

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



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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.

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(Filed September 20, 2004;
Amended July 14, 2005)

JOINT RESPONSE OF CALIFORNIA-AMERICAN WATER COMPANY, MARINA COAST WATER DISTRICT, AND MONTEREY COUNTY WATER RESOURCES AGENCY TO THE APPLICATION FOR REHEARING OF D.10-12-016

MANATT, PHELPS & PHILLIPS, LLP
LORI ANNE DOLQUEIST
SARAH E. LEEPER
One Embarcadero Center, 30th Floor
San Francisco, CA 94111-3719
Telephone: (415) 291-7400
Facsimile: (415) 291-7474
Email: ldolqueist@manatt.com

Attorneys for Applicant
CALIFORNIA-AMERICAN WATER
COMPANY

FRIEDMAN DUMAS & SPRINGWATER LLP
MARK FOGELMAN
DERRICK N.D. HANSEN
STEFANIE A. ELKINS
33 New Montgomery Street, Suite 290
San Francisco, CA 94105
Telephone: (415) 834-3800
Facsimile: (415) 834-1044
Email: mfogelman@friedumspring.com

Attorneys for MARINA COAST WATER
DISTRICT

DOWNEY BRAND LLP
DAN L. CARROLL
KEVIN M. O'BRIEN
621 Capitol Mall 18th Floor
Sacramento, CA 95814
Telephone: (916) 444-1000
Facsimile: (916) 444-2100
Email: dcarroll@downeybrand.com

Attorneys for MONTEREY COUNTY WATER
RESOURCES AGENCY

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JOINT RESPONSE OF CALIFORNIA-AMERICAN WATER COMPANY, MARINA COAST WATER DISTRICT, AND MONTEREY COUNTY WATER RESOURCES AGENCY TO THE APPLICATION FOR REHEARING OF D.10-12-016

Pursuant to Rule 16.1(d) of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”), California-American Water Company (“California American Water”), Marina Coast Water District (“MCWD”) and the Monterey County Water Resources Agency (“MCWRA”) (collectively “the Joint Parties”) hereby submit this response to the Application for Rehearing of D.10-12-016 (“Rehearing Application”),¹ filed by the Division of Ratepayer Advocates (“DRA”) on January 3, 2011. The basic premise of the Rehearing Application is that the Commission committed legal error in relying on constitutional, statutory, contractual, and procedural safeguards to protect the interests of customers regarding the Regional Desalination Project and ensure that the rates the Commission will eventually adopt for California American Water will be just and reasonable. This premise is legally incorrect and unsupported by the cases DRA cites.

DRA’s argument is not new; DRA made the same argument throughout the proceeding and the Commission repeatedly rejected DRA’s position. DRA also alleges that D.10-12-016 contains factual errors but, with minor exceptions, these are merely similarly recycled contentions that the Commission previously considered and found wanting. Because DRA failed to demonstrate that the Commission’s decision is unlawful or erroneous, as required

¹ Counsel for MCWD signs these Joint Reply Comments on behalf of the Joint Parties pursuant to Rule 1.8(d) of the Commission’s Rules of Practice and Procedure.

by Public Utilities Code Section 1732 and Rule 16.1(c), the Joint Parties urge the Commission to deny rehearing of D.10-06-012. Additionally, in order to prevent a potentially costly delay in implementation of the Regional Desalination Project, the Joint Parties request that the Commission dispose of the Rehearing Application expeditiously.²

I. THE COMMISSION SHOULD EXPEDITIOUSLY DENY THE REHEARING APPLICATION

As will be demonstrated below, this application for rehearing is without merit and will only serve to delay implementation of the Regional Desalination Project. Delay in implementation of the Regional Desalination Project will make the project more costly, harming California American Water ratepayers. The record of this proceeding demonstrates that delay caused by the failure of all parties to agree to a settlement that was eventually approved by the Commission with only a small number of non-material modifications has already increased the cost of the Regional Desalination Project significantly for ratepayers. Such delay has imposed tens of millions of dollars in added costs, and undue delay in the disposition of the application for rehearing can only lead to additional millions or tens of millions of dollars in costs for ratepayers. Moreover, depending on the views of municipal bond underwriters, the uncertainty raised by the pendency of DRA's application for rehearing may make the project unbondable or significantly more costly to finance while the application for rehearing remains pending. Given the appropriate concerns expressed by the Commission in D.11-12-016 over the cost of financing, the Commission should not permit the extended pendency of the application for rehearing to adversely affect the costs of the project, which the Commission, DRA, and the Joint Parties all desire to control. Expedited disposition of DRA's application for rehearing will thus serve the interests of the Commission, DRA and the Joint Parties, and, perhaps most importantly, California American Water ratepayers.

The Joint Parties respectfully request that the Commission act on DRA's

² MCWRA's Board of Supervisors voted unanimously to reaffirm its prior approval of the project on January 11, 2011.

application for rehearing as expeditiously as possible and in no event later than the first Commission voting meeting more than 60 days after the filing of the application, or March 10, 2011.

II. BACKGROUND

In D.10-12-016, after considering the extensive record, the Commission approved the settlement between California American Water, MCWD, MCWRA, the Monterey Regional Water Pollution Control Agency, the Surfrider Foundation, the Public Trust Alliance, and Citizens for Public Water (the “Settling Parties”). The Settling Parties represent a unique and diverse coalition of utility, public agency, environmental, and ratepayer interests. The settlement established an innovative public-private partnership, known as the Regional Desalination Project, to solve the long-standing water supply deficit on the Monterey Peninsula.³ The Commission’s decision represents a huge step forward for Monterey residents, who have struggled for decades to develop a reliable water supply and protect the Carmel River and its habitat.

