

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



**FILED**  
02-25-10  
02:13 PM

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.

Application 08-01-027  
(Filed January 30, 2008)

And Related Matters.

Application 08-01-024  
(Filed January 30, 2008)

**RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO  
CALIFORNIA-AMERICAN WATER COMPANY'S PETITION FOR  
MODIFICATION OF D.09-07-021**

MONICA McCRARY  
MARCELO POIRIER

Attorneys for the Division of Ratepayer  
Advocates

California Public Utilities Commission  
505 Van Ness Ave.  
San Francisco, CA 94102  
Phone: (415) 703-1288  
Fax: (415) 703-2262

February 25, 2010

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA

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.

Application 08-01-027  
(Filed January 30, 2008)

And Related Matters.

Application 08-01-024  
(Filed January 30, 2008)

**RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO CALIFORNIA-AMERICAN WATER COMPANY'S PETITION FOR MODIFICATION OF D.09-07-021**

Pursuant to Rule 16.4 of the Commission's Rules of Practice and Procedure ("Rules"), the Division of Ratepayer Advocates ("DRA") files this Response to California-American Water Company's ("Cal Am") Petition for Modification of D.09-07-021 ("Petition"), the decision on Cal Am's Monterey Water District General Rate Case ("GRC"). In its Petition, Cal Am requests that the Commission make eight modifications to D.09-07-021. While DRA does not oppose several of these changes, DRA strongly objects to Cal Am's request to allow it to recover the costs of modifying its

billing system to implement its new rate design.<sup>1</sup> DRA also opposes Cal Am's proposed modifications regarding unaccounted for water.

**I. DRA OPPOSES CAL AM'S REQUEST TO RECOVER BILLING SYSTEM MODIFICATION COSTS**

**A. The Settlement Did Not Condition the Rate Design Changes on Funding of Billing System Changes.**

In its Petition, Cal Am asks the Commission to modify D.09-07-021 to allow it to submit an advice letter to recover up to \$945,720 in billing system modification costs. Cal Am also seeks authority to recover retroactively any additional costs in its next general rate case.<sup>2</sup> Cal Am argues that recovery of such costs was "implicit in the Commission's approval of the rate design settlement."<sup>3</sup> DRA strongly disagrees. Nothing in D.09-07-021 indicates that the Commission intended to authorize any additional funding for Cal Am to implement the agreed to rate design settlement. Absent substantial evidence supporting its position, Cal Am's apocryphal statements about what was "implicit" in the Commission's approval of the rate design settlement agreement do not constitute grounds for granting Cal Am's request.

In A.08-01-027, Cal Am requested \$450,000 to modify its billing system to incorporate rate design changes. The \$450,000 was part of Cal Am's request for \$3.2 million in regulatory expenses. On August 21, 2008, DRA issued its Report on the

---

<sup>1</sup> It is DRA's position that Cal Am violated the rate design settlement agreement and D.09-07-021 because it did not implement the agreed upon rate design until February of 2010. Mr. Stephenson stated at the prehearing conference in A.07-12-010, that if Cal Am reached a settlement with DRA on the rate design issue it could begin implementation of the rate design billing system changes at the time the settlement was reached. Mr. Stephenson stated that implementation would take six months. The Settlement was filed on November 24, 2008. (See A.07-12-010, Reporter's Transcript, February 15, 2008 PHC, pp. 9 & 14. At the March 20, 2008 PHC, the rate design issue was moved from A.07-12-010 to A.08-01-027. This was confirmed in the Scoping Memo for this proceeding.) On February 9, 2010, Cal Am informed DRA that the billing system changes had been implemented and that February usage would be billed under the new rate design. However, DRA understands that Cal Am has not completed updating all commercial, industrial, and public authority allotments as required by paragraph V.7. of the rate design settlement. Under the settlement agreement, Cal Am was required to do this by no later than September 1, 2009.

<sup>2</sup> Cal Am does not have a Commission authorized memorandum account to book these costs.

<sup>3</sup> Petition at p. 6.

