment by creating the perception that California American Water is not recovering its prudent and reasonable costs associated with the provision of service. This alone is reason enough to choose the APD (with suggested revisions) over the PD.

#### **IV. ERROR IN THE APD**

In its discussion of the need for the Regional Desalination Plant, the APD states, “D.09-07-021 also removed the lot size and seasonal discounts from Cal-Am’s rate design scheme and therefore customers are, appropriately, no longer insulated from the high cost of outdoor irrigation.”<sup>35</sup> This is not entirely accurate. In D.09-07-021, the Commission removed the lot size and seasonal discounts for the first two rate blocks of the tiered rate design for

---

<sup>33</sup> PD, pp. 137, 147.

<sup>34</sup> Exh. 103, Stephenson Rebuttal, pp. 3-5; Exh. 104, Revised Direct Testimony of F. Mark Schubert, Phase 2 Issues, Originally Served May 22, 2009, Revised June 4, 2010 (“Schubert Revised Direct”), pp. 48-102; Exh. 105, Rebuttal Testimony of F. Mark Schubert, dated May 27, 2010 (“Schubert Rebuttal”), pp. 4-10.

<sup>35</sup> APD, p. 30.

California American Water's Monterey District, not all of the rate blocks.<sup>36</sup> California American Water respectfully requests that the Commission correct the APD to reflect the actual rate design adopted in D.09-07-021.

## V. DRA COST COMPARISON

At the oral argument on November 10, 2010 and in its ex parte meetings, DRA cites to a cost comparison from a "2010 WRF International Panel Discussion."<sup>37</sup> This comparison, which DRA attached to its ex parte notices, purports to show the cost per acre-foot of water from various desalination plants worldwide, from 1991 to the anticipated completion of the Regional Desalination Plant in 2014.

This comparison does not appear to be part of the record of this proceeding and it is not a document appropriate for judicial notice. This comparison provides no information regarding the basis and methodology for the cost comparison, and the parties did not have the opportunity to issue discovery, provide rebuttal, or conduct cross-examination related to the comparison document.<sup>38</sup> As such, it would be inappropriate for the Commission to consider or rely upon the comparison document in reaching its final decision in this proceeding. Accordingly, the Commission should give no weight to the cost comparison document or any DRA arguments that rely upon it.

## VI. CONCLUSION

The proposed Regional Desalination Project, which has the support of the Monterey community at large, will have a momentous effect on California American Water's Monterey District customers and beyond. The Settlement Agreement and Water Purchase

---

<sup>36</sup> D.09-07-021, *Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service in its Monterey District by \$24,718,200 or 80.30% in the year 2009; \$6,503,900 or 11.72% in the year 2010; and \$7,598,300 or 12.25% in the year 2011 Under the Current Rate Design and to Increase its Revenues for Water Service in the Toro Service Area of its Monterey District by \$354,324 or 114.97% in the year 2009; \$25,000 or 3.77% in the year 2010; and \$46,500 or 6.76% in the year 2011 Under the Current Rate Design, and Related Matters*, 2009 Cal. PUC LEXIS 346, fn 24, \*28.

<sup>37</sup> RT 2060:23-26 (Brooks/DRA); *Notice of Ex Parte Communication of The Division of Ratepayer Advocates*, filed November 10, 2010.

<sup>38</sup> Compare, e.g., the cross-examination of DRA witness Dr. Shah re his testimony regarding the comparable costs of other desalination projects. On cross-examination, Dr. Shah was unable to answer questions regarding the basis for the numbers presented. (RT 1554-1562 (Shah/DRA).)

Agreement address and reasonably resolve concerns raised by the parties during this lengthy proceeding, as well as those raised in the PD and APD. The Settling Parties are a broad representation of stakeholders: the utility, government bodies that are accountable to the public, environmental groups, and Monterey ratepayer advocates. The Regional Desalination Project has the overwhelming support of nearly all of the active parties to the proceeding, and, as suggested by Commissioner Bohn at the oral argument,<sup>39</sup> the Settling Parties will continue to meet with the parties opposed to the Regional Desalination Project to see if there is a possibility of finding common ground.

The Regional Desalination Project is the most environmentally benign and cost-effective project and will provide tremendous benefits to California American Water customers. It is a reasonable solution that can be immediately implemented to solve the urgent water supply needs set forth in Order 95-10, the Cease and Desist Order, and the Seaside Basin adjudication. It is also an innovative public-private venture that captures the benefits of public agencies and a private entity. The modifications in the PD and APD are not necessary to protect customer interests and, in fact, would do more harm than good. California American Water is already taking on significant risk. Instead of jeopardizing the success of the Regional Desalination Project through unnecessary modifications, California American Water respectfully requests that the Commission revise the APD to adopt the Settlement Agreement and Water Purchase Agreement with no material modifications.

Dated: November 17, 2010

MANATT, PHELPS & PHILLIPS, LLP

By:   
Lori Anne Dolqueist  
Attorneys for Applicant  
California-American Water Company

300176429.1

<sup>39</sup> RT 2096:13-17 (Commissioner Bohn).

