

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



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Application of California-American Water Company (U210W) for an Order Authorizing Recovery of Costs for the Lease of the Sand City Desalination Facility and Associated Operating and Maintenance Costs.

A.10-04-019
(Filed April 12, 2010)

**COMMENTS OF CALIFORNIA-AMERICAN WATER COMPANY (U210W)
ON THE REVISED PROPOSED DECISION OF
ADMINISTRATIVE LAW JUDGE BUSHEY**

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I. INTRODUCTION

Pursuant to Article 14 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”) and as permitted by Administrative Law Judge (“ALJ”) Bushey via email on December 19, 2011, California-American Water Company (“California American Water”) hereby submits its opening comments on the Revised Proposed Decision of ALJ Bushey, issued December 2, 2011 (“RPD”). Although the RPD correctly recognizes that California American Water should recover the cost of producing water from the Sand City Desalination Plant (“SCDP”), its makeshift ratemaking approach is inequitable, unreasonable, overly burdensome and based on legal and factual errors. Furthermore and as a result of the makeshift ratemaking approach and an Order directing California American Water to file a duplicative and unnecessary application, the RPD contradicts the Commission’s Water Action Plan objective of streamlining regulatory decision-making.

As it is written, the RPD creates a disincentive for innovative public-private partnerships to address water supply issues in Monterey and elsewhere. The SCDP has provided the only new drought-proof source of water since State Water Resources Control Board (“SWRCB”)

Order 95-10 required curtailment of diversions from the Carmel River. The RPD ignores the decade long-effort to develop this water supply and the benefit of \$2.9 million of Proposition 50 grant funding from the City of Sand City (“Sand City”). The value of this public-private partnership has been widely recognized, including by the California Legislature and the SWRCB, which encouraged California American Water to pursue similar projects. The RPD, however, penalizes both Sand City and California American Water for their involvement in this resourceful and beneficial project.

If the Commission adopts the RPD unchanged, it will significantly diminish California American Water’s or any other entities’ desire to pursue a similar project. The Commission should modify the conclusions of the RPD and at a minimum grant California American Water’s alternate ratemaking treatment proposed in its comments on the original PD – without the unnecessary and harmful changes the RPD makes. California American Water’s suggested modifications to the RPD are set forth in Appendix A to these comments.

II. THE SAND CITY LEASE IS PRUDENT

As California American Water discussed in comments on the original PD, it has demonstrated throughout this proceeding that it acted reasonably based on the circumstances and facts known when it began discussions with Sand City, when it negotiated the original lease, and most importantly, when it renegotiated the amended lease in 2009.¹ Water production from the SCDP is a vital component of the Monterey water supply. It provides a new, cost effective source of water and will help California American Water meet its government-mandated obligations to take less water from other sources.

Not only was California American Water’s decision to enter into a renegotiated lease reasonable at the time it was made, but the SCDP project is reasonable now. California American Water’s water supply constraints have not become any less dire since 2009, and no

¹ *California-American Water Company’s Comments on the Proposed Decision of Administrative Law Judge Bushey*, filed September 7, 2011 ("California American Water Opening Comments"), pp. 6-7; *Reply Comments of California-American Water Company on the Proposed Decision of Administrative Law Judge Bushey*, filed September 14, 2011 ("California American Water Reply Comments"), pp. 3-5.

other source of water has become available since which will timely meet the mandates of the SWRCB Cease and Desist Order (“CDO”). Although the Commission approved the Regional Desalination Project in December 2010, it will still be several years before water produced as a result of that project is available. California American Water needs the SCDP water in the meantime to reduce its diversions from the Carmel River as required by the CDO. Moreover, even after the Regional Desalination Project is completed, the average cost of the SCDP water will be significantly lower than the average cost of the Regional Desalination Project, making the availability of SCDP a benefit to customers.

Despite the changes from the original PD, the RPD still contains significant legal and factual errors and is contrary to Commission goals and precedent. California American Water believes that the SCDP lease is reasonable and prudent, and the SCDP benefits all Monterey County District customers, not just Sand City residents. Rather than duplicate its original comments, California American Water hereby incorporates them by reference and will focus on the RPD’s new ratemaking proposal.

III. THE RPD’S MODIFICATIONS TO CALIFORNIA AMERICAN WATER’S ALTERNATIVE RATEMAKING PROPOSAL ARE UNREASONABLE AND PUNITIVE

Although the proposed SCDP cost that California American Water included in its application is the lowest cost for any new source of supply in the District,² California American Water also provided an alternative ratemaking proposal for the Commission to consider in its comments on the original PD.³ The RPD incorporates some aspects of California American Water’s alternative proposal, namely the estimated costs, but its proposed method of cost recovery is imbalanced and unjust.

California American Water’s initial annual cost of \$1.441 million was comprised of an

² A.10-04-019, *Application of California-American Water Company (U210w) for an Order Authorizing Recovery of Costs for the Lease of the Sand City Desalination Facility and Associated Operating and Maintenance Costs*, filed April 12, 2010 ("Application"), pp. 11-14; *California-American Water Company Response to the Assigned Commissioner's Ruling Setting Schedule for Completing the Record* ("California American Water Response to Ruling"), filed October 18, 2010, pp. 12-13.

³ California American Water Opening Comments, pp. 17-18; California American Water Reply Comments, pp. 6-7.