Results of Operation recommending that Cal Am be allowed \$600,000 in regulatory expenses.<sup>4</sup> In its testimony, DRA noted that Cal Am's justification for the \$450,000 to modify its billing system was limited to one e-mail from an ITS Project Manager, that did not provide any specific information, to support its \$450,000 billing system modification cost request.<sup>5</sup>

On November 24, 2008, three months after DRA issued its testimony, Cal Am and DRA filed its rate design settlement. At the time Cal Am and DRA were negotiating this settlement, Cal Am knew that DRA was recommending that the Commission reduce its regulatory expense request significantly. Despite this knowledge, the rate design settlement did not include any specific amount of funding for rate design billing changes. Moreover, the rate design settlement did not condition implementation of the agreement on receiving any specific amount of funding. Instead, Cal Am chose to litigate this issue.<sup>6</sup>

If Cal Am needed additional money to implement the rate design agreed to by the parties in the settlement, it could have and should have negotiated this as part of the rate design settlement. Cal Am's decision to now seek additional money<sup>7</sup> for these changes outside of the settlement process undermines the cooperative spirit underlying the initial agreement and represents a breach of good faith. One of the underlying premises of the settlement process is that the final agreement reached by the parties is an integrated document that cannot be modified absent the assent of the settling parties. Had DRA

---

<sup>4</sup> DRA used a three year average of Cal Am's recorded regulatory expenses, adjusted for inflation and reduced to reflect the sale of the Felton District.

<sup>5</sup> DRA did not specifically disallow billing system cost but rather forecasted total regulatory expenses using a macro approach by using a three year average.

<sup>6</sup> D.09-08-021 granted Cal Am \$350,000 a year or \$1,050,000 total for regulatory expenses. The decision notes that it approved "Cal-Am's request for five full-time rate staff and three engineers, who will devote a portion of their time to regulatory matters" and noted that "Support Services, such as information technology necessary to implement billing changes, are also funded through the service companies." (D.09-08-021, pp. 74-75.) Thus Cal Am has received some compensation for the billing system changes.

<sup>7</sup> Cal Am is now seeking over double the amount it requested in its GRC application.

known that Cal Am would now seek additional funding to make some of the changes agreed to in the settlement, DRA may not have agreed to those terms.<sup>8</sup>

There is nothing in the rate design settlement that makes it contingent on obtaining additional funding for billing system changes or that would permit Cal Am to seek funding for the changes in the future.<sup>9</sup> The Commission should deny Cal Am's request for additional funding to implement the rate design changes.

**B. There is No Evidence in the Record to Support Cal Am's Request.**

In its Petition, Cal Am is making a new request to recover approximately \$1 million in billing system modification costs and is offering new information that is not in the record to support its request. Specifically, Cal Am has attached an estimate from its vendor in Appendix F to support part of its request, and then increases the vendor estimate with internal costs and a 20 percent contingency factor in Appendix G.<sup>10</sup>

The Commission cannot grant Cal Am's request based upon new information that is not in evidence in this proceeding. This information has not been subject to discovery and DRA has not had an opportunity to cross-examine a Cal Am witness on it.<sup>11</sup> Relying on this document to grant Cal Am's request would violate due process.

---

<sup>8</sup> For example, the annual true up for Commercial Customers located in at paragraph V.E. of the Rate Design Settlement Agreement could be a costly change that DRA may not have agreed to. (See Exhibit F, p. 57, Section 5.2.1.7. describing the billing system changes necessary to meet this requirement.) Moreover, as Mr. Stephenson stated in his testimony, Cal Am is planning to **replace** its billing system in the future. (Exhibit 73, Further Rebuttal Testimony of David P. Stephenson, p. 14) Had Cal Am raised the cost reimbursement issue as part of the negotiations, perhaps the settled terms would be different.

<sup>9</sup> For instance, the parties could have negotiated that a memorandum account be established that was capped at a certain level. There is no such provision in the settlement.

<sup>10</sup> DRA strongly objects to the 20 percent contingency adder. In his Declaration, Mr. Stephenson states that a 20 percent contingency is necessary because the new Monterey Rate Design is complex and it is not possible to determine each and every modification until the billing system work has begun (Declaration of David P. Stephenson, ¶ 7, emphasis added.) Because Cal Am implemented the new rate design this month, the billing system work should be complete.

