

DWA/RSK

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion to Develop Rules and Procedures to Ensure That Investor-Owned Water Utilities Will not Recover Unreasonable Return on Investments Financed by Contamination Proceeds, Including Damage Awards, and Public Loans Received Due to Water Supply Contamination.

FILED  
PUBLIC UTILITIES COMMISSION  
March 12, 2009  
SAN FRANCISCO, CALIFORNIA  
RULEMAKING 09-03-XXX

ORDER INSTITUTING RULEMAKING

**INTRODUCTION**

**Overview**

This rulemaking is initiated to establish standardized rules and policies to govern the accounting and ratemaking treatment of damage awards and public loans received by a regulated water utility as a result of contamination of its water supply. Given the current lack of standardized rules that govern contamination-related proceeds and loans, it is imperative that we set clear guidelines regarding the inclusion or exclusion of replacement plant in ratebase, in order to assure a fair and reasonable allocation of proceeds between ratepayers and shareholders, and assure that ratepayers only pay a return on used and useful plant in service.

**Background**

Over the past fifteen years, we have considered numerous cases in which a regulated water utility received various types of funds as a result of the contamination

of its sources of water. In each of these proceedings, none of which were precedential, we authorized a unique resolution based on the specific circumstances of each case. We have also considered these issues as part of generic proceedings that addressed the gain on sale of utility property and government grant funds. We discuss some of these cases below to illustrate the various ways in which we have addressed the allocation and ratemaking treatment of contamination proceeds in the past, and as guidance in developing rules in the current proceeding.

### Utility Specific Cases

In the case of Great Oaks Water Company (Great Oaks), we approved a settlement, which split the net contamination proceeds invested in plant in service - 50% to Contribution in Aid of Construction (CIAC)<sup>1</sup> and 50% to rate base (which earns a rate of return).<sup>2</sup>

In the case of Bakman Water Company (Bakman), the utility utilized various funding mechanisms to pay for the repair of its contaminated wells, including: (1) a loan from the Department of Water Resources under the Safe Drinking Water Bond Act, a portion of which was the responsibility of the ratepayers (recorded in rate base) and the balance was the responsibility of the shareholders (not recorded in rate base); (2) lawsuit damages from E&J Gallo totaling \$300,000, of which \$75,000 was used to reimburse the utility for legal fees and \$225,000 recorded in CIAC;<sup>3</sup> and (3) lawsuit damages from Shell Oil Company, with half of these net proceeds recorded in CIAC.<sup>4</sup>

In the case of Southern California Water Company (now Golden State), we allocated some contamination proceeds to the ratepayers to compensate them for higher water rates that were due to the contaminated groundwater, and the balance for use in infrastructure improvements, that would be ratebased.<sup>5</sup>

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<sup>1</sup> Plant recorded in CIAC is not included in rate base, and therefore does not earn a rate of return.

<sup>2</sup> *Great Oaks Water Company*, Decision (D.) 93-04-061, 49 CPUC2d 116 and D.93-09-077, 51 CPUC2d 366.

<sup>3</sup> Resolution W-3785.

<sup>4</sup> D.03-10-002.

<sup>5</sup> D.04-07-031.

By D.06-04-073 for Fruitridge Vista Water Company (Fruitridge Vista) we approved a settlement, in which funding was provided from five sources, including: (1) a California Department of Public Health (CDPH) Drinking Water Treatment and Research Fund loan; (2) a State Revolving Fund zero interest loan; (3) a 20-year loan from the City of Sacramento; (4) special facilities fees to be paid by specified existing developers and future developers; and (5) ratepayers. As with other government funded loans discussed above, Fruitridge Vista was allowed to ratebase the \$1.98 million loan from the City of Sacramento. If Fruitridge Vista is able to recover damages from polluters, it may ratebase up to \$5 million of the plant funded with the proceeds from the lawsuit invested in lieu of the funding sources listed above.

By D.08-04-005 for San Gabriel Valley Water Company (San Gabriel), we authorized the allocation of \$8.6 million of contamination proceeds received by San Gabriel from the County of San Bernardino as follows: (1) replacement plant to be recorded in CIAC; and (2) the condemnation award in excess of replacement costs to be split by ratepayers and shareholders 67%/33%.