\$850,000 cash lease payment, \$122,764 in annualized repair cost, \$227,311 of working cash requirement, \$156,374 of power costs and \$86,012 for other O&M.⁴ As an alternative, California American Water suggested the Commission use the *average* annual lease cost of \$414,677, track the annualized repair cost in a memorandum account, and allow power costs and other O&M costs in rates or track them in the same memorandum account.⁵ California American Water also indicated that it would be willing to accept shareholder responsibility for the working cash requirement associated with the carry cost of the lease prepayments.⁶ California American Water's alternative proposal would significantly reduce the initially requested annual revenue requirement, while still taking into account the significant benefits of the SCDP for Sand City and all Monterey County District customers.

The RPD uses the estimated costs from California American Water's alternative proposal to develop a new ratemaking methodology that includes an SCDP surcharge and balancing account. The SCDP balancing account will reflect the cost (based on the estimates that California American Water provided in its comments and actual purchased power costs) of the actual amount of water from the SCDP that California American Water uses to reduce diversions from the Carmel River.⁷ The SCDP surcharge the RPD proposes applies to all existing Monterey County District water connections.⁸ The RPD also proposes a special tariff for new or expanded connections in Sand City. Under the RPD's proposed tariff the water supply costs for this service:

shall be based on the actual costs of the Sand City Desalination Plant instead of Cal-Am's Monterey District average system supply costs. All other cost components of Cal-Am's Monterey District revenue requirement shall also be included in the cost tabulation for the Sand City Moratorium Exemption tariff including water delivery system costs, overheads, cost allocation, and rate design as authorized by the Commission in the latest general rate case.⁹

According to the RPD, the Sand City tariff is to remain in effect until the service

⁴ Application, Appendix B, p. 1. The power cost plus other O&M cost total \$242,386.

⁵ Application, pp. 3-6.

⁶ California American Water Opening Comments, p. 18.

⁷ RPD, pp. 29-30.

⁸ RPD, p. 29.

⁹ RPD, pp. 32-33.

connection moratorium ordered by the SWRCB and confirmed by the Commission in D.11-03-048 is lifted.¹⁰

Unlike California American Water's alternative proposal, which reduces the revenue requirement and correctly recognizes the benefit of the SCDP to all Monterey County District customers, the RPD devises a ratemaking method that is inequitable and unfairly penalizes Sand City and the Company.

A. The Proposed Stand-Alone Sand City Tariff is Unfair to New or Expanded Use Sand City Customers

1. The Proposed Stand-Alone Sand City Tariff Violates Established Commission Practices

The RPD's stand-alone tariff for new or expanded use customers in Sand City violates the Commission's well-established practice of adopting uniform rates for utility service in contiguous or centralized service areas.¹¹ With uniform rates, costs are spread over the entire customer base within that contiguous or centralized area. While the actual cost to serve a particular customer or subset of customers may be higher or lower, all customers pay the same rates.

With a few minor exceptions, California American Water has consolidated rates for the customers in its Monterey County District. There is not a different rate structure for customers to whom the SWRCB moratorium does not apply. All customers that receive water from either or both the Seaside Basin and the Carmel River have the same rate or are in the process of transitioning to the same rates. This applies even to cities or service areas that require significant capital investments for water service. For example, the Ambler Park Arsenic Treatment Plant, which cost approximately \$2.5 million, only serves the customers of Ambler Park area, but the cost of that facility is charged to all Monterey County District customers. Similarly, the Eardly

¹⁰ RPD, p. 32.

¹¹ D.06-08-017, *In re Application of Suburban Water Systems (U 339-W) for Authority to Increase Rates Charged for Water Service*, 2006 Cal. PUC LEXIS 369, **1-2, 12-15; D.05-07-022, *In re Application of California Water Service Company (U 60 W), a Corporation, for an Order Authorizing it to Increase Rates Charged for Water Service*, 2005 Cal. PUC LEXIS 286, *29; D.82-03-014, *Application of SoCal Water Co. to Increase the Rates for Water Service in its Arden-Cordova District (dba Arden Cordova Water Service)*, 1982 Cal. PUC LEXIS 1221, **10-11, 30, Ordering ¶ 1.

Booster Pumping Plant, which was constructed and put into service in 2008, serves only to lift water to customers at higher elevations within a portion of the Monterey Main System, yet its \$1.5 million dollar cost is charged to all Monterey customers. There are many booster pumping stations and storage tanks within the main Monterey system that benefit only the customers within lift zone they serve, yet the costs associated with them are charged to all of the customers in the district. Nonetheless, the Commission has not singled out these customers for stand-alone rates – nor should it.

Uniform rates are a basic tenet of utility ratemaking. Indeed, the Commission recently initiated a rulemaking proceeding (R.11-11-008) to determine whether consolidated rates on a broader level would help meet the Commission’s Water Action Plan objectives. In the Order Instituting Rulemaking, the Commission recognized “that there can be a significant difference in the cost of providing safe, reliable, and adequate water in different geographical areas. In some areas, charging the full cost of providing water service could result in either rates that are unaffordable to many customers in the region or in rate shock where the price increases by a large amount.”¹²

Not only does the RPD contradict the Commission’s well-established practices, it would also create a significant administrative burden. If the purpose of the RPD’s stand-alone Sand City tariff is truly to ensure that the new or expanded use Sand City customers are charged the cost of water produced from the SCDP, then the returns of and on California American Water’s other production facilities, purchased power costs for facilities other than SCDP, water treatment and well costs and possibly a whole host of other costs should also be removed from the Sand City charge – which the RPD fails to do. Moreover, because the Sand City new or expanded use customers would receive water from only the SCDP and will have a dedicated source or drought resistant water, California American Water’s tiered conservation rates, conservation and rationing rules, and related surcharges should not apply. In order to develop a truly accurate and

¹² R.11-11-008, *Order Instituting Rulemaking Into Addressing the Commission’s Water Action Plan Objective of Setting Rates That Balance Investment, Conservation, and Affordability For Multi-District Water Utilities*, filed November 20, 2011, p. 3.

fair stand-alone rate for Sand City, California American Water would have unravel its entire rate structure and conduct a study to determine the true cost of service for these customers. The RPD's half-measures seem designed more to penalize Sand City than provide a true reflection of costs.