In its decision, the Commission recognized the necessity for a long-term water supply solution and the widespread support for the Regional Desalination Project, despite its expected significant impact on customer rates:

The Monterey Peninsula has been struggling to find solutions to the water supply deficit for decades. We emphasize the history to provide a context for our decision to reach outside the usual procedure and to approve a costly desalination project as a reasonable solution. The severity and immediacy of the problem requires such an approach. We heard clearly from residents and business-owners that inaction at this point is unacceptable.⁴

The urgent need to find an alternative supply to water from the Carmel River, in order to ensure that California American Water complies with SWRCB Order 95-10, the Seaside Basin adjudication, and the SWRCB Cease and Desist Order, is undisputed. Moreover, the

³ The settlement also included two implementing agreements, the Water Purchase Agreement (“WPA”) and the Outfall Agreement.

⁴ D.10-12-016, *In the Matter of the 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*, 2010 Cal. PUC LEXIS 548 (“D.10-12-016, 2010 Cal. PUC LEXIS 548”), *36.

record demonstrates that the Regional Desalination Project is the only viable solution.⁵ All of the other options that the Commission considered have legal, political, or financial constraints that make them infeasible, and, as the Commission noted in D.10-12-016, cannot be constructed in time to satisfy the deadline established by the SWRCB Cease and Desist Order.

Failure to develop a long-term water supply solution would have severe legal, environmental, and economic consequences for California American Water and its customers. The uncontested testimony of expert economists, cited by the Commission in D.10-12-016, estimated that the economic loss imposed on the Monterey Peninsula economy by that reduction in water supply would be more than \$1 billion per year, plus the loss of 6,000 jobs.⁶ This potential devastation informed the Commission's decision and led the Commission to find that the procedural, contractual, and other legal safeguards contained in the WPA and Settlement Agreement, combined with the legal mandates imposed the Public Agencies under current law, are reasonably certain to produce the lowest cost, viable, and timely solution to California American Water's long-term water supply needs.⁷ This determination is well within the Commission's discretion and DRA cites no law to the contrary.

The Commission found that having no project "is not a tenable option,"⁸ yet DRA stubbornly insists on advocating actions that would lead to that result. DRA's Rehearing Application demonstrates that DRA would rather the Monterey Peninsula residents suffer the catastrophic effect of failure to find a water supply solution than have the Commission approve a process that is not to DRA's liking.

III. DRA'S USE OF THE REHEARING APPLICATION TO REARGUE PREVIOUSLY REJECTED POSITIONS CONTRAVENES COMMISSION PRECEDENT

The Commission traditionally frowns upon using the rehearing process as an

⁵ *Opening Brief of California-American Water Company in Support of the Settlement Agreement*, filed July 2, 2010 ("California American Water Opening Brief"), pp. 2-4; *Marina Coast Water District's Concurrent Opening Brief*, filed July 2, 2010 ("MCWD Opening Brief"), pp. 1-2; *Opening Brief of Monterey County Water Resources Agency*, filed July 2, 2010 ("MCWRA Opening Brief"), pp. 1-2.

⁶ D.10-12-016, 2010 Cal. PUC LEXIS 548, **62-63.

⁷ *Id.*, **3-4.

⁸ *Id.*, *63.

opportunity to reargue positions that it has already rejected. The Commission has warned, “The vehicle of the application for rehearing is not to be construed as an extra opportunity to brief issues already argued.”⁹ The Commission has found that it is “improper” for a utility to “use the application for rehearing process to extend or reargue policy matters,”¹⁰ and has admonished utilities that have tried to do so – “Certainly, Applications for Rehearing should not be used to reargue parties' positions which have been rejected during the proceeding.”¹¹ The Commission generally denies such applications. For example, in a 2007 energy case, the Commission denied an application for rehearing, stating, “Rehearing Applicants merely reargue the points made in their protests and comments, which we have previously considered and rejected.”¹²

Despite the Commission’s warnings, DRA’s Rehearing Application follows that disfavored and inappropriate path. DRA merely reiterates arguments that it made multiple times before, despite the fact that the Commission previously rejected them. For example, DRA previously argued that the Commission cannot rely on statutory and contractual safeguards to protect customer interests,¹³ that the advice letter process does not provide adequate protection,¹⁴ and that the Monterey Peninsula Cities must have a voting role on the Advisory Board¹⁵ – all

⁹ D.93-10-043, *Placid, N.V., Complaint, vs. Southern California Edison Company*, 1993 Cal. PUC LEXIS 780, *4-5

¹⁰ D.98-12-093, *Application and Request of Southern California Edison Company (U338-E) for Order Approving Termination Agreement of ISO4 Power Purchase Agreement Between Southern California Edison Company and Harbor Cogeneration Company*, 84 CPUC2d 621 (1998), p. 625.

¹¹ D.93-10-046, *Application of Great Oaks Water Company (U-0162-W) For Authority to Increase Rates for Water Service and to Establish a Balancing Account for Water Testing Expenses*, 1993 Cal. PUC LEXIS 783, *2-3

¹² D.07-12-056, *Application of Merced Irrigation District, Modesto Irrigation District, California Municipal Utilities Association, Northern California Power Agency, City of Hercules, and Rancho Cucamonga Municipal Utility for Rehearing on Resolution E-4064*, 2007 Cal. PUC LEXIS 597, *48; *see also* D.06-06-070, *Joint Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching in Its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050, et al.*, 2006 Cal. PUC LEXIS 236, *4.

¹³ *Comments of The Division of Ratepayer Advocates on the Proposed Settlement Agreement*, filed April 30, 2010 (“DRA Comments on Settlement Agreement”), pp. 64-67; *Reply Brief of The Division of Ratepayer Advocates*, filed July 26, 2010 (“DRA Reply Brief”), pp. 4-6, 28-31; *Reply Comments of The Division of Ratepayer Advocates on the Proposed Decision of Administrative Law Judge Minkin and Alternate Proposed Decision of Commissioner Bohn*, filed November 22, 2010 (“DRA Reply Comments on PD and APD”), pp. 3-4.