### *Generic Proceedings*

We have considered how to account for contamination proceeds and government grant funds in two generic proceedings, both of which, even though they did not provide rules that govern contamination-related proceeds or government loans, may provide guidance in our development of rules and policies that govern how contamination-related proceeds and government loans should be addressed in contamination proceedings.

In D.06-05-041 in R.04-09-003, we addressed how to account for the gain on sale of utility property. In part, we considered whether that rulemaking was the appropriate proceeding to address contamination proceeds. The Commission determined that since contamination proceeds received from a third party did not

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involve the sale of real property, any dollars received over and above the value of the asset were not gains, and therefore not within the scope of the proceeding.

In D.06-03-015 in R.04-09-002, we adopted rules for investor-owned water utilities that govern the accounting and ratemaking treatment for state grant funds. We designed rules that would preserve the public interest integrity of state grant funds by ensuring that water utilities would not be able to profit in any way through the receipt of state grant funds. The rules adopted in D.06-03-015 apply to all future state grant funds, including grants that may be received due to water supply contamination. We do not revisit the treatment of state grant funds in the new rulemaking initiated today.

Given the current lack of standardized rules that govern the accounting and ratemaking treatment of contamination-related proceeds and loans, it is imperative that we set clear guidelines regarding the inclusion or exclusion of replacement plant in ratebase, in order to assure a fair and reasonable allocation of proceeds between ratepayers and shareholders, and assure that ratepayers only pay a return on used and useful plant in service.

### **PRELIMINARY SCOPING MEMO**

As required by Rule 7.1(d)<sup>6</sup> of our Rules of Practice and Procedure, this order includes a preliminary scoping memo as set forth below. The issues to be considered in this proceeding relate only to contamination-related proceeds and loans, and include, but may not be limited to, the following:

1. Should plant funded by government loans be included in rate base and earn a rate of return or should it be recorded in CIAC?
2. Should plant funded by damages from polluters (via litigated case, settlement, or government order) be included in rate base and earn a rate of return or should it be recorded in CIAC?

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<sup>6</sup> Rulemakings. An order instituting rulemaking shall preliminarily determine the category and need for hearing, and shall attach a preliminary scoping memo. The preliminary determination is not appealable, but shall be confirmed or changed by assigned Commissioner's ruling pursuant to Rule 7.3, and such ruling as to the category is subject to appeal under Rule 7.6.

3. Should contaminated plant that is replaced by new plant and funded via government funded loans or damages from polluters be valued at book value or replacement cost?
  - a. If the new plant is valued at replacement cost, should ratepayers pay a rate of return on the difference between the book value and replacement cost?
4. Should damages from polluters be shared between ratepayers and shareholders?
5. What criteria should be used to allocate the net amount of damages from polluters, between ratepayers and shareholders, after contaminated plant is replaced?
6. Should allocation of damages be based on who paid for litigation (ratepayers or shareholders)?
7. How should past decisions of the Commission be considered in the development of rules governing how the damage awards and public loans received by a regulated water utility as a result of contamination of its water supply are accounted for?

Rules and policies to be adopted in this proceeding may apply to all California regulated water utilities.

#### **PROCEEDING SCHEDULE**

This proceeding will conform to the statutory case management deadline for quasi-legislative matters set forth in Public Utilities Code Section 1701.5. In particular, it is our intention to resolve all relevant issues within 18 months of the date of the assigned Commissioner's Scoping Memo.

The timetable for this proceeding will depend on the input we receive from the parties. For purposes of addressing the scoping memo requirements, we establish the following tentative schedule, which is subject to change by the assigned Commissioner or the assigned Administrative Law Judge (ALJ):

March 12, 2009	Issuance of Order Instituting Rulemaking
April 1, 2009	Parties request inclusion on service list
June 1, 2009	Parties file Opening Comments on issues identified in the preliminary scoping memo
July 1, 2009	Division of Water and Audits (DWA) workshop
August 1, 2009	DWA Workshop Report issued
September 3, 2009	Parties file Comments on Workshop Report
February 2010	Proposed Decision mailed for comment
March 2010	Final Decision on Commission agenda

Interested parties may file Opening Comments no later than June 1, 2009 addressing the issues and questions identified in the preliminary scoping memo. Responses to questions should be complete and provide a rationale for the response. Comments should include recommended alternative approaches, and discuss the anticipated impact of the recommended approach. Interested parties may offer any other suggestions regarding policies, practices, rules, and procedures regarding the accounting and ratemaking treatment of contamination-related proceeds and public loans received by a regulated water utility as a result of contamination of its water supply. The Opening Comments should follow the requirements of Rule 6.2, and should include any objections to the preliminary scoping memo regarding the category, need for hearing, issues to be considered, or schedule.