There is no reason to deviate from Commission's established practice for Sand City, particularly when it is estimated that over the term of the lease more than half of the water produced by the SCDP will benefit the entire Monterey District by reducing California American Water's diversions from the Carmel River.¹³ The Commission should modify the RPD to remove the stand-alone Sand City tariff.

2. The Term of the Tariff is Unfair

In addition to contradicting Commission policy and practice, the RPD's stand-alone Sand City tariff also manages to provide new or expanded use Sand City customers with the worst of both worlds. This is due the fact that while the cost of water from the SCDP is currently higher than water from the Carmel River or the Seaside Basin, it will be less than the cost of water from the Regional Desalination Project.¹⁴ According to the RPD, while the service connection moratorium is in effect, new or expanded use customers will pay rates based on the higher cost of water from the SCDP under the proposed stand-alone Sand City tariff.¹⁵ Once the Regional Desalination Project is completed and the service connection moratorium is lifted, the new or expanded use Sand City customers will pay the same rates as the rest of the Monterey County District, despite the fact that the cost of the water from the SCDP used to serve them will be approximately half the estimated cost of the Regional Desalination Project water used to serve the rest of the District.

Although the RPD claims that its ratemaking treatment results in rates that are "just and reasonable," they actually appear to be designed to ensure that the Sand City new or expanded

¹³ California American Water Response to Ruling, pp. 13-14; California American Water Opening Comments, pp. 2-3.

¹⁴ California American Water Opening Comments, p. 4.

¹⁵ RPD, p. 24.

use customers consistently pay the highest rates possible and an unfair portion of existing rates. By ending the stand-alone tariff at the point at which the cost of water from the SCDP would be lower than the cost of water elsewhere in the Monterey County District, the RPD unfairly penalizes these customers.

3. The RPD Fails to Consider the Effect of the MPWMD Connection Charges

In addition to ensuring that the new or expanded use Sand City customers are always charged the highest rates, the RPD decides not to opine on the effect of the substantial connection fees that Monterey Peninsula Water Management District (“MPWMD”) will charge these customers. Any new or expanded use Sand City customer will face substantial MPWMD connection fees. As California American Water noted in its comments on the original PD, the current connection fee is \$23,567 per acre-foot, and MPWMD escalates the connection fee annually 1% to 5%.¹⁶ MPWMD’s boundaries are generally concurrent with California American Water service area; therefore, the MPWMD SCDP-related connection fees should benefit *all* California American Water Monterey County District customers. Connection fees for the entire 206 acre-feet will total approximately \$6 million and should be used to fund new sources of water for California American Water customers – new sources that the Sand City customers do not need and will not use.

Contrary to the RPD’s claim, California American Water never requested that the Commission “approve or validate” such fees.¹⁷ The amended lease recital merely takes note of the fact that MPWMD “currently charges connection fees to new or expanded water connections within the Company’s service area.”¹⁸ Although ignored by the RPD, California American Water cited the basis for these connection fees and the nature of the fees in its comments on the original PD.¹⁹ As California American Water noted, MPWMD Rule 24 sets forth the process for

¹⁶ California American Water Opening Comments, p. 5.

¹⁷ See RPD, p. 34.

¹⁸ Application, Appendix A, *City of Sand City and California-American Water Company, Inc. Amended and Restated Lease Agreement*, dated as of October 30, 2009 (“Amended Lease”), p. 2.

¹⁹ California American Water Company Opening Comments, p. 5, fn 30.

calculation of connection charges.²⁰ In evaluating the effect of the RPD's inequitable ratemaking proposal on Sand City customers, the Commission should take into account the existing obligation of these customers to pay the substantial MPWMD connection fees.

Sand City undertook the SCDP project at its own considerable risk, to facilitate redevelopment and reduce urban blight. Instead of rewarding Sand City for its initiative and innovative solution to the Monterey water constraints, the RPD targets much needed redevelopment with unfair rates. The Commission should reject the RPD's inequitable ratemaking proposal.

B. The Inability to Update Estimates in the Sand City Surcharge and Balancing Account is Unreasonable

Not only does the RPD treat new or expanded use Sand City customers unfairly, it also prohibits California American Water from updating its estimates for SCDP operational and repair costs for the *entire thirty-one year term of the lease*. The RPD's SCDP surcharge and balancing account allow "only the current estimates for repairs and other operations and maintenance costs, (\$122,764 and \$86,012), to be escalated annually and included in the price for the water delivered from the Plant for the 31-year term of the Lease."²¹

The RPD's stated purpose is to ensure that customers are "shielded from the risk of unexpected cost increases."²² However, to the extent the customers of the Monterey County District benefit from SCDP water, and the increased costs are reasonable, then California American Water should be able to recover those costs from customers, even if it was not able to predict them at this current point in time. It is important to remember that California American Water has only been operating the SCDP for a little over a year. While California American Water believed its estimates were accurate based on conditions and the information available at the time of the application, it is quite possible that unforeseen developments outside California American Water's control could cause costs to increase beyond the rate of inflation at some point

²⁰ See MPWMD Reg. II, Rule 24, available at http://www.mpwmd.dst.ca.us/rules/2010/June/pdfs/RegII/RegII_rule24.pdf

²¹ RPD, p. 31.

