

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

Application 12-04-019
(Filed April 23, 2012)

PROTEST OF THE DIVISION OF RATEPAYER ADVOCATES

I. INTRODUCTION

Pursuant to Rule 2.6 of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure the Division of Ratepayer Advocates ("DRA") files this protest to Application ("A.") 12-04-019 of California American Water Company ("Cal-Am") requesting approval of its proposed Monterey Peninsula Water Supply Project ("MPWSP" or "project") and authorization to recover all present and future costs in rates.

Cal-Am filed the application on April 23, 2012 and it appeared on the Commission's Daily calendar on April 25, 2012. This protest is timely filed.

In this application, Cal-Am seeks authorization to construct and operate its Monterey Peninsula Water Supply Project. Cal-Am has proposed a three-pronged approach to replace the water supply reductions required by the State Water Resources Control Board ("SWRCB") in its Cease and Desist Order ("CDO") by December of 2016.¹ As stated in Cal-Am's application, the three prongs consist of: (1) desalination; (2) groundwater replenishment; and (3) aquifer storage and recovery ("ASR").² The MPWSP is the desalination prong; as proposed, it would consist of slant intake wells,

¹ SWRCB Order 2009-0060, p.57, available at http://www.waterboards.ca.gov/waterrights/water_issues/programs/hearings/caw_cdo/docs/wro2009_0060.pdf.

² A.12-04-019, at 5.

brackish water pipelines, the desalination plant, product water pipelines, brine disposal facilities, and related appurtenant facilities.³

Cal-Am also requests authorization to modify or use cost recovery mechanisms previously approved by the Commission. Specifically, Cal-Am proposes to subcategorize the types of costs tracked in the existing memorandum account, which was authorized by the Commission to track costs related to a long-term water supply solution for the Monterey Peninsula, in order to recover costs that Cal-Am incurred for the Regional Desalination Project (“RDP”) before the project’s demise, and costs related to the MPWSP, including test well and pre-construction activities, through rates and interim relief.⁴ Further, Cal-Am seeks approval to reinstitute Surcharge 2 with modifications to fund construction costs on a pay-as-you-go basis.⁵ Moreover, Cal-Am requests the Commission authorize the creation of the same type of mechanism for an overall cost cap for the MPWSP that it approved for the RDP, *i.e.*, provide for review and recovery of reasonable costs above the cap upon a showing that such costs were the result of extraordinary circumstances, subject to a heightened level of scrutiny.⁶ Finally, Cal-Am seeks Commission authorization to continue the previously authorized ratemaking treatment for the “California American Water-only facilities.”⁷

Cal-Am’s three-pronged approach, and, more specifically, the MPWSP, for which Commission approval is currently sought in this application, appears to be a project that could provide a consistent, reliable, and long-term water supply solution for the Monterey Peninsula which could be implemented in time to comply with the December 2016 deadline. However, as explained in detail below, many issues need to be favorably

³ *Id.*

⁴ *Id.* at 15.

⁵ *Id.* at 16-17.

⁶ *Id.* at 17-18.

⁷ *Id.* at 18-19. See *id.* at 8 (explaining the California American Water-only facilities consist of the “Transfer Pipeline, the Seaside Pipeline, the Monterey Pipeline, the Terminal Reservoir, the ASR Pipeline, the ASR Recirculation and Backflush Pipelines, the ASR Pump Station and the Valley Greens Pump Station.”).

resolved to ensure its timely completion.⁸ Thus, DRA proposes that Administrative Law Judge (“ALJ”) Weatherford convene quarterly, all-party status or case management conferences to ensure that Cal-Am meets critical progress points, such as securing all necessary permits and approvals for the MPWSP, in time to comply with the December 2016 deadline.