**APPENDIX A**

## REVENUE REQUIREMENT VARIATIONS

|         | Per<br>Settling Party<br>Proposal | 120 Day<br>Lag<br>Original AFUDC | 210 Day<br>Lag<br>Original AFUDC | 120 Day<br>Lag<br>2.5% AFUDC |
|---------|-----------------------------------|----------------------------------|----------------------------------|------------------------------|
| 2011 \$ | 730,000                           | \$ 308,000                       | \$ 94,395                        | \$ 300,000                   |
| 2012 \$ | 4,860,000                         | \$ 3,179,000                     | \$ 2,361,662                     | \$ 3,080,000                 |
| 2013 \$ | 10,570,000                        | \$ 9,061,000                     | \$ 8,430,518                     | \$ 8,760,000                 |
| 2014 \$ | 14,180,000                        | \$ 13,296,000                    | \$ 13,060,671                    | \$ 12,850,000                |
| 2015 \$ | 13,080,000                        | \$ 13,270,000                    | \$ 13,617,012                    | \$ 12,760,000                |
| 2016 \$ | 12,520,000                        | \$ 12,719,000                    | \$ 13,061,567                    | \$ 12,230,000                |

## Accumulated AFUDC

|      |             |             |             |             |
|------|-------------|-------------|-------------|-------------|
| 2011 | \$46,000    | \$64,000    | \$95,000    | \$19,000    |
| 2012 | \$840,000   | \$1,179,000 | \$1,772,000 | \$349,000   |
| 2013 | \$2,311,000 | \$3,233,000 | \$4,846,000 | \$953,000   |
| 2014 | \$3,163,000 | \$4,413,000 | \$6,602,000 | \$1,301,000 |
| 2015 | \$3,456,000 | \$4,813,000 | \$7,191,000 | \$1,419,000 |
| 2016 | \$3,456,000 | \$4,813,000 | \$7,191,000 | \$1,419,000 |

**PROOF OF SERVICE**

I, Cinthia A. Velez, 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 November 17, 2010, I served the within:

***California-American Water Company Comments on  
Proposed Decision of Administrative Law Judge Minkin and  
Alternate Proposed Decision of Commissioner Bohn***

on the interested parties in this action addressed as follows:

***See attached service list***

- (BY CPUC E-MAIL SERVICE)** By transmitting such document electronically from Manatt, Phelps & Phillips, LLP, San Francisco, California, to the electronic mail addresses listed above. I am readily familiar with the practice of Manatt, Phelps & Phillips, LLP for transmitting documents by electronic mail, said practice being that in the ordinary course of business, such electronic mail is transmitted immediately after such document has been tendered for filing. Said practice also complies with Rule 2.3(b) of the Public Utilities Commission of the State of California and all protocols described therein.
  
- (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 November 17, 2010, at San Francisco, California.

  
\_\_\_\_\_  
Cinthia A. Velez

**CPUC E-Mail Service List**  
**A.04-09-019**  
**(Updated November 16, 2010)**

venskus@lawsv.com  
rmcglathlin@bhfs.com  
mall@ci.monterey.ca.us  
georgeriley@hotmail.com  
dave@laredolaw.net  
mlm@cpuc.ca.gov  
mfogelman@friedumspring.com  
sleeper@manatt.com  
nelsonp34@hotmail.com  
dcarroll@downeybrand.com  
steller@rtmmlaw.com  
andy@mpwmd.dst.ca.us  
jgeever@surfrider.org  
connere@west.net  
carrie.gleeson@amwater.com  
robert.maclean@amwater.com  
tim.miller@amwater.com  
tmontgomery@rbf.com  
Gregory.Wilkinson@bbklaw.com  
jason.Ackerman@bbklaw.com  
llowrey@nheh.com  
ffarina@cox.net  
weeksc@co.monterey.ca.us  
stecllns@aol.com  
nisakson@mbay.net  
Glen.Stransky@LosLaurelesHOA.com  
bobmac@qwest.net  
davi@ci.monterey.ca.us  
jim@mcwd.org  
manuelfierro02@yahoo.com  
erickson@stamplaw.us  
bobh@mrwpca.com  
catherine.bowie@amwater.com  
john.klein@amwater.com  
darby@mpwmd.dst.ca.us  
heidi@laredolaw.net  
tgulesserian@adamsbroadwell.com  
ezigas@esassoc.com  
dhansen@friedumspring.com  
selkins@friedumspring.com  
lweiss@manatt.com  
ldolqueist@manatt.com

cem@newsdata.com  
michael@rri.org  
lmelton@rmcwater.com  
scorbin@surfrider.org  
swilliams@poseidon1.com  
joyce.ambrosius@noaa.gov  
kobrien@downeybrand.com  
abl@bkslawfirm.com  
dstephen@amwater.com  
llk@cpuc.ca.gov  
bca@cpuc.ca.gov  
ang@cpuc.ca.gov  
cjt@cpuc.ca.gov  
dsb@cpuc.ca.gov  
jzr@cpuc.ca.gov  
jws@cpuc.ca.gov  
mzx@cpuc.ca.gov  
mml@cpuc.ca.gov  
nks@cpuc.ca.gov  
jpn@cpuc.ca.gov  
pva@cpuc.ca.gov  
rkk@cpuc.ca.gov  
rra@cpuc.ca.gov  
steve@seacompany.org  
jb2@cpuc.ca.gov  
ayk@cpuc.ca.gov

**U.S. Mail Service List**  
**A.04-09-019**  
**(Updated November 16, 2010)**

Commissioner John A. Bohn  
California Public Utilities Commission  
505 Van Ness Avenue, Room 5303  
San Francisco, CA 94102-3214

Amy Yip-Kikugawa  
California Public Utilities Commission  
Executive Division  
505 Van Ness Avenue  
San Francisco, CA 94102-3214

ALJ Angela K. Minkin  
California Public Utilities Commission  
Division of Administrative Law Judges  
505 Van Ness Avenue, Room 5105  
San Francisco, CA 94102-3214