²² RPD, p. 31.

over the next three decades. The Commission should modify the RPD to allow the Company to modify its estimates as necessary, as California American Water originally proposed.²³

IV. THE PROPOSED POTABLE WATER APPLICATION IS UNECESSARY

In addition to its inequitable and punitive ratemaking proposal, the RPD also arbitrarily addresses the use of potable water for landscape irrigation. Contrary to the Scoping Memo and without any basis in the record, the RPD sets requirements for a program to use non-potable water for landscaping and directs California American Water to file an application for such a program within 120 days.²⁴ The potable water application would be duplicative of other Commission proceedings and local efforts and contradicts the Commission's Water Action Plan objectives.

A. The Proposed Potable Water Application Would be Duplicative of Other Proceedings

In general, there are three main ways to reduce the use of potable water for landscape irrigation: (1) conservation programs that promote low water use landscaping or eliminate landscaping altogether, (2) rate design that charges higher rates for the portion of a customer's usage that is assumed or estimated to be outdoor water use, and (3) making another source of water available, such as recycled water and providing the extensive piping, pumping and service line and metering networks to carry such water to customers through a non-potable distribution system (for health reasons, recycled water cannot be served to customers through a potable water distribution system). Unlike electricity, where various forms of green energy are transported to customers through existing infrastructure, the same cannot be accomplished by water utilities. Potable water is the only utility consumed by customers and it must meet stringent health requirements that prohibit comingling with partially treated or untreated sources. All of these potential actions are being addressed in currently ongoing Commission proceedings.

California American Water requested funding for landscape conservation programs in its most recent general rate case application (A.10-07-007), including landscape water audits,

²³ California American Water Opening Comments, pp. 17-18; California American Water Reply Comments, pp. 6-7.

²⁴ RPD, p. 31.

outreach and training program, and rebates for rainwater storage, smart controllers, rain sensors, soil moisture sensors, lawn removal and replacement with drought tolerant or permeable landscape (aka Cash for Grass), and synthetic turf.²⁵ As part of that proceeding, California American Water entered into a settlement with DRA and The Utility Reform Network (“TURN”) that addresses California American Water’s conservation program and provides funding for landscape conservation measures such as rain sensor installation, large landscape upgrade grants, WaterWise gardening, and rainwater/greywater education and demonstrations.²⁶ These are all measures designed to reduce the use of potable water for landscaping. A decision has not yet been issued on this settlement.

The assigned commissioner and ALJs recently issued as scoping memo for the second phase of the general rate case.²⁷ Rate design for California American Water’s Monterey County District, including steps to take to discourage the use of potable water for irrigation, will be addressed in Phase 2, beginning with California American Water’s direct testimony on March 30, 2011.²⁸ A key component of Monterey County District rate design is discouraging the use of potable water for landscaping through price signals. The various components of rate design are interdependent, however, and it would be problematic to address the use of potable water for landscaping without also addressing other components, such as the affordability, distribution through the rate tiers, and the impact on the water revenue adjustment mechanism. These rate design components will be examined as a whole in Phase 2 of the general rate case. Since the scope of that proceeding includes an assessment of the entire Monterey water supply situation, addressing the potable water issue outside the general rate case context would be the worst kind of single-issue ratemaking.

²⁵ A.10-07-007, CAW Exh. 17, *Direct Testimony of Monica Na*, dated May 16, 2011, p. 13.

²⁶ A.10-07-007, *Joint Motion for the Adoption of Partial Settlement Agreement Between The Division of Ratepayer Advocates, The Utility Reform Network, and California-American Water Company on Revenue Requirement Issues in The General Rate Case*, Exhibit A, *Partial Settlement Agreement Between The Division of Ratepayer Advocates, The Utility Reform Network and California-American Water Company on Revenue Requirement Issues*, filed July 28, 2011, Section 7.1, pp. 79-82.

²⁷ See A.10-07-007, *Joint Revised Scoping Ruling and Memo of the Assigned Commissioner and Administrative Law Judges*, filed December 12, 2011 (“Revised Scoping Memo”).

²⁸ A.10-07-007, Revised Scoping Memo, pp. 2, 9.

Additionally, the Commission has been examining issues related to recycled water in R.10-11-014. In that proceeding, the Commission is considering many of the same issues that would be raised in the RPD's proposed potable water application, such as recycled water inventory, studies, cost-effectiveness, planning, benchmarks, customer outreach, cost allocation, rate design and incentives, among others.²⁹ The Commission has held two recycled water workshops already and has scheduled two more for 2012.³⁰ By singling out California American Water from other water utilities and requiring a specific non-potable water program – particularly without any evidence on the record – adoption of the RPD would be legal error.

The RPD also ignores the role of MPWMD in discouraging the use of potable water for landscaping.³¹ Certain uses of potable water for landscaping may be considered non-essential water use or water waste and could be subject to MPWMD enforcement actions.³² Moreover, the separate proceeding the RPD proposes would add unnecessary and duplicative costs to Monterey County District customers.