¹⁴ *Opening Brief of The Division of Ratepayer Advocates*, filed July 2, 2010 (“DRA Opening Brief”), pp. 48-51; *DRA Reply Brief*, pp. 31-22; *DRA Reply Comments on PD and APD*, p. 22.

¹⁵ *DRA Opening Brief*, pp. 35-36; *DRA Reply Brief*, pp. 19-20; *Comments of The Division of Ratepayer Advocates on the Proposed Amendment to Section 6 of the Water Purchase Agreement*, filed July 27, 2010 (“DRA Comments on Section 6 of WPA”), pp. 1-3; *DRA Opening Comments on PD and APD*, pp. 2, 6-7, 23.

claims it makes again in its Rehearing Application. DRA similarly recycles earlier claims regarding the cost per acre-foot of water from the Regional Desalination Plant,¹⁶ the ability of the Parties to obtain low-cost financing,¹⁷ and even the Commission need to mandate slant wells,¹⁸ for use in the Rehearing Application.

The Joint Parties, separately and together, already refuted the claims that DRA makes in the Rehearing Application. Rather than repeat themselves by addressing each allegation in detail, the Joint Parties incorporate their earlier responses by reference¹⁹ and limit this response to addressing the key failures of the Rehearing Application. The Joint Parties respectfully request, consistent with Commission precedent, that the Commission deny DRA's Rehearing Application.

IV. DRA FAILED TO DEMONSTRATE LEGAL ERROR

A. There is Not One Single Way to Ensure that Rates are Just and Reasonable

In its Rehearing Application, as it has previously, DRA argues that the Commission "abdicated" its duties by relying on existing constitutional, statutory, contractual, and procedural safeguards to assist it in ensuring that California American Water's rates will be

¹⁶ DRA Comments on Settlement Agreement, pp. 2-3, 5-8; DRA Opening Brief, pp. 6-12; DRA Reply Brief, pp. 6-10.

¹⁷ DRA Reply Brief, p. 18; DRA Opening Comments on PD and APD, pp. 3-4.

¹⁸ DRA Opening Comments, pp. 8-9.

¹⁹ See *California-American Water Company's Reply to Comments on The Settlement Agreement*, filed May 27, 2010; *California American Water Opening Brief*, *MCWD Opening Brief*, *MCWRA Opening Brief*, *Reply Brief of California-American Water Company*, filed July 16, 2010 ("California American Water Reply Brief"), *Marina Coast Water District's Concurrent Reply Brief*, filed July 26, 2010 ("MCWD Reply Brief"), *Reply Brief of Monterey County Water Resources Agency MCWRA*, filed July 26, 2010 (MCWRA Reply Brief"), *Joint Reply Comments on The Article 6 Changes*, filed August 4, 2010 ("Joint Reply Comments on The Article 6 Changes"), *California-American Water Company Comments on Proposed Decision of Administrative Law Judge Minkin and Alternate Proposed Decision of Commissioner Bohn*, filed November 17, 2010 ("California American Water Opening Comments on PD and APD"), *Marina Coast Water District's Consolidated Comments on Proposed Decision and Alternate Proposed Decision MCWD*, filed November 17, 2010 ("MCWD Opening Comments on PD and APD"), *Comments of Monterey County Water Resources Agency on Alternate Proposed Decision MCWRA*, filed November 17, 2010 ("MCWRA Opening Comments on PD and APD"), *California-American Water Company Reply Comments on Proposed Decision of Administrative Law Judge Minkin and Alternate Proposed Decision of Commissioner Bohn*, filed November 22, 2010 ("California American Water Reply Comments on PD and APD"), *Marina Coast Water District's Consolidated Reply Comments on Proposed Decision and Alternate Proposed Decision*, filed November 22, 2010 ("MCWD Reply Comments on PD and APD"), *Reply Comments of Monterey County Water Resources Agency Concerning Proposed Decision and Alternate Proposed Decision*, filed November 22, 2010 ("MCWRA Reply Comments on PD and APD").

just and reasonable.²⁰ Just because the Commission has chosen to do things in a way other than DRA wants or DRA is used to, however, does not make the Commission's actions unlawful.

Section 451 of the Public Utilities Code requires public utility charges to be "just and reasonable" and states every "unjust or unreasonable charge demanded . . . is unlawful." Section 728 requires that when the commission finds a public utility rate to be unjust and unreasonable, it must set just and reasonable rates to be set from that point forward. Interestingly, though DRA frequently discusses the Commission's "constitutional" obligation to ensure rates are just and reasonable, the California Constitution contains no such requirement. It simply states, "The commission may fix rates . . . for all public utilities subject to its jurisdiction."²¹

The law does not require the Commission to find rates or the costs underlying them to be just and reasonable in any particular fashion. In fact, the Constitution allows the Commission to establish its own procedures.²² Indeed, according to the Public Utilities Code:

The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction.²³

The Commission does not have to decide how rates or costs are just and reasonable in any particular way, and DRA cites no law that holds so. The Commission's approach is lawful so long as it "regularly pursued its authority,"²⁴ which it plainly did here.

Here, the Commission decided the costs of the project would be just and reasonable based on the evidence on the record. The evidence addressed forecasts and estimates, cost caps the parties to the WPA suggested, legal processes the two public agencies have in place as well as the legal requirements they are constitutionally and statutorily mandated to follow, and various terms of the WPA that were expressly fashioned to contain costs, including provisions

²⁰ Rehearing Application, pp. 7-23.

²¹ Cal. Const., art. XII, §6.

²² Cal. Const., art XII, § 2

²³ Pub. Util. Code, §701.