II. ISSUES

Although DRA is still reviewing and analyzing this application, including proposed costs, financing, ownership, and ratepayer impact, DRA has identified a non-exhaustive list of issues that it will examine in this proceeding. DRA anticipates that some of these issues may be the subject of evidentiary hearings, others may be resolved, and still others may arise, as discovery proceeds. Before approving this application, the Commission should thoroughly examine the issues listed below:

A. MPWSP Foundational Issues

As noted, numerous issues need to be favorably resolved to ensure timely completion of the MPWSP. None of these issues are adequately addressed by the application. DRA recommends that the Commission closely monitor Cal-Am’s progress in resolving these issues through quarterly case management conferences to ensure that ratepayers do not pay millions of dollars for another project that may turn out to be plagued with insurmountable problems.

At this time, DRA recommends the Commission closely monitor the following issues:

1. Permits and Approvals

Although the table provided in Appendix D of the application provides a list of potential permits and approvals that are apparently necessary for the project, the table

⁸ *Id.* at 2 (wherein Cal-Am readily acknowledges that permitting issues and potential litigation threaten to impede timely completion of the MPWSP, stating, “[a]ssuming reasonable permitting times and limited litigation, either version of the [MPWSP] can be approved, financed, and constructed by the SWRCB’s 2016 deadline.”).

also includes many question marks, indicating uncertainty as to whether a specific permit or approval is, in fact, required. Further, the table provided in Appendix D does not provide a timeline, *i.e.*, the expected date upon which each identified permit or approval will be secured, and the current status of Cal-Am’s efforts vis-à-vis each required permit or approval. Cal-Am must secure all required permits and approvals for the MPWSP in order to complete the project in time to comply with the CDO. Therefore, questions regarding whether specific permits or approvals are required to build the project, the timeline for securing such permits and approvals, and the current status of Cal-Am’s efforts to obtain the necessary permits and approvals, are of critical importance.

2. Acquisition of Land and Easements

In its application Cal-Am explains that it has not yet secured the land or access rights necessary for the project. Cal-Am states that it “is in the process of securing an approximately 46-acre parcel of land located just to the northwest of the [Monterey Regional Water Pollution Control Agency’s (“MRWPCA”)] wastewater treatment plant as the site for the proposed desalination plant,” and that it is “working to secure permanent easements on an approximately 376-acre parcel of land located due west of its proposed desalination plant site for the slant intake wells.”²

The expense associated with obtaining the necessary land and easements to build the proposed facility has the potential to significantly impact the cost and feasibility of the MPWSP. Since expeditious processing of this application is of critical importance, the progress made by Cal-Am in obtaining necessary land and easements is a pivotal issue. DRA recommends the Commission require Cal-Am to provide a timeline for when the necessary property rights will need to be in place to meet the CDO deadline and ongoing status updates.

² A.12-04-019, at 7.

3. Water Rights

It is possible that the desalination intake wells will extract a small amount of groundwater from the Salinas Valley Groundwater Basin (“SVGB”) in addition to seawater.¹⁰ However, the application does not indicate whether Cal-Am has the water rights in the SVGB it needs to be able to extract groundwater via the intake wells. The Commission should ensure early in this proceeding that Cal-Am has the necessary water rights to locate its source water wells in the SVGB.

4. Source Water Contingency Plan

The location and design of the desalination plant, and Cal-Am’s corresponding cost estimates are all based on the assumption that slant wells will be used at the proposed site. However, test wells have yet to confirm the viability of the location. DRA recommends that Cal-Am supplement its application to include a contingency plan in the event that the slant wells are not a viable option for any reason at the proposed site.

5. Brine Disposal Contingency Plan

Cal-Am plans to utilize MRWPCA’s existing outfall to dispose of the reverse osmosis concentrate, or brine that will be generated by the MPWSP. DRA notes that the State Water Resources Control Board is currently developing new requirements to address issues associated with the disposal of brine discharges from desalination facilities and other sources.¹¹ DRA recommends that Cal-Am supplement its application to include a contingency plan in the event that Cal-Am is unable to utilize the MRWPCA’s outfall due to new regulatory requirements, or for any other reason.