B. The Proposed Potable Water Application Would Contradict the Water Action Plan

Objective #5 of the Commission's Water Action Plan is to "streamline CPUC regulatory decision-making."³³ The Commission is already considering the issues that the RPD recommends that California American Water address in the proposed potable water application in current ongoing proceedings. Requiring California American Water to file an additional application in order to reduce the use of potable water for landscape irrigation goes against the spirit of streamlining Commission decision-making and would be duplicative, inefficient, and costly.

²⁹ R.10-11-014, *Assigned Commissioner's Ruling and Scoping Memo* ("Scoping Memo"), filed June 16, 2011, pp. 4-5.

³⁰ R.10-11-014, Scoping Memo, p. 7.

³¹ MPWMD Reg. XV, Rule 160-A, *available at* http://www.mpwmd.dst.ca.us/rules/2010/June/pdfs/RegXV/RegXV_rule160.pdf.

³² MPWMD Reg. XV, Rule 171, *available at* http://www.mpwmd.dst.ca.us/rules/2010/June/pdfs/RegXV/RegXV_rule171.pdf.

³³ Commission 2010 Water Action Plan, dated October 2010 ("2010 Water Action Plan"), p. 3, *available at* http://www.cpuc.ca.gov/PUC/hottopics/3Water/051109_wateractionplan.htm.

Objective #6 of the Water Action Plan is to “set rates that balance investment, conservation, and affordability.”³⁴ According to the Water Action Plan, the Commission seeks a “more balanced approach that takes into account investment and conservation benefits, as well as rate impacts.”³⁵ The Commission will review rate case revenue requirements in light of their long-term water supply needs in order to ensure that these requirements are justified and adequate, “in terms of long-term cost minimization efforts, investment in conservation, and new water supplies required to meet consumers’ needs.”³⁶ The proposed application thwarts the Water Action Plan’s goal of reviewing rate case revenues in light of their long-term impact. It does not allow for consideration of alternative conservation mechanisms that may be better suited for California American Water specific service area.

C. If the Issue of the Use of Potable Water Landscaping Must Be Addressed, It Should Be Done in Phase 2 of the General Rate Case

The RPD’s failure to comply with Commission rules concerning the scope of issues to be addressed in this proceeding is prejudicial and legally erroneous.³⁷ The separate application that the RPD recommends would be administratively burdensome and would hardly be the best use of the limited resources of the Commission, DRA, California American Water, or interested customer groups. Although California American Water believes that the RPD’s concerns regarding the use of potable water for landscaping are already being adequately addressed, to the extent that the Commission deems it necessary to give this issue further attention, it should do so as part of Phase 2 of California American Water’s general rate case, where the Commission and the parties will be able to evaluate the RPD’s concerns within the context of *all* of the issues affecting the Monterey County District.

³⁴ 2010 Water Action Plan, pp. 3, 31-32.

³⁵ 2010 Water Action Plan, p. 20.

³⁶ 2010 Water Action Plan, p. 20.

³⁷ In 2006, the California Court of Appeal annulled a CPUC decision for failing to proceed in the manner required by law because it addressed in its decision an issue beyond the scope of issues identified in the scoping memo and violated its own rules by considering an issue not identified in the scoping memo. The Court held, “The PUC’s failure to comply with its own rules concerning the scope of issues to be addressed in the proceeding therefore was prejudicial.” *S. Cal. Edison Co. v. Pub. Util. Comm’n*, 140 Cal. App. 4th 1085, 1106 (2006).

V. THE RPD'S DIRECTIVES REGARDING LABOR COSTS ARE CONTRADICTORY

The RPD imposes a quarterly requirement to file and serve a quarterly verified statement showing all personnel and assets are not included in the regulated utility revenue requirement.³⁸ California American Water has requested no incremental labor costs to run the SCDP.³⁹ Existing employees in Monterey, who have already been authorized in revenue requirement during the general rate case, have been able to operate the SCDP. As written, this quarterly requirement would disallow labor expenses that were already authorized and would create the need to change the current revenue requirement. The \$2,599 includes no labor to make up for the disallowance. Disallowing labor while adding the need for additional labor to file a quarterly statement is counterintuitive and unfair. This also demonstrates part of the difficulty of establishing a new tariff for new Sand City customers.

VI. THE SAND CITY CONNECTION FEE IS VALID

Finally, and somewhat confusingly, the RPD claims that the Section 3(c) of the amended SCDP lease is void because it allegedly attempts to fix rates for water service in the Monterey County District other than those approved by the Commission.⁴⁰ The RPD, however, selectively quotes the amended lease, omitting the language that recognizes the authority of the Commission with respect to any connection fees Sand City may charge. Section 3(c) states, in its entirety:

The Parties agree that the City may, in its sole discretion, charge connection fees, hookup charges or similar fees or charges to new or expanded water uses within City's city limits. If City chooses to impose such fees or charges, then such fees or charges, less a reasonable administration fee, shall be paid to the Company within 15 days of the end of the calendar month such charge or fee was collected by the Company. ***Company shall apply such fee in the manner directed by the CPUC.*** (Emphasis provided.)

Contrary to the RPD's arguments, the amended lease recognizes the authority of the Commission over rates and awaits the Commission's direction as to the application of the connection fees. The RPD's errs in concluding that this provision is void and failing to provide

³⁸ RPD, p. 48, Ordering ¶ 3.