²⁴ Pub. Util. Code, §§ 1757(b), 1757.1(b).

that require the WPA parties to contain costs.²⁵ The Commission reached its decision following an “extensive vetting of the severity of the water supply problem,” and after:

extensive review of the information supplied by the parties over many months, extensive discussion, and a thorough analysis of the agreements, the circumstances surrounding those agreements, vigorous public vetting, a review of the applicable law, and an assessment of the political and economic situation surrounding this application.²⁶

The Commission’s decision to rely on existing constitutional, statutory, contractual and procedural safeguards to help ensure that the rates that it adopts for California American Water will be just and reasonable is not the cavalier abandonment of regulatory duties as DRA asserts in its Rehearing Application. Rather, D.10-12-016 was the result of a thoughtful and thorough analysis of an extensive record and recognition that the unique problems of the Monterey Peninsula required the solution the Commission adopted.

B. The Commission Has Previously Relied on Other Agencies

DRA’s Rehearing Application implies that the Commission has never before recognized the validity of processes other than its own in protecting customer interests and has never relied on other agencies for an assessment of the reasonableness of certain costs. To the contrary, in D.10-12-016 the Commission correctly noted that it “can take into account the legal and constitutional processes and duties of other agencies of government, such as we do in the case of the Department of Public Health and the California Energy Commission.”²⁷ Similarly, the Commission relies on the internal processes of, for example, the Metropolitan Water District, to ensure reasonableness of its water costs, which Commission-regulated water utilities pass through directly to customers. Indeed, even the case that DRA uses as the centerpiece of its legal error claim shows that the Commission has relied on the assessments of outside agencies as to the reasonableness of certain costs.

²⁵ There is abundant evidence in the record of multiple cost controls designed to ensure that costs and rates are just and reasonable. (See, e.g., MCWD Exh. 305, Rebuttal Testimony of James Heitzman on Behalf of Marina Coast Water District, dated May 27, 2010, revised June 7, 2010, pp. 12-17; MCWD Exh. 361, Rebuttal Testimony of Lloyd W. Lowrey Jr. on Behalf of Marina Coast Water District, dated May 27, 2010, pp. 3-6.)

²⁶ D.10-12-016, 2010 Cal. PUC LEXIS 548, *5.

²⁷ *Id.*, *47.

In its Rehearing Application, DRA relies heavily on *Pacific Gas and Electric v. Department of Water Resources* (“*Pacific Gas and Electric*”), in which the California Court of Appeal addressed the obligations of the Department of Water Resources (“DWR”) regarding contracts for the purchase and sale of electrical power during the energy crisis.²⁸ The Court of Appeal found that the Water Code required DWR to make a determination that its costs, which it passed on to Commission-regulated energy utilities, were just and reasonable.²⁹ DRA incorrectly argues that *Pacific Gas and Electric* requires the Commission to review the Public Agencies’ costs and determine whether they are just and reasonable.³⁰ DRA’s argument ignores the fact, however, that the *Pacific Gas and Electric* decision required DWR – not the Commission – to make the determination that DWR’s power costs were just and reasonable, which the Commission could then rely upon in setting rates.

In D.10-12-016, the Commission found that the Public Agencies have established processes and legal requirements to ensure that their costs are reasonable and prudent. As with DWR’s determination in *Pacific Gas and Electric*, the Commission is able to rely on these processes and legal requirements in establishing reasonable rates for utility customers. Therefore, contrary to DRA’s contention, *Pacific Gas and Electric* provides precedent for the Commission’s decision, rather than a basis for legal error.

C. Statutory, Contractual and Procedural Safeguards Protect Customers

DRA continues to fail to accept, despite overwhelming evidence, that its concerns about cost control are met through established measures for local accountability and the many provisions in WPA designed to ensure proper cost controls. Although at times DRA admits that the Commission does not have jurisdiction over the Public Agencies,³¹ it goes on to ignore that reality and suggest that somehow, some way, the Commission can still exercise such non-existent jurisdiction to directly control Public Agency cost. To do so, however, would constitute

²⁸ *Pacific Gas and Electric Co. v. Dept. of Water Resources, et al.*, (2003) 112 Cal. App. 4th 477.

²⁹ 112 Cal. App. 4th 477, 495.

³⁰ Rehearing Application, pp. 16-17.

³¹ *Id.*, p. 8.

legal error.

1. MCWD and MCWRA Legal Protections

MCWD and MCWRA have separate legal and regulatory regimes that require them to ensure that their costs, rates and charges are reasonable and prudent. It is appropriate for the Commission to rely on the Public Agencies to perform their official duties, follow the law, and ensure that the charges paid by California American Water for product water are reasonable, prudent and in the public interest. The Joint Parties, separately and together, have discussed at length the rigorous system of local accountability and the significant protections built into the WPA. Rather than repeat themselves by addressing each provision in detail, the Joint Parties incorporate their earlier responses by reference, as noted above, and will summarize the main ways in which customer interests are protected.

The Monterey County Water Resources Agency Act (“Agency Act”)³² establishes a public two-step budgeting process for MCWRA. MCWRA’s Board of Directors prepare, hold public hearings on, and approve an annual budget, and then submit that budget for adoption to the MCWRA Board of Supervisors.³³ The Board of Supervisors then adopts the annual budget after further public hearings.³⁴ Direct local accountability of MCWRA to Monterey County voters, including California American Water customers, combined with participation of representatives of Peninsula cities in the Advisory Committee under the WPA, with the leadership of such cities also answerable at the ballot box, establishes local control of project costs and strong incentives for MCWRA to control costs.

Similarly, MCWD’s budgeting processes are open, transparent, and closely monitored by the public;³⁵ MCWD must utilize and “follow a public process involving notice and hearings in adopting rates, fees and charges, and to fix water rates that are reasonable and

³² Wat. Code, Appendix, Chapter 52 (Monterey County Water Resources Agency Act).

³³ Agency Act § 52-54.

³⁴ Agency Act § 52-70(e).