¹⁰ See A.12-04-019, at 7 (wherein Cal-Am states that the MPWSP will use “a series of slant wells located west of the sand dunes to draw ocean water and *potentially* a small amount of groundwater from the ground.”) (emphasis added).

¹¹ See Website of the California Environmental Protection Agency, State Water Resources Control Board, Desalination Facilities and Brine Disposal, *available at* http://www.waterboards.ca.gov/water_issues/programs/ocean/desalination/ (explaining, “State Water Board staff is developing an amendment to the Ocean Plan that would address issues associated with desalination facilities and the disposal of brine discharges from other sources. . . . The issue has been identified as very high priority for the State Water Board to address, because several new desalination facilities have been planned along the California coast to augment existing potable water supplies.”).

6. Environmental Review

The environmental impacts of the MPWSP are currently being analyzed by Commission staff who, depending on their assessment, will prepare a Supplemental or Subsequent Environmental Impact Report (“EIR”) to address proposed changes to the size and location of the new desalination plant. The EIR may create new mitigation requirements or other concerns that must be resolved if this application is to be approved.

7. Financing

In its application, Cal-Am explains that based on its discussions with SWRCB it understands that “it is eligible for a SWRCB State Revolving Fund [SRF] Loan for the entire project, including the California-American Water only facilities that the Commission previously approved in D.10-12-016.”¹² Cal-Am states that it is “continuing to work with [SWRCB staff] to obtain this financing.”¹³

According to the testimony of Cal-Am’s Director of Finance, Jeffrey Linam, the revenue requirement calculations in the application are “based on the current capital structure of 58% long term debt, 42% equity and cost of equity of 10.2%.”¹⁴ As Mr. Linam states, “[t]he rate for the long term debt depends upon whether the project qualifies for SRF financing.”¹⁵ Mr. Linam further explains that “[t]he revenue requirement calculations assume a rate of 2.5% for the SRF financing, and a rate of 5.0% if Cal Am is required to obtain long-term debt for the project.”¹⁶

Cal-Am provides four separate revenue requirement scenarios in its application – two for each of the two plant-size options.¹⁷ The revenue requirement scenarios vary

¹² A.12-04-019, at 13 (further explaining that the “State Revolving Fund is authorized by the Federal Clean Water Act and provisions of the California Water code, and provides low interest loans for projects that will improve water quality. The program is implemented in California by the Division of Financial Assistance within the SWRCB, with oversight by the United States Environmental Protection Agency.”).

¹³ *Id.*

¹⁴ A.12-04-019, Direct Testimony of Jeffrey T. Linam, at 6:19-21.

¹⁵ *Id.* at 6:21-22.

¹⁶ *Id.* at 6:22-24.

¹⁷ A.12-04-019, Appendix G.

based on the size of the plant and the inclusion of SRF funding, and the corresponding interest rate on the long term debt used to finance the project. The four scenarios provided, with utilized interest rates identified in parenthesis, are as follows:

1. 9.0 mgd plant with SRF funding (2.5%)
2. 9.0 mgd plant with no SRF funding (5.0%)
3. 5.4 mgd plant with SRF funding (2.5%)
4. 5.4 mgd plant with no SRF funding (5.0%)

DRA needs to investigate the details of Cal-Am's financing plan and review the funding and debt making proposals. DRA will review each of the above scenarios, compare the revenue requirements, review the ratemaking options, analyze the impact on ratepayers, and develop recommendations based on the results of the analyses.

Given that the revenue requirement for the project is significantly impacted by the interest rate on the long term debt used to finance it, DRA is concerned that if Cal-Am is unable to obtain an SRF loan ratepayers will be faced with higher levels of rate increases. The type and form of financing used to build the proposed facility will have a significant impact on the ultimate cost of this project.