³⁹ *Direct Testimony of Eric J. Sabolsice*, served April 12, 2010, p. 5; *Direct Testimony of Jeffrey M. Dana*, served April 12, 2010, p. 9.

⁴⁰ RPD, pp. 34-36, 47, Conclusion of Law ¶ 12.

the necessary direction to California American Water as to the application of these fees.

VII. CONCLUSION

As discussed above, the RPD still contains numerous legal and factual errors. Although the RPD correctly recognizes that California American Water should recover the cost of producing water from the SCDP, its ratemaking approach is inequitable, unreasonable, overly burdensome and based on legal and factual errors. Furthermore, the RPD contradicts the Commission's Water Action Plan objective of streamlining regulatory decision-making by directing California American Water to file a duplicative and unnecessary application. The Commission should correct those errors by revising the RPD as set forth in Appendix A.

December 29, 2011

Respectfully submitted,

MANATT, PHELPS & PHILLIPS, LLP

By: /s/ Lori Anne Dolqueist
Lori Anne Dolqueist

Attorneys for Applicant
California-American Water Company

APPENDIX A

Findings of Fact

1. Cal-Am's Monterey District is and has been experiencing a water supply shortage.
2. In D.09-07-021, the Commission rejected the Sand City Desalination Plant Lease signed on November 5, 2007, between the City of Sand City and Cal-Am, for the Sand City Water Supply Project, a reverse osmosis desalinization facility with a projected annual capacity of 300 acre-foot per year that had been constructed by the City.
3. Thereafter, Cal-Am entered into the Amended Sand City Desalination Plant Lease which requires Cal-Am at its expense to produce 300 acre-feet per year of water ~~regardless of cost~~.
4. Cal-Am is operating the Sand City Desalination Plant and has delivered water to the Monterey District for the use of District customers. Cal-Am's Monterey District revenue requirement does not include any of the costs of the Sand City Desalination Plant.
5. The Amended Sand City Desalination Plant Lease allows the City of Sand City to redirect up to 206 acre-feet per year from serving Cal-Am's existing customers to serving new or expanded uses in Sand City.
6. The reliable supply of water from the Sand City Desalination Plant available pursuant to the Amended Sand City Desalination Plant Lease to reduce Cal-Am's draw from the Carmel River is 94 acre-feet per year.
7. The Amended Sand City Desalination Plant Lease imposes all operating, maintenance, and capital replacement costs on Cal-Am. The City of Sand City will share the costs of capital replacements where the expected usefulness that will exceed the term of the lease.
8. ~~The Amended Sand City Desalination Plant Lease exposes Cal-Am to significant operational and financial risk because Cal-Am must produce 300 acre-~~

~~feet of potable water each year of the 31-year term regardless of cost.~~

9. The terms of the Amended Sand City Desalination Plant Lease ~~do not~~ meet the Monterey District system needs ~~or~~ and serve existing District customer interests because, among other things, Cal-Am is obligated to produce 300 acre-feet per year of water, very little of which is currently being used by the City of Sand City and which is being used by California American Water to offset withdrawals from the Carmel River ~~but only has reliable access to 94 acre-feet per year.~~

10. Cal-Am's decision to deploy management and capital resources in pursuing the Sand City Desalination Plant lease was ~~not~~ reasonable and prudent.

~~11. All management and capital costs associated with the Sand City Desalination Plant should be removed from any Cal-Am ratemaking recovery requests, including but not limited to any memorandum account and its current general rate case, except as authorized in the Sand City Desalination Plant Purchased Water Balancing Account and Surcharge.~~

12. No evidentiary hearing was necessary for this proceeding.

13. Cal-Am proposed an alternative ratemaking treatment for costs of the Sand City Desalination Plant with \$414,677 included in revenue requirement each year of the 31-year term of the lease for the lease payments, and memorandum accounts or general rate case treatment for costs of operations and maintenance, repairs, and purchased power.

14. Cal-Am's proposed \$414,677 per year for the term of the Sand City Desalination Plant lease is a reasonable proxy for fixed costs over the expected life of the Plant.

15. The escalation rates for expense items in attrition years in Section VII of the Rate Case Plan adopted in D.07-05-062, or its successor, are reasonable escalation rates for current estimates of the operations and maintenance and

repair expenses to be included in the Sand City Desalination Plant Purchased Water Balancing Account and Surcharge.

~~16. Amended Sand City Desalination Plant Lease Section 3(c) does not relate to the authority of the City of Sand City to issue building permits or development entitlements.~~

17. Amended Sand City Desalination Plant Lease Section 3(c) purports to authorize the City of Sand City to set and collect a connection or hook up fee for new or expanded use connections in Sand City public utility water service in Cal-Am's Monterey District and then give the money collected, minus an administrative fee, to Cal-Am. California American Water shall apply such fee in the manner directed by the Commission.

18. Amended Sand City Desalination Plant Lease recital 15 states that "the Monterey Peninsula Water Management District currently charges connection fees to new or expanded water connections with Company's service area." The current connection fee is \$23,567 per acre-foot, and MPWMD escalates the connection fee annually 1% to 5%. Connection fees for the entire 206 acre-feet available for new or expanded uses in Sand City will total approximately \$6 million.