³⁵ Exh. 305, Rebuttal Testimony of James Heitzman on Behalf of Marina Coast Water District, dated May 27, 2010, revised June 7, 2010, p. 17.

fair and related to costs.”³⁶ Finally, California law requires that MCWD’s rates and charges to its customers be reasonable and be reasonably related to the cost of providing water. Any MCWD fee or charge for service to customers must meet the following requirements:

(1) Revenues derived from the fee or charge shall not exceed the funds required to provide the property related service.

(2) Revenues derived from the fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.

(3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership shall not exceed the proportional cost of the service attributable to the parcel.

(4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question.

(5) No fee or charge may be imposed for general governmental services.³⁷

Because this standard applies to water supplied to MCWD’s customers from the desalination facility, and because the WPA requires MCWD to pay the same charge for permanently allocated water as California American Water, the company and its customers will have full benefit of the constitutional standard.

Contrary to DRA’s claims, the Public Agencies’ legal and regulatory regimes will protect the interests of California American Water customers. The charges of legal error in the Commission’s recognition and reliance on these requirements are baseless.

2. WPA and Settlement Agreement Protections

Many of the provisions contained within the WPA are already designed to address the concerns that DRA expressed in its Rehearing Application and throughout this proceeding. For example, Section 11.2(d) states, “All costs of the Parties [to the WPA] pursuant to this Agreement shall be reasonably and prudently incurred.” Failure to follow this contract provision

³⁶ MCWD Exh. 361, Rebuttal Testimony of Lloyd W. Lowrey Jr. on Behalf of Marina Coast Water District, dated May 27, 2010, p. 4.

³⁷ Cal. Const., art. XIII D, § 6, subd. (b).

would subject a breaching party to default and dispute resolution. Sections 4.11 and 11.12 together establish the right to monitor the other parties' progress in developing the Regional Desalination Plant and to review and copy the other parties' records. Sections 6.4 through 6.6 establish a series of cost containment measures applicable during the construction and operational periods of the Regional Desalination Plant. If the Parties cannot come to unanimous agreement, under section 6.6, they must submit the matter on which they cannot agree to an appropriately expert independent third party who is empowered to make a binding decision on the issue. Section 4.3(b) requires use of a competitive selection process to choose the contractors and/or consultants required to design, construct and permit the Regional Desalination Project. Other sections of the WPA provide for value engineering review of facilities designs³⁸ and a constructability review.³⁹

These important contractual obligations are in addition to, and further supplement, the already existing political, constitutional and statutory obligations to which the public agencies must adhere. Furthermore, the section of the Settlement Agreement that seems to most concern DRA includes significant controls that DRA seems to ignore. Section 10.1 of the Settlement Agreement, which DRA quotes in part in its Rehearing Application, provides:

The Parties agree that, given the status of MCWD and MCWRA as governmental agencies and the requirements under law that they incur only reasonable and prudent costs and expenses for purposes related to their governmental duties and the fact that such costs and expenses are subject to public review and scrutiny, all Regional Desalination Project costs incurred by MCWD and MCWRA in compliance with the terms of the WPA shall be deemed reasonable and prudent and the Commission, by its approval of this Settlement Agreement, shall be deemed to have agreed that such costs are reasonable and prudent. (Emphasis added.)

The Settlement Agreement could not be clearer that MCWD and MCWRA do not receive the benefit of costs being deemed reasonable and prudent if they do not incur those costs in compliance with the WPA.

DRA correctly notes that the Commission in D.10-12-016 states that it will hold

³⁸ Agency Act § 4.3(c)

³⁹ Agency Act § 4.6

the Parties accountable to their obligations under the Settlement Agreement and the WPA.⁴⁰ The Commission will be watching to be sure costs are incurred in compliance with the terms of the WPA, and if they are not, it will take action. The Commission still has full jurisdiction over California American Water, and can require California American Water to pursue the public agencies if it believes the public agencies have expended funds in a manner that does not comply with the WPA. Indeed, over the years the Commission has frequently required utilities to pursue legal remedies, including litigation, where it appears that doing so will benefit customers.⁴¹

As with the statutory and regulatory obligations of the Public Agencies, the safeguards written into the WPA also protect customer interests. Similarly, it is not legal error for the Commission to recognize and rely on these contractual safeguards.

3. Procedural Protections

DRA incorrectly argues that the Commission's addition of the Tier 2 review of the operations and maintenance ("O&M") budget and the Commission's approval of the Settlement Agreement's Tier 1 adjustment of purchased water costs and Tier 2 review of the costs of the California American Water facilities constitute legal error.⁴² DRA fails to take into account that these processes, when combined with the statutory, regulatory and contractual safeguards discussed above, protect customer interests without attempting to regulate the Public Agencies.⁴³ For example, the Tier 2 process that the Commission added for approval of the O&M budget allows the Commission to provide its input and guidance before the Joint Parties adopt its annual budget.⁴⁴

DRA also claims that Commission erred in establishing a Tier 2 advice letter

⁴⁰ Rehearing Application, p. 23.

⁴¹ E.g., *In re Subpoena Served on California Public Utilities Commission* (9th Cir. 1989) 892 F.2d 778; *In re Electric Refund Cases* (2010) 184 Cal.App.4th 149.

⁴² Rehearing Application, pp. 17-21.

⁴³ DRA notes with chagrin that under D.10-12-016 the Public Agencies would still recover costs even if staff founds costs unjust and unreasonable because the Commission's ability to prevent recovery of costs extends only to California American Water. (Rehearing Application, p. 21, fn. 50.) This is correct, and was a very important, in fact critical, part of the deal for the Public Agencies. DRA's desire to regulate the Public Agencies as if they were public utilities is at the heart of its Rehearing Application.