B. Costs

In order to permit, design and construct a 9 million gallon per day ("mgd") plant, Cal-Am estimates a capital cost of \$260 million and proposes a cost cap of \$281.2 million. In the event that the Groundwater Replenishment Project ("GWR") is incorporated into the MPWSP, Cal-Am estimates the capital cost of a smaller plant capable of producing 5.4 mgd of water to be \$213 million with a cost cap of \$227.1 million. Regardless of the size of the plant, Cal-Am requests that the previously approved cap of \$106.8 million be adopted for the facilities previously referred to as the Cal-Am only facilities.

In addition to the capital costs, Cal-Am estimates a yearly operation and maintenance cost of \$12.74 million for the 9 mgd plant, and \$9.85 million for the 5.4

mgd plant, plus the cost of purchased water from the Groundwater Replenishment Project.¹⁸ Cal-Am's Operations and Maintenance ("O&M") estimates primarily include the following cost categories: Energy, Chemicals, Labor & Miscellaneous, Membrane and Media Replacement, and General Repair and Replacement.¹⁹

Depending on Cal-Am's ability to obtain an SRF loan, the proposed 2017 revenue requirement varies as shown below:

- 5.4 mgd plant
 - SRF: \$31.1 million
 - No SRF: \$34.7 million
- 9.0 mgd plant
 - SRF: \$31.4 million
 - No SRF: \$34.2 million²⁰

Cal-Am states that the preliminary costs included in the application are in 2012 dollars and that the estimates include the appropriate contingencies.

DRA intends to review the reasonableness of the identified cost for each plant option. A cost cap would provide ratepayers with some measure of protection from cost overruns. However, DRA will need to evaluate the reasonableness of the proposed cost caps. DRA's review of costs is necessary to assure that the ratepayers are only financing reasonable costs that are essential to achieve a new water supply.

C. Ratemaking

DRA intends to review and analyze the accounting mechanisms requested in the application, including Allowance for Funds Used During Construction ("AFUDC") and memorandum accounts. Additionally, DRA intends to analyze the proposed rate design, including proposed cost recovery.

¹⁸ A.12-04-019, at 13.

¹⁹ A.12-04-019, Appendix E, at 9 (notably Cal-Am has included purchased water from the GWR at \$3,000 per acre foot as a line item in their O&M estimate for the 5.4 mgd plant, increasing the O&M cost of the smaller plant option to \$20.35 million).

²⁰ A.12-04-019, Direct Testimony of Jeffrey T. Linam, at 9.

Cal-Am proposes the following:

1. Surcharge 1A

The application proposes subdividing the existing Surcharge 1 into two categories. Surcharge 1A would consist of costs related to the Regional Desalination Project that were incurred by Cal-Am before the project's demise, as well as costs to "unwind" the RDP and related agreements. Cal-Am proposes to handle these costs in the same way that preconstruction costs are handled, as approved in D.06-12-040, with an annual application. Because there are potentially millions of dollars of stranded costs, and the costs may be hotly disputed, DRA recommends that recovery of these costs be addressed in A.04-09-019, and not in this application.²¹ Expenses associated with this application should be fully segregated from the Regional Desalination Project. Costs related to that abandoned project may take months to resolve; remaining RDP costs should be addressed separately and clearly distinguished from the evaluation of the proposed MPWSP.

2. Surcharge 1B

Surcharge 1B would consist of costs related to the Monterey Peninsula Water Supply Project, including costs related to a test well and other pre-construction costs. Further, Cal-Am requests that the Commission issue "an interim decision addressing the ability to track costs related to the test well and recover them in rates."²² Because it is imperative to determine the feasibility of slant wells as soon as possible, DRA supports Cal-Am's request for Commission authorization, via an interim decision or advice letter filing, to track all reasonable and necessary costs associated with a slant test well and needed infrastructure in a memorandum account capped at \$5 million for later reasonableness review and recovery in rates.

²¹ See California-American Water Company Withdrawal of Its Petition for Clarification and Modification of D.10-12-016, April 23, 2012, at 2 (stating, "[t]he new application renders the Petition moot; California American Water therefore withdraws the Petition. This proceeding should remain open, however, *to address recovery of any remaining costs from the Regional Desalination Project.*") (emphasis added).