~~19. The use of potable water for landscape irrigation is unreasonable in the Monterey District due to the severe supply restrictions.~~

~~20. Cal-Am has not exhausted the unique features of the Monterey District to reduce Carmel River withdrawals. Among these features is the potential for further limiting the use of potable water in landscape irrigation and aggressively pursuing opportunities to reduce unaccounted for water.~~

Conclusions of Law

1. The Amended Sand City Desalination Plant Lease is not reasonable and

prudent because it exposes Cal-Am to the significant operational and financial risk of producing 300 acre feet of potable water each year of the 31-year term regardless of cost, and the Lease retains the authority to designate the bulk of the water production for new and expanded residential and commercial development in Sand City, rather than reduction of provides an additional source of water to reduce Cal-Am's withdrawals from the Carmel River.

2. Cal-Am's request to include in Monterey District revenue requirement the annual lease payments to the City of Sand City pursuant to the Amended Sand City Desalination Plant Lease should be granted ~~denied~~.

3. Cal-Am's request to establish balancing accounts to recover in the Monterey District revenue requirement the operating, maintenance, and repair costs of the Sand City Desalination Plant Amended Lease should be granted ~~denied~~ because the balancing accounts have the effect of transferring to customers all the operational risk of the Plant.

[ALTERNATIVE: California American Water's alternative ratemaking proposal is adopted.]

4. ~~Cal-Am should remove all management and capital costs associated with the Sand City Desalination Plant from any existing ratemaking recovery requests, including but not limited to its existing memorandum account and its current general rate case and instead should recover costs of the Sand City Desalination Plant only through the specific ratemaking mechanisms authorized by today's decision.~~

5. ~~Cal-Am should be authorized to collect a surcharge for the reasonable costs of water produced at the Sand City Desalination Plant and delivered to the Monterey District for the use of District customers.~~

6. The annual amount for lease payments offered by Cal-Am in the alternative ratemaking proposal is a reasonable proxy for the fixed costs of the

Sand City Desalination Plant over the life of the plant. California American Water may update its estimated costs as part of the general rate case process as necessary.

~~7. Escalating current forecasts of repair and operations and maintenance costs is a sound ratemaking methodology to compensate Cal-Am for reasonable costs while at the same time protecting ratepayers from the financial risk inherent in Cal-Am's Amended Sand City Desalination Plant Lease.~~

~~8. The actual costs of electric power purchased from a Commission-regulated public utility are reasonable costs to be included in the price of purchased water from the Sand City Desalination Plant.~~

~~9. Cal-Am should be authorized to file a Tier 2 Advice Letter creating the Sand City Desalination Plant Purchased Water Surcharge and Sand City Desalination Plant Purchased Water Balancing Account.~~

~~10. No later than 180 days before providing service, Cal-Am should file a Tier 2 Advice Letter to create a Sand City Moratorium Exemption Service Tariff for any new water service connection provided in Sand City while Cal-Am's Monterey District service connection moratorium remains in effect. Water service provided under the Sand City Moratorium Exception Service Tariff shall include all amounts included in the Monterey District revenue requirement, with the exception that water supply costs shall be the actual costs incurred by Cal-Am for water production at the Sand City Desalination Plant in the 12 months immediately preceding the filing of the Advice Letter.~~

~~11. This Commission has exclusive authority pursuant to the California Constitution and the Public Utilities Code to fix the rates for public utility water service provided by Cal-Am in its Monterey District. Amended Sand City Desalination Plant Lease Section 3(c) attempts to fix rates different than the rates approved by this Commission for public utility water service in Cal-Am's~~

~~Monterey District, this intruding on this Commission's authority to fix rates, and is therefore void.~~

12. Amended Sand City Desalination Plant Lease recital 15 regarding the Monterey Peninsula Water Management District's "connection fee" does not and cannot grant any authority to the District that it does not otherwise have.

~~13. Cal Am should be required to file an application with a program to move toward significantly reducing the use of potable water for landscape irrigation.~~

14. This decision should be effective today.

15. This proceeding should be closed.

ORDER

IT IS ORDERED that:

1. California-American Water Company's request for authorization to increase its Monterey District revenue requirement to reflect the annual payments to the City of Sand City for the Sand City Desalination Plant is granted denied. [ALTERNATIVE: California American Water's alternative ratemaking proposal is adopted.] California American Water may update its estimated costs as part of the general rate case process as necessary.

2. California-American Water Company's request for authorization to increase its Monterey District revenue requirement to reflect the operations, maintenance, and capital replacement costs of the Sand City Desalination Plant is granted denied.

~~3. If, and to the extent, California American Water Company (Cal Am) decides to have a role in operating the Sand City Desalination Plant, Cal Am must file and serve quarterly verified statements showing that personnel and assets used in operating the Plant are not included in any regulated utility revenue requirement, other than as authorized pursuant to the Sand City~~

~~Desalination Plant Surcharge and the Sand City Moratorium Exemption tariff.~~

~~4. No later than 45 days after the effective date of this order, California American Water Company must file and serve in this proceeding a compliance statement and accounting showing that it has removed all expense and capital costs associated with the Sand City Desalination Plant from any ratemaking recovery requests, including but not limited to any existing memorandum account and its current general rate case, other than as authorized pursuant to the Sand City Desalination Plant Surcharge and the Sand City Moratorium Exemption tariff.~~

~~5. California American Water Company must file and serve within 120 days of the effective date of today's decision an application setting forth a program to reduce the use of potable water for landscape irrigation in the Monterey District:~~