<sup>11</sup> For example, DRA is concerned about why the costs have doubled since Cal Am made its initial request in its GRC application. Since many of the changes adopted in the Rate Design settlement involved merely changing how the existing allotments are calculated, it is not clear why such costly billing system changes are necessary.

Moreover, DRA has concerns about the accuracy of the estimate in Appendix F. Although Appendix G indicates that Cal Am is removing the rationing billing system change costs from this request, it does not provide support demonstrating how the \$162,200 it removed was calculated. A review of Appendix F suggests that many of the changes documented therein are attributable to rationing.<sup>12</sup> Moreover, it appears that billing system changes may also be related to Cal Am's Tariff Rule 14.1.1 and the seven conservation stages required under the rule, issues that were part of separate settlements in Cal Am's conservation proceeding A.07-12-010.<sup>13</sup>

The Commission cannot rely on this new, untested information to grant Cal Am's request. To do so would violate DRA's due process rights.

### **C. Funding Cal Am's Request Is Retroactive Ratemaking.**

Cal Am's Petition for Modification asks the Commission to approve its request to recover costs associated with changing its billing system (after they have been incurred) through the advice letter process. Cal Am also requests that if their costs exceed the requested \$945,720, that the Commission permit it to seek recovery of additional costs retroactively in the next GRC.

It is well established that ratemaking is done on a prospective basis. Under general ratemaking principles, the Commission allows a utility to file a general rate case application to recover in base rates a forecast of its operating costs to provide customers safe and reliable service.<sup>14</sup> The Commission adopts a test year forecast based on the best information about expected future events and historical trends.<sup>15</sup> By using a prospective forecast methodology the utility has an opportunity to recover its costs and earn a return

---

<sup>12</sup> See Appendix F, p. 24, Section 4. The high level objectives which describe why the project is being implemented indicates that Cal Am "requires the ability to bill customers accurately according to water rations that would be available during conservation and rationing . . ."

<sup>13</sup> See *e.g.* Appendix F, p. 11, Section 2.1.

<sup>14</sup> D.07-07-041, p. 3.

<sup>15</sup> *Id.*

(profit) on its investment in plant in service.<sup>16</sup> The utility is expected to exercise discretion to expertly manage its operations during the test year and adapt as necessary to differences between the forecast and actual events.<sup>17</sup>

The specific bar against retroactive ratemaking stems from the clear and unambiguous language of Public Utilities Code § 728. As stated therein:

Whenever the commission, after a hearing, finds that the rates . . . demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity . . . are insufficient, unlawful, unjust, unreasonable, . . . the commission shall determine and fix, by order, the just, reasonable, or sufficient rate . . . to be **thereafter** observed and in force. (Emphasis added.)

As the Commission has long stated:

It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not 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.<sup>18</sup>

Here Cal Am is requesting that the Commission allow it to increase rates for previously incurred expenses<sup>19</sup> through the advice letter process. These expenses have not been booked to a previously authorized memorandum or balancing account. Such a request goes against the general ratemaking principles and the bar on retroactive ratemaking.

---

<sup>16</sup> Id.

<sup>17</sup> Id.

<sup>18</sup> *Re Southern California Water Company*, D.92-03-094, 43 CPUC 2d 596, 600 (1992).

<sup>19</sup> Cal Am began billing under the new rate design this month. Thus, the costs associated with the billing system changes have already been incurred.

It was Cal Am's responsibility to properly forecast these costs and provide adequate support for the costs as part of the GRC. If Cal Am thought that the rate design settlement would increase these cost, it should have negotiated this issue as part of the rate design settlement. Cal Am failed to do both. The Commission should deny Cal Am's petition for recovery of billing system costs as it violates long-established general ratemaking principles and the prohibition on retroactive ratemaking.