⁴⁴ D.10-12-016, 2010 Cal. PUC LEXIS 548, *180.

process for the O&M budget review and approving a modified Tier 2 process for recovery of the cost of the California American Water facilities above the price cap,⁴⁵ arguing that these processes do not comport with the Tier 2 process set forth in General Order 96-B (“GO 96-B”). The Commission, however, has the authority to modify the existing advice letter process set forth in GO 96-B to suit its needs. GO 96-B states, “An Industry Rule may differ from the otherwise applicable General Rule to the extent authorized by General Rule or other Commission order.”⁴⁶ Additionally, “The Commission may authorize exception to the operation of this General Order where appropriate.”⁴⁷ Therefore, to the extent that the Tier 2 process for approval of the O&M budget differs from the Tier 2 process in GO 96-B, the Commission has acted within its authority in so ordering and has not committed legal error.

DRA also complains that the Tier 1 process for adjustments to purchased water costs is inadequate and constitutes legal error.⁴⁸ DRA neglects to mention, however, that this is the same process that California American Water currently uses for all of its purchased water costs, making DRA’s claim of legal error implausible.

DRA’s claims regarding the procedural processes that the Commission established and approved in D.10-12-016 are without merit. While DRA may have recommended different procedures, the Commission’s rejection of DRA’s suggestions does not constitute legal error.

V. DRA FAILED TO DEMONSTRATE FACTUAL ERROR

In addition to its unsupported allegations of legal error, DRA claims that D.10-12-016 also contains factual error rising to the level of legal error. A closer examination of these so-called “factual errors,” however, reveals that they are just instances where the Commission made findings that contradict DRA’s entrenched positions. As discussed above, the bulk of DRA’s claims regarding factual errors are recycled from earlier pleadings. The Joint Parties already

⁴⁵ Rehearing Application, pp. 20-23.

⁴⁶ GO 96-B § 1.1 (emphasis added).

⁴⁷ GO 96-B § 1.3.

⁴⁸ Rehearing Application, p. 20.

addressed and refuted DRA's claims and the Commission rejected DRA's arguments. Therefore, the Joint Parties limit their response to two particular claims of factual error: (1) that the record does not support the Commission's estimated \$6,200 cost per acre foot for water from the Regional Desalination Plant and its finding that the estimated cost is reasonable,⁴⁹ and (2) that Monterey Peninsula customer interests can only be protected by providing the Municipal Advisor with a voting role on the Advisory Committee.⁵⁰ Not only does DRA fail to show that these findings are factual errors, but its arguments reveal fundamental misconceptions about the Regional Desalination Project, its governance, and the Commission's obligations.

The Joint Parties will also address DRA's attempt to use a typographical error as justification for modification of D.10-12-016, the Settlement Agreement, and the process for recovery of the cost of California American Water facilities. Finally, there is also one instance where the Joint Parties agree with DRA's suggested correction to D.10-12-016, as discussed below.

A. Cost of Water

In D.10-12-016, the Commission discussed DRA's focus on the short-term rate impacts. The Commission correctly summarized the shortcomings of DRA's approach to the issue of the solution to the long-term water supply problem in D.10-12-016:

[T]his proceeding, unique in so many ways, extends beyond obtaining safe and reliable levels of water service at reasonable rates today. As we observed recently in Decision (D.) 10-08-008, "While it is DRA's mission to focus on costs and their impact on rates (footnote omitted), the Commission must consider the viability of the Coastal Water Project as a whole and the need for water on the Monterey Peninsula." The Commission's broader mission means that we must look beyond a single rate cycle.⁵¹

The Commission elaborated:

Unlike DRA, the Commission must consider and balance the viability of the project, and the interests of all ratepayers, the interests of the utilities.⁵²

⁴⁹ Rehearing Application, pp. 25-26.

⁵⁰ *Id.*, pp. 27.

⁵¹ D.10-12-016, 2010 Cal. PUC LEXIS 548, **11-12

⁵² D.10-12-016, 2010 Cal. PUC LEXIS 548, *12 (emphasis added).

In its Rehearing Application, however, and throughout this proceeding, DRA has ignored the differences between its own mission and the Commission's obligations and has claimed legal or factual error whenever the Commission has considered the broader implications of the Project or balanced the competing interests of all stakeholders. While the Commission has explained that it must "look at what may be 'reasonable' in an expanded way,"⁵³ DRA has failed to recognize that its traditional focus on immediate rate impacts is particularly shortsighted in this situation.

For example, DRA argues that there are insufficient facts to support the Commission's findings that the estimated \$6,300 per acre-foot cost of water from the Regional Desalination Plant is reasonable.⁵⁴ DRA ignores the extensive testimony, the lengthy workshops, and the evidentiary hearings that provide ample support for the Commission's findings. Moreover, the Commission based its cost estimate on the Unified Financing Model jointly developed by all of the parties, including DRA. DRA urges the Commission to ignore the substantial record evidence and instead rely on estimates of desalination costs that are not part of the record, were not subject to cross-examination, and do not provide information as to their underlying assumptions.⁵⁵ This is inappropriate and following DRA's recommendations would actually lead to the legal and factual errors that DRA alleges in its Rehearing Application.

DRA also takes issue with Finding of Fact 124, which explains the \$6,300 cost. The \$6,300 estimate is based on the projected capital cost and financing (including the use of some State Revolving Fund ("SRF") financing) of cost per acre-foot of water from the Regional Desalination Project will be approximately \$6,300. DRA argues that because the Commission did not require a certain level of low-cost SRF financing, it must ignore the possibility of such funding altogether in developing its estimates.

DRA's position is extreme and absurd. The Commission makes it quite clear in the finding that the \$6,300 acre-foot cost is an estimate or approximation and is based on certain

⁵³ *Id.*, * 45.

⁵⁴ Rehearing Application, pp. 25-26.