- ~~a. Gradually implemented but mandatory restrictions on the use of potable water for landscape irrigation based on time of year or Carmel River levels;~~
- ~~b. Each year, projects sufficient to produce no less than 300 acre-feet per year of additional alternative sources of irrigation water or reduced potable water demand;~~
- ~~c. Customer education plan to inform customers that the use of potable water for landscape irrigation is highly disfavored, will be subject to increasing restrictions and higher prices, and ultimately may be prohibited; and~~
- ~~d. Other innovative programs, projects, pilots, experiments, or other measures that may be reasonably designed to reduce the use of potable water for landscape irrigation.~~

~~6. California American Water Company is authorized to file and serve a Tier 2 Advice Letter establishing the Sand City Desalination Plant Purchased Water Surcharge. Such surcharge must provide for recovery of amounts properly~~

~~recorded in the Sand City Desalination Plant Purchased Water Balancing Account, and shall apply to all volume tiers of service in systems subject to the service connection moratorium in D.11-03-048.~~

~~7. California American Water Company is authorized to file and serve a Tier 2 Advice Letter establishing the Sand City Desalination Plant Purchased Water Balancing Account. Such balancing account must include the annual cost of water provided from the Sand City Desalination Plant and used to reduce the Monterey District's withdrawals from the Carmel River subject to the limitations set forth below:~~

- ~~a. Only costs for actual water delivered, measured in acre feet, may be included.~~
- ~~b. The price for each acre foot of water delivered shall be determined annually. Below is the calculation for the first year of the Sand City Desalination Plant Purchased Water Balancing Account. The fixed cost and annual plant production amounts are permanently established; other amounts shown are subject to change, as specified below, in the ensuing years that the Plant produces water for delivery to the Monterey District system:~~

Fixed cost	\$ 414,672
Escalated costs	
Repair Costs	\$ 122,764
Other O&M	\$ 86,012
Actual Purchased Power	\$ 156,374
COST TOTAL	\$ 779,822

Annual Plant Production	300 acre feet
Price per acre foot	\$ 2,599

~~Fixed Cost: this amount shall not change for each year of the 31-year contract, shall not be subject to further review, escalation, or modification, and may in no way be increased to reflect any other cost related to the Sand City Desalination Plant.~~

~~Escalated Costs: shall use the amounts specified above as the base amount for 2012 and may be annually escalated using the ratemaking formula for expense items in attrition years as set forth in Section VII of the Rate Case Plan in D.07-05-062 or its successor.~~

~~Actual Purchased Power: shall be forecasted in each general rate case and tried up annually to actual costs incurred.~~

~~Annual Plant Production: this amount shall not change for each year of the 31-year contract, shall not be subject to further review, modification, and may in no way be decreased to reflect any operational changes at the Sand City Desalination Plant, but this amount must be increased to reflect increased production at the Plant.~~

- ~~c. Interest on all amounts properly recorded in the balancing account, less debits, shall accrue at the 90-day commercial paper rate as specified in Utility Standard Practice U-27-W (May 2008) or its successor.~~
- ~~d. California American Water may include in the balancing account all water delivered from and after the date of this decision.~~

~~8. California American Water is authorized to include in the Sand City Desalination Plant Purchased Water Balancing Account \$2,599 per acre-foot for water delivered to the Monterey District system from the Sand City Desalination Plant prior to the effective of today's decision, to the extent such costs were properly recordable in a memorandum or balancing account at the time the costs were incurred. California American Water Company must include in its Advice Letter creating the Sand City Desalination Plant Purchased Water Balancing Account an auditable accounting of the actual monthly water production from the Plant delivered to the Monterey District. Such production, measured in acre-feet, must be priced at \$2,599 per acre-foot delivered. The resulting total price for~~

~~water delivered may be included in the Sand City Desalination Plant Purchased Water Balancing Account Surcharge and amortized over a period of not less than twelve months. For the period prior to the effective date of this decision, interest shall accrue as specified for the memorandum or balancing account in which the costs were properly recordable at the time they were incurred, based on allowable costs of \$2,599 per acre foot. From and after the effective date of this decision, the interest rate on such amounts shall be as specified for other amounts recorded in the Sand City Desalination Plant Purchased Water Balancing Account.~~

~~9. So long as the service connection moratorium established in Decision 11-03-048 remains in effect for the Monterey District, California American Water Company must file a Tier 3 Advice Letter and obtain Commission authorization for a Sand City Moratorium Exemption Service tariff no less than 180 days prior to the proposed date for commencing such service. The Sand City Moratorium Exemption tariff must provide that new service connections in Sand City shall be subject to California American Water's Monterey District tariffs, with the exception that the water supply price for such service shall be based solely on the actual costs of the Sand City Desalination Plant. To determine such actual costs, California American Water Company must include in its Advice Letter creating the Sand City Moratorium Exemption tariff an auditable accounting of the actual costs of water production at the plant for the 12 months immediately preceding the Advice Letter filing. Water delivery, other district system costs, overheads, cost allocation, and rate design, and all other requirements for Monterey District customers shall be as authorized by the Commission in the Monterey District's most recent general rate case. The Advice Letter filing shall include work papers and other supporting documents necessary to demonstrate the calculations of the Exemption tariff rate. To the extent water from the Sand City Desalination Plant~~

~~is used to serve customers pursuant to the Sand City Moratorium Exemption Service tariff, that water production shall be excluded from the Sand City Desalination Plant Purchased Water Balancing Account and Surcharge.~~

10. ~~Amended Sand City Desalination Plant Lease Section 3(c) is void and shall be of no force and effect.~~

11. Application 10-04-019 is closed.

This order is effective today.

12. Dated _____, at San Francisco, California.