²² A.12-04-019, at 15.

3. Surcharge 2

In its application, Cal-Am states that money collected from ratepayers via the proposed Surcharge 2 “should not be included as contributions.”²³ If these monies are not considered a contribution, DRA is concerned that the public’s contemporaneous investment on a pay-as-you-go basis in the MPWSP collected under Surcharge 2 would not be protected in the event that the facility is sold. Therefore DRA will investigate how to protect the public interest integrity of any ratepayer contributions and develop recommendations on the best way to account for ratepayer contributed funds.

Further, DRA will need to investigate the feasibility, level, timing, rate impact, ratemaking, equity requirements, and whether the use of this type of surcharge is an appropriate method of financing the MPWSP.

4. Low-Income Program

This application provides few details on Cal-Am’s Low-Income Program for its Monterey service territory or how the program will affect eligible customers. DRA acknowledges the necessity of keeping water affordable for low-income customers, and will need to further review how to balance this need with the importance of minimizing the rate impact on other customers. The Low-Income Program could significantly impact rates for all ratepayers. Further information is required to adequately assess this impact.

III. CATEGORIZATION AND NEED FOR HEARING

DRA agrees with the preliminary categorization as ratesetting. Given the complexity of this application, disputed issues of fact are likely to arise in this case. Any proposed schedule should reflect that evidentiary hearings will be necessary.

IV. PROPOSED SCHEDULE

DRA recognizes that the water supply situation in the Monterey Peninsula requires that the Commission expeditiously process this application, yet DRA needs to thoroughly review Cal-Am’s application in terms of costs, financing, and ratemaking treatment. Due

²³ *Id.* at 17.

to current staffing constraints in DRA's Water Branch (which will be resolved as of June 1st), the aggressive schedule proposed by Cal-Am does not provide DRA sufficient time to evaluate the application and serve its testimony by July 23, 2012. Thus, DRA proposes the following schedule:

Proposed Schedule for Overall Proceeding		
Element	Applicant's Proposed Schedule	DRA's Proposed Schedule
Protests and Responses to Application	30 days from Calendar Notice	30 days from Calendar Notice
Reply to Protests	10 days from Protest/Response Deadline	10 days from Protest/Response Deadline
Prehearing Conference	June 2012	June 2012
Public Participation Hearings	July 2012	July 2012
DRA/Intervenor Testimony	July 23, 2012	September 21, 2012
Rebuttal Testimony	August 23, 2012	October 22, 2012
Settlement	August 27 - September 7, 2012	October 29 - November 9, 2012
Evidentiary Hearings	September 17 - September 21, 2012	November 13 - November 19, 2012
Briefing	October 12-26, 2012	December 10-24, 2012
Proposed Decision	January 28, 2013	March 25, 2013
Final Decision	February 2013	April 2013

IV. CONCLUSION

Although the MPWSP appears to be a project that could provide a viable water supply solution for the Monterey Peninsula, as explained above, many issues need to be favorably resolved to ensure its timely completion. Thus, DRA recommends that the Commission closely monitor Cal-Am's progress in resolving the foundational issues identified in this Protest, and other issues that may arise, through quarterly case management conferences to ensure that ratepayers do not pay millions of dollars for another project that may turn out to be plagued with insurmountable problems.

Moreover, as it is imperative to determine the feasibility of slant wells as soon as possible, DRA supports Cal-Am's request for Commission authorization to track all reasonable and necessary costs associated with a slant test well and needed infrastructure in a memorandum account capped at \$5 million for later reasonableness review and recovery in rates.

Respectfully submitted

/s/ JONATHAN KNAPP
ALLISON BROWN

Jonathan Knapp
Allison Brown

Attorneys for the Division of Ratepayer
Advocates

California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
Phone: (415) 703-5377
Fax: (415) 703-2262

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