⁵⁵ *Id.*, p. 9.

assumptions that may or may not come to fruition. This is standard practice for the Commission, in particular in general rate cases, which are based on future test years. In general rate cases the Commission looks at the expected cost of certain items, issues related to financing and other factors that might influence costs, and develops an estimate, which it then determines is reasonable or not. That is no different from the process the Commission went through in this case. Because these are projected costs, there are a variety of factors, including financing, that could change and affect the estimate. That does not, however, negate the validity of the Commission's finding regarding the cost per acre-foot.

DRA has failed to demonstrate that the Commission's findings regarding the projected cost of water from the Regional Desalination Plant and the reasonableness thereof are based on factual errors. Therefore, the Commission should reject DRA's so-called "corrections."

B. Municipal Advisor

DRA claims that Finding of Fact 141, which states that "providing the Monterey Peninsula Cities with a meaningful advisory role on the Advisory Committee provides adequate ratepayer protection,"⁵⁶ is "clearly erroneous."⁵⁷ According to DRA, unless the Municipal Advisor has a voting role, customer interests are not protected. It is of no small significance that the majority of the Peninsula Cities themselves disagreed with DRA, stating that they believed that an advisory role, as opposed to a voting role, was sufficient.⁵⁸ Somehow, to DRA, a voting role that most of the Cities agreed was unnecessary and that would have jeopardized the viability of the Regional Desalination Project is absolutely necessary to protect customer interests. It is DRA's position, not the Finding of Fact, that is "clearly erroneous."

C. Typographical Error

Finding of Fact 213 states:

It is reasonable to require Cal-Am to update DRA and DWA staff on the design and refined cost estimates of the Cal-Am only

⁵⁶ D.10-12-016, 2010 Cal. PUC LEXIS 548, **267-268.

⁵⁷ Rehearing Application, p. 27.

⁵⁸ *Notice of Agreement by the Cities of Seaside, Sand City, Carmel-by-the-Sea, and Pacific Grove to Proposed Modifications to Water Purchase Agreement*, filed July 28, 2010.

facilities, because this approach will help to ensure that Cal-Am explains and justifies the project costs that are included in each Tier 3 advice letter.⁵⁹

The reference to the Tier 3 advice letter is a clear typographical error. In D.10-12-016, the Commission established and approved certain Tier 1 and Tier 2 advice letter requirements, as discussed above, but it did not impose any Tier 3 advice letter requirements on California American Water. In fact, in D.10-12-016, the Commission lists nine modifications to the Settlement Agreement and Water Purchase Agreement that had been proposed in the Alternate Proposed Decision. The eighth of these would have required California American Water to utilize Tier 3 advice letter processes for recovery of product water and California American Water facilities costs. The Commission then rejected the modifications, including the Tier 3 requirement.⁶⁰ The reference to a Tier 3 in Finding of Fact 213 was thus a typographical error, not an indication of the Commission's intent to impose a more stringent process for California American Water's recovery of costs.

This conclusion, which is obvious from reading the Commission's decision, does not deter DRA from seizing upon this typographical error and recommending that the Commission modify D.10-12-016, the Settlement Agreement and the processes agreed to by the Joint Parties to require a Tier 3 advice letter for recovery of the costs of the California American Water facilities. Not only would this directly contradict the Commission's intent in D.10-12-016, it would, as California American Water discussed at length in its comments on the Proposed Decision and Alternate Proposed Decision,⁶¹ cause severe financial harm to the company and jeopardize the Regional Desalination Plant as a whole.

The Joint Parties therefore request that the Commission reject DRA's request and correct the typographical error by replacing the "3" with a "2" in Finding of Fact 213. Doing so would be in keeping with Rule 16.5, which provides, "Correction of obvious typographical errors or omissions in Commission decisions may be requested by letter to the Executive Director, with

⁵⁹ D.10-12-016, 2010 Cal. PUC LEXIS 548, *284 (emphasis added).

⁶⁰ *Id.*, **229-232.

⁶¹ California American Water Reply Comments on PD and APD, pp. 6-10.

a copy sent at the same time to all parties to the proceeding.” It would serve the interest of accurate decision making if the typographical error were corrected in the order resolving DRA’s application for rehearing.

D. Lot Size and Seasonal Discount

DRA correctly notes in its Rehearing Application that the Commission erroneously states in D.10-12-016 that the lot size and seasonal discounts were removed from California American Water’s conservation rate design.⁶² The Joint Parties also raised this issue in their comments on the Proposed Decision and the Alternate Proposed Decision. The Joint Parties recommend that the Commission correct this language in its order resolving DRA’s application for rehearing.

VI. CONCLUSION

DRA’s Rehearing Application is without merit. It is merely a retread of arguments that DRA made before and the Commission correctly rejected. DRA failed to prove that the Commission committed legal error in D.10-12-016. DRA’s Rehearing Application demonstrates its stubborn insistence on trying to regulate the Public Agencies and fails to recognize that its recommendations would harm California American Water and its customers, prevent the implementation the Regional Desalination Project, and jeopardize the chances of future public/private partnerships. Therefore, the Joint Parties urge the Commission to deny the application for rehearing of D.10-12-016 as expeditiously as possible.

January 18, 2011

FRIEDMAN DUMAS & SPRINGWATER LLP

By: /s/Mark Fogelman
Mark Fogelman

Attorneys for Marina Coast Water District

⁶² Rehearing Application, p. 27.