## **II. DRA OPPOSES CAL AM'S REQUESTED MODIFICATIONS REGARDING THE UNACCOUNTED FOR WATER REWARD/PENALTY SYSTEM**

Cal Am seeks to modify D.09-07-021 in regards to the reward/penalty system for unaccounted for water ("UAF"), requesting that: (1) the effective date of the reward/penalty system be back-dated to August 1, 2009, and (2) the UAF reward/penalty system be based on volumetric rather than a percentage allowance.<sup>20</sup> DRA opposes both of these requests.

### **A. The UAF penalty/reward system should be effective concurrent with the new Water Revenue Adjustment Mechanism/Modified Cost Balancing Account decoupling mechanism.**

DRA opposes Cal Am's requested August 1, 2009 effective date of the reward/penalty system because the system should be effective concurrent with the new Water Revenue Adjustment Mechanism ("WRAM")/ Modified Cost Balancing Account ("MCBA") decoupling mechanism. D.09-07-021 stated that the adopted UAF penalty/reward program was needed because the Water Revenue Adjustment Mechanism adopted in D.09-07-021 "fully insulates Cal-Am from any financial consequences of unaccounted for water." Thus, the new WRAM adopted in D.09-07-021 is the reason the Commission adopted the UAF penalty/reward system.

---

<sup>20</sup> Petition at pp. 7-10.

Cal Am implemented the new WRAM adopted by D.09-07-021 effective February 1, 2010 via Advice Letter.<sup>21</sup> The WRAM is part of a pilot program that includes the WRAM, MCBA, and changes to the increasing block rate design.<sup>22</sup> As discussed earlier in these comments, Cal Am only recently implemented the agreed-upon and adopted rate design and also only recently implemented the revenue decoupling portion of the pilot program adopted in D.09-07-021. Until Cal Am implemented the adopted changes to the rate design and the associated WRAM and MCBA revenue decoupling mechanism, Cal Am was not fully insulated from the financial consequences of UAF. Consequently, Cal Am should only be subject to the UAF penalty/reward system effective on the same date as the WRAM/MCBA.<sup>23</sup>

In summary, the Commission should clarify that the UAF penalty/reward system should be effective concurrent with the rate design and revenue decoupling pilot program adopted in Ordering Paragraph 28 of D.09-07-021.

**B. The UAF penalty/reward should be based on a percentage allowance as determined in D.09-07-021**

DRA opposes Cal Am's request to modify D.09-07-021 to base the UAF reward/penalty system on volumetric rather than a percentage allowance because of two major concerns with the proposal.

First, the UAF used for ratemaking purposes differs from the UAF used to measure operational efficiency. Cal Am confuses the two. UAF for ratemaking purposes is currently calculated as a percentage of total production. Volumetric UAF measures, on the other hand, are useful as operational performance indicators to set long term distribution system efficiency goals or to make comparisons between systems.<sup>24</sup> To be

---

<sup>21</sup> Cal Am submitted Advice Letter 827, to the Commission on February 3, requesting an effective date for the WRAM/MCBA of February 1, 2010 "in conjunction with Advice Letter 826 which implements the new rate design," (Advice Letter 827, pp. 2). Advice Letter 827 is a Tier 1 Advice Letter and is effective pending disposition pursuant to General Order 96-B, Water Industry Rule 7.3.1.

<sup>22</sup>D.09-07-021, Ordering Paragraph 28.

<sup>23</sup> Advice Letter 827 was effective February 1, 2010.

<sup>24</sup> IWA 2007 Water Loss Conference. [http://www.waterloss2007.com/pdf\\_vortraege/Montag/B2-1.pdf](http://www.waterloss2007.com/pdf_vortraege/Montag/B2-1.pdf)

consistent, the financial reward/penalty system that seeks to eliminate the disincentive in the WRAM to reduce unaccounted for water losses should use the same type of metric as the ratemaking UAF. Since the Commission adopted 9% as the UAF to be used for ratemaking purposes, the reward/penalty metric should be consistent with the approved and established ratemaking mechanism.