Following the receipt of Opening Comments, the assigned Commissioner will issue a scoping memo that determines the category, need for hearing, scope, and schedule of this rulemaking. The ruling, only to category, may be appealed under the procedures in Rule 7.6. Through the scoping memo and other rulings, the assigned

Commissioner or the assigned ALJ, with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding and establish the schedule for remaining events.

### **PARTIES AND SERVICE LIST**

The rule development to be considered in this Rulemaking could affect all Commission regulated water utilities. We will therefore direct that this rulemaking be served on all Commission regulated water utilities, the Water Branch of the Division of Ratepayer Advocates (DRA), CDPH, The Utility Reform Network, and the California Water Association.

Such service does not confer party status upon any person or entity, and does not result in that person or entity being placed on the service list for this proceeding. The following procedures regarding party status and inclusion on the service list shall be followed. While all California regulated water utilities may be bound by the outcome of this proceeding, only those who notify us that they wish to be on the service list will be accorded service until a final decision is issued.

After initial service of this Order Instituting Rulemaking, the Commission's Process Office will create a service list, which will be posted on the Commission's website at [www.cpuc.ca.gov](http://www.cpuc.ca.gov). Any person or representative of an entity interested in monitoring or participating in this proceeding should send a letter to the Commission's Process Office ([process\\_office@cpuc.ca.gov](mailto:process_office@cpuc.ca.gov)), located at 505 Van Ness Avenue, San Francisco, California 94102. The letter should specify the docket number of this rulemaking in the subject line, and must include the name, address, phone number, organization and e-mail address of those who wish to be added to the service list. The letter should specify whether the person wishes to be a "Party" (i.e., those who actively participate in the proceeding by filing comments or appearing at workshops or hearings), "State Service" (i.e., employees of the State of California who will not be submitting comments), or "Information Only" (i.e., those who will not participate actively, but simply wish to follow the proceeding and receive electronic service of all documents in this rulemaking). Those who seek to be a "party" should indicate how

they intend to participate in the proceeding. Letters may be sent either by electronic mail or regular mail, but must be received by the Commission by April 1, 2009.

In addition, pursuant to Rule 1.4(a), persons and entities may also gain party status by (a) filing comments in this rulemaking, or (b) filing a motion to become a party at a later date. Those seeking party status through filing comments or by a subsequent motion shall comply with Rule 1.4(b).<sup>7</sup>

A party to a Commission proceeding has certain rights that non-parties (those in “State Service” and “Information Only” service categories) do not have. For example, a party has the right to participate in evidentiary hearings, file comments on a proposed decision, and appeal a final decision. A party also has the ability to consent to waive or reduce a comment period. Non-parties do not have these rights, even though they are included on the service list for the proceeding and receive copies of some or all documents.

Any party interested in participating in this rulemaking who is unfamiliar with the Commission’s procedures should contact the Public Advisor’s Office in Los Angeles at (213) 576-7055 or toll free at (866) 849-8391 or e-mail [public.advisor.la@cpuc.ca.gov](mailto:public.advisor.la@cpuc.ca.gov), or in San Francisco at (415) 703-2074 or toll free at (866) 849-8390 or e-mail [public.advisor@cpuc.ca.gov](mailto:public.advisor@cpuc.ca.gov). The TTY number is (866) 836-7825.

Parties are encouraged to serve documents electronically, in accordance with Rule 1.10 of the Commission’s Rules of Practice and Procedure and Resolution ALJ-188. Consistent with those rules, a hard copy of all pleadings shall be served concurrently on the assigned ALJ.

All comments and pleadings must be filed in this proceeding, and served on the current service list for this proceeding, as of the date service is undertaken.

Commission service lists, updated on an ongoing basis, are available from the Commission’s website: [www.cpuc.ca.gov](http://www.cpuc.ca.gov). Parties should ensure that they are using

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<sup>7</sup> Rule 1.4(b) states that those seeking party status shall “(1) fully disclose the persons or entities in whose behalf the filing, appearance or motion is made, and the interest of such persons or entities in the proceeding; and (2) show that the contentions will be reasonably pertinent to the issues already presented.”

the most up-to-date service list by checking the Commission's website prior to each service/filing date.