PROOF OF SERVICE

I, Celeste Alas, hereby declare:

I am over the age of 18 years and not a party to or interested in the within entitled cause. I am an employee of Friedman Dumas & Springwater LLP and my business address is 33 New Montgomery Street, Suite 290, San Francisco, California 94105. On January 18, 2011, at my place of business as listed above, the following document:

**JOINT RESPONSE OF CALIFORNIA-AMERICAN WATER COMPANY,
MARINA COAST WATER DISTRICT,
AND MONTEREY COUNTY WATER RESOURCES AGENCY TO
THE APPLICATION FOR REHEARING OF D.10-12-016**

was sent:

- by first class mail. I am familiar with the business practice at my place of business for collection and processing of correspondence for mailing with the United States Postal Service. Correspondence so collected and processed is deposited with the United States Postal Service that same day in the ordinary course of business. The document(s) was (were) placed for deposit in the United States Postal Service in a sealed envelope(s), with postage fully prepaid, addressed as set forth on the attached service list.
- by messenger by handing a copy of said documents for personal service by its agent to the persons at the addresses set forth on the attached service list.
- by transmitting such document electronically from Friedman Dumas & Springwater LLP, San Francisco, California, to the electronic mail addresses attached. I am readily familiar with the practice of Friedman Dumas & Springwater, 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 1.10(b) of the Public Utilities Commission of the State of California and all protocols described therein.

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 at San Francisco, California on January 18, 2011.

/s/Celeste Alas
Celeste Alas

A.04-09-019
SERVICE LIST
(List taken from CPUC Website January 18, 2011)

Service by Email

Name		Email Address
Sabrina D.	Venskus	venskus@lawsv.com
Russell	Mcglathlin	rmcglathlin@bhfs.com
Deborah	Mall	mall@ci.monterey.ca.us
George	Riley	georgeriley@hotmail.com
David C.	Laredo	dave@laredolaw.net
Monica L.	Mccrary	mlm@cpuc.ca.gov
Mark	Fogelman	mfogelman@friedumspring.com
Sarah E.	Leeper	sleeper@manatt.com
Patricia	Nelson	nelsonp34@hotmail.com
Dan L.	Carroll	dcarroll@downeybrand.com
Sabrina V.	Teller	steller@rtmmlaw.com
Andrew M.	Bell	andy@mpwmd.dst.ca.us
Joe	Geever	jgeever@surfrider.org
Conner	Everts	connere@west.net
Carrie	Gleeson	carrie.gleeson@amwater.com
Robert G.	Macleam	robert.macleam@amwater.com
Tim	Miller	tim.miller@amwater.com
Tyla	Montgomery	tmontgomery@rbf.com
Gregory K.	Wilkinson	Gregory.Wilkinson@bbklaw.com
Jason M.	Ackerman	jason.Ackerman@bbklaw.com
Lloyd W.	Lowrey, Jr.	lloyrey@nheh.com
Frances M.	Farina	ffarina@cox.net
Curtis V.	Weeks	weeksc@co.monterey.ca.us
Stephen	Collins	steclln@aol.com
Nancy	Isakson	nisakson@mbay.net
Glen	Stransky	Glen.Stransky@LosLaurelesHOA.com
Bob	Mckenzie	bobmac@qwest.net
Christine	Davi	davi@ci.monterey.ca.us
James	Heitzman	jim@mcwd.org
Manuel G.	Fierro	manuelfierro02@yahoo.com
Molly	Erickson	erickson@stamplaw.us
Robert B.	Holden	bobh@mrwpca.com
Catherine A.	Bowie	catherine.bowie@amwater.com
John	Klein	john.klein@amwater.com
Darby W.	Fuerst	darby@mpwmd.dst.ca.us
Heidi	Quinn	heidi@laredolaw.net
Michael	Bowhay	generalmanager@mpccpb.org
Tanya A.	Gulesserian	tgulesserian@adamsbroadwell.com
Eric	Zingas	ezigas@esassoc.com
Derrick N.D.	Hansen	dhansen@friedumspring.com
Stefanie A.	Elkins	selkins@friedumspring.com
Lenard G.	Weiss	lweiss@manatt.com

Lori Ann California Energy Markets	Dolqueist Idolqueist@manatt.com cem@newsdata.com
Michael Lyndel	Warburton michael@rri.org
Sarah	Melton lmelton@rmcwater.com
Stan	Corbin scorbin@surfrider.org
Tara S.	Williams swilliams@poseidon1.com
Joyce	Kaushik tkaushik@manatt.com
Kevin M.	Ambrosius joyce.ambrosius@noaa.gov
Alan B.	O'brien kobrien@downeybrand.com
David P.	Lilly abl@bkslawfirm.com
Laura L.	Stephenson dstephen@amwater.com
Andrew	Krannawitter llk@cpuc.ca.gov
Angela K.	Barnsdale bca@cpuc.ca.gov
Cynthia J.	Minkin ang@cpuc.ca.gov
Diana	Truelove cjt@cpuc.ca.gov
Jonathan J.	Brooks dsb@cpuc.ca.gov
Joyce	Reiger jzr@cpuc.ca.gov
Max	Steingass jws@cpuc.ca.gov
Mike	Gomberg mzx@cpuc.ca.gov
Pamela	Miller mml@cpuc.ca.gov
Peter V.	Nataloni jpn@cpuc.ca.gov
Ravi	Allen pva@cpuc.ca.gov
Richard	Kumra rkk@cpuc.ca.gov
Steve	Rauschmeier rra@cpuc.ca.gov
Michael	Kasomer steve@seacompany.org
Lester	Peevey MP1@cpuc.ca.gov
Carol A.	Wong llj@cpuc.ca.gov
	Brown cab@cpuc.ca.gov

Service by Messenger

President Michael Peevey
California Public Utilities Commission
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

Carol A. Brown
Chief of Staff to President Michael Peevey
California Public Utilities Commission
505 Van Ness Avenue, Room 5303
San Francisco, CA 94102-3214

Lester Wong
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3214

Commissioner Nancy E. Ryan
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3214

Jonathan J. Reiger
California Public Utilities Commission
Executive Division
505 Van Ness Avenue, Room 5035
San Francisco, CA 94102-3214

Commissioner Timothy Alan Simon
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3214

Kenneth Koss
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3214

Karen Shea
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3214

U.S. Mail

Jerry Gallego
Monterey County Civil Grand Jury
15790 Horizon Way
Prunedale, CA 93907