One reason for adopting the UAF percentage for ratemaking purposes was to give Cal Am an incentive to reduce its UAF to MPWMD's 7% target.<sup>25</sup> Cal Am will be less likely to reach this target if it has no incentive to make a specific percentage reduction. The Rate Case Plan also requires that, "If unaccounted water is more than approximately 7% for each district or service area, [the utility should] submit a plan to reduce unaccounted water to a specific amount."<sup>26</sup> Therefore, a percentage based UAF for ratemaking purposes and as a basis for a reward/penalty system is appropriate and consistent with established ratemaking. A reward/penalty mechanism based on a fixed volume will not create the proper signal for Cal Am to take prompt and urgent actions to reduce UAF.

The second problem with Cal Am's request is that volumetric measures of UAF should be made on a service connection or length of mains basis. Many water industry organizations (AWWA, IWA, and CUWCC) use volumetric measures of UAF per service connection<sup>27</sup> or per miles of main to determine operational efficiency.<sup>28</sup> Cal Am's volumetric UAF proposal does not conform to established efficiency metrics. A purely volumetric quantity for UAF ignores changes in the number of customers and modifications to the distribution system that should be included on a yearly basis.

---

<sup>25</sup> D.09-07-021, p.55.

<sup>26</sup> D.07-05-062, Appendix A-28.

<sup>27</sup> A.08-01-027, Exhibit A – Chapter 3 – Section 1 – Table 4, p.3.

<sup>28</sup> See the AWWA free water loss audit software available through CUWCC which is a requirement of the 2007 Rate Case Plan: [http://www.cuwcc.org/bmps.aspx?ekmense1=b86195de\\_24\\_0\\_7794\\_7](http://www.cuwcc.org/bmps.aspx?ekmense1=b86195de_24_0_7794_7). Further description of the revised BMP for Water Loss Control can be found here: <http://www.cuwcc.org/mou/bmpl-utility-operations-programs.aspx>

### III. CONCLUSION

For the reasons discussed above, DRA recommends that the Commission deny the portions of Cal Am's Petition to modify D.09-07-021 requesting: (1) recovery of the costs to modify Cal Am's billing system to implement the rate design settlement agreement and (2) modification of the UAF reward penalty system.

Respectfully submitted,

/s/ MONICA MCCRARY

---

Monica McCrary  
Staff Counsel

Attorney for the Division of Ratepayer  
Advocates

California Public Utilities Commission  
505 Van Ness Ave.  
San Francisco, CA 94102  
Phone: (415) 703-1288  
Fax: (415) 703-2262

February 25, 2010

**CERTIFICATE OF SERVICE**

I hereby certify that I have this day served a copy of **RESPONSE OF THE DIVISION OF RATEPAYER ADVOCATES TO CALIFORNIA-AMERICAN WATER COMPANY'S PETITION FOR MODIFICATION OF D.09-07-021** in A.08-01-027, et al., by using the following service:

**E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

**U.S. Mail Service:** mailing by first-class mail with postage prepaid to all known parties of record who did not provide electronic mail addresses.

Executed on February 25, 2010 at San Francisco, California.

/s/ CHARLENE D. LUNDY  
CHARLENE D. LUNDY

**SERVICE LIST**  
**A0801027**  
**A0801024**

terrance.spann@hqda.army.mil  
carlwwood@verizon.net  
kdursa@salinas.net  
sheri@lomgil.com  
mickey3643@aol.com  
Glen.Stransky@LosLaurelesHOA.com  
dave@laredolaw.net  
mpo@cpuc.ca.gov  
ldolqueist@manatt.com  
edwardoneill@dwt.com  
jimmosher@sbcglobal.net  
cs1001@co.santa-cruz.ca.us  
dstephen@amwater.com  
mccay4213@comcast.net  
samweinstein@uwua.net  
uwua@redhabanero.com  
lflowrey@nheh.com  
ffarina@cox.net  
stuart@brandon-tibbs.com  
memoman2@gmail.com  
aengusj@horanlegal.com  
bobmac@qwest.net  
stephen.morrison@amwater.com  
joshdavidson@dwt.com  
lweiss@manatt.com  
sleeper@manatt.com  
salleyoo@dwt.com  
jmueller@slvwd.com  
clara@cwo.com  
jcm@cpuc.ca.gov  
jws@cpuc.ca.gov  
lwa@cpuc.ca.gov  
mab@cpuc.ca.gov  
mlm@cpuc.ca.gov