### **PRELIMINARY CATEGORIZATION OF PROCEEDING AND NEED FOR HEARING**

Rule 7.1(d) requires that an order instituting rulemaking preliminarily determine the category of the proceeding and the need for hearing. As a preliminary matter, we determine that this proceeding is "quasi-legislative," as defined in Rule 1.3(d). We anticipate that the issues in this proceeding may be resolved through a combination of workshops and filed comments, and that evidentiary hearings will not be necessary. Any person who objects to the preliminary categorization of this rulemaking as "quasi-legislative" or to the preliminary hearing determination, shall state the objections in their Opening Comments, as described above. After considering the Opening Comments, the assigned Commissioner will issue a scoping ruling making a final category determination; this final category determination is subject to appeal as specified in Rule 7.6(a).

### **INTERVENOR COMPENSATION**

Any party that expects to claim intervenor compensation for its participation in this rulemaking shall file its notice of intent to claim intervenor compensation no later than 30 days after the scoping memo is issued.

### **EX PARTE COMMUNICATIONS**

In accordance with Rule 8.2, ex parte communications in this proceeding are allowed without restriction or reporting requirement.

### **FINDINGS OF FACT**

1. Over the past fifteen years, the Commission has considered numerous cases in which a utility received various types of funds as a result of the contamination of its sources of water.
2. In each of these proceedings, none of which were precedential, the Commission authorized a unique resolution based on the specific circumstances of each case.

3. The Commission currently does not have a set of standard rules or guidelines that address how to account for and allocate contamination proceeds or government funded loans used to finance replacement of contaminated utility assets.
4. The Commission has also considered contamination proceeds and government funded grants as part of generic proceedings.

#### CONCLUSIONS OF LAW

1. The Commission should open an Order Instituting Rulemaking, in order to establish standard rules and policies to govern the accounting and ratemaking treatment of contamination proceeds and government funded loans used to finance replacement of contaminated utility assets.
2. Parties should respond to the questions posed in the preliminary scoping memo.

#### **Therefore, IT IS ORDERED that:**

1. A rulemaking on the Commission's own motion is instituted to develop standard rules and policies applicable to Commission regulated water utilities that govern the accounting and ratemaking treatment of contamination proceeds and government funded loans used to finance replacement of contaminated utility assets.
2. This rulemaking is preliminarily determined to be a quasi-legislative proceeding as that term is defined in the Commission's Rules of Practice and Procedure, Rule 1.3(d).
3. This proceeding is preliminarily determined not to need a hearing.
4. The expected timetable for this proceeding is as set forth in the body of this order. The assigned Commissioner by scoping memo and other rulings, and the assigned Administrative Law Judge by ruling with the assigned Commissioner's concurrence, may adjust the timetable as necessary during the course of the proceeding, provided that in no instance shall this proceeding require longer than 18 months to complete after the scoping memo is issued.
5. The Commission's Division of Ratepayer Advocates shall, and Commission regulated water utilities and other parties may, file Opening Comments containing

responses to the issues and questions identified in the preliminary scoping memo.

The Opening Comments shall be filed no later than June 1, 2009, unless that date is modified by the assigned Commissioner or assigned Administrative Law Judge.

6. Pursuant to Rule 6.2, parties shall include in their Opening Comments any objections they may have regarding the category, need for hearing, issues to be considered, or schedule.
7. All comments shall conform to the requirements of the Commission's Rules of Practice and Procedure.
8. The Executive Director shall serve a copy of this Order Instituting Rulemaking on all Commission regulated water utilities, the Water Branch of the Division of Ratepayer Advocates, the California Department of Public Health, The Utility Reform Network, and the California Water Association.
9. The service list for this proceeding shall be formed following the procedures set forth in the Parties and Service List section in the body of this Order Instituting Rulemaking and shall be posted on the Commission's Website ([www.cpuc.ca.gov](http://www.cpuc.ca.gov)). Parties may also obtain the service list by contacting the Process Office at (415) 703-2021.

This order is effective today.

Dated \_\_\_\_\_, 2009 at San Francisco, California.