

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Application of California-American Water Company
(U210W) for Authorization to Implement the Carmel
River Reroute and San Clemente Dam Removal
Project and to Recover the Costs Associated with the
Project in Rates.

A.10-09-018
(Filed September 22, 2010)

**CALIFORNIA-AMERICAN WATER COMPANY REPLY COMMENTS ON THE
ALTERNATE PROPOSED DECISION OF COMMISSIONER SANDOVAL**

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May 21, 2012

EXECUTIVE SUMMARY

DRA's comments contain numerous misstatements and unsupported claims, which CAW briefly addresses below. In its reply comments, CAW will discuss the key issues in more detail. The CPUC should disregard DRA's comments and adopt the APD as indicated in CAW's opening comments.

DRA Claim	Correction/Explanation
The APD ignores the record.	The APD consistently cites to the record and CPUC policy and precedent to support its conclusions and recommendations. By contrast, the RPD systematically omits, ignores, or mischaracterizes key facts.
The APD provides more relief than CAW sought in its application with respect to recovery of estimated costs and the authorized rate of return.	In its application and supporting testimony CAW explained that it was seeking to include estimated costs in the regulatory asset and would be seeking its authorized rate of return.
Under the APD, the average customer will see a nearly 30% increase on their bill, or an \$11.33 monthly surcharge.	If the APD adopts a flat percentage increase, the increase will be limited to 15.78% of each customers base bill and the average customer will see a \$5.99 surcharge.
The SCD is not used and useful in providing water service.	The SCD is currently used as an authorized point of redirection for water diverted at Los Padres Dam. The SCD is also an authorized point of diversion for water for ASR and CAW may withdraw water at the SCD during high-flow periods and emergencies.
In its pursuit of dam buttressing, CAW only addressed DSOD's requirements.	CAW pursued dam buttressing and dam removal on parallel tracks in order to address the concerns of both DSOD and NMFS.
CAW's pursuit of buttressing delayed the resolution of the seismic safety issues.	Any delay was not due to lack of CAW effort but to lack of a viable dam removal option and the complexity of the issues.
Dam buttressing was never viable.	NMFS never definitively stated whether it would issue a jeopardy opinion. It could be possible to modify the dam buttressing alternative to address NMFS's concerns.
The APD's cost cap does not provide adequate protection to customers.	The APD's cost cap incents CAW to manage costs, but avoids unfairly penalizing CAW for costs beyond its control.
There was no reasonableness review of the pre-2002 costs.	DRA previously reviewed these costs and found them reasonable, and had more than enough data to conduct a reasonableness review in this proceeding. The APD states that it conducted a review of "actual invoices."
Information about QBS was not provided until rebuttal testimony.	CAW provided information regarding the requirement to use QBS processes as part of discovery.
The APD will allow estimated costs of the Project to be recovered from customers without future CPUC approval.	The difference between the surcharge collected based on the revenue requirement estimated costs and the actual revenue requirement based on approved final costs will be tracked in a balancing account and trued up.
CAW failed to properly maintain the SCD.	According to DRA's own expert, CAW's management is in keeping with accepted industry practice.
CAW's actions with respect to sediment exacerbated the SCD's seismic issues.	According to DRA's own expert, the SCD's safety issues are not related to sedimentation accumulation.
The 77.6 acre parcel should be part of the Project.	The 77.6 acre parcel is unrelated to the Project and is currently being used to provide service to customers.
The facilities located on the 77.6 acre parcel could be easily moved.	The 1.5 million gallon reinforced concrete water storage tank cannot be moved.

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I. INTRODUCTION

California-American Water Company (CAW) hereby submits its reply comments on the *Alternate Proposed Decision of Commissioner Sandoval* (APD), in which it will address comments by the Division of Ratepayer Advocates (DRA) and the Planning and Conservation League Foundation (PCLF).¹ The APD corrects the errors in the revised *Proposed Decision of ALJ Walwyn* (RPD) and appropriately authorizes recovery of CAW's cost of the Carmel River Reroute and San Clemente Dam Removal Project (Project) and the costs in the San Clemente Dam (SCD) memo account.² The CPUC should adopt the APD as requested in CAW's opening comments.

II. DRA COMMENTS

DRA's comments are filled with misstatements and unsupported claims. DRA uses the terms "managerial negligence" and even "malfeasance"³ – without any citations to support its accusations. DRA also claims that the APD includes "legal errors," yet does not provide cites to support its claims and fails to show that the evidence contradicts the APD. It is not legal error to disagree with DRA. The CPUC should give DRA's comments no weight.

A. Rate Impact

DRA's claim that the APD will result in a 30% rate increase is incorrect.⁴ CAW recommends that the CPUC adopt a flat percentage of base bill surcharge until the revenue requirement for the Project is included in base rates.⁵ The table below shows that this method would limit the increase to 15.78% of each customers' base bill.⁶

	Usage (ccf)	Monthly Bill ⁷	Project Increase (\$)	Project Increase (%)
residential	3	\$21.12	\$3.33	15.78%
	5	\$28.90	\$4.56	15.78%
	7	\$37.98	\$5.99	15.78%
	8	\$44.48	\$7.02	15.78%
	16	\$146.58	\$23.13	15.78%
commercial	62	\$348.97	\$55.07	15.78%

B. Used and Useful

DRA incorrectly claims that the APD errs in finding that the SCD is used and useful.⁸ DRA makes much of the SCD's limited water storage capacity,⁹ despite the fact that it is the ability to divert water, not the storage capacity, that has more bearing on the SCD's usefulness. The SCD is currently used as a point of redirection for

¹ Water Plus served its "response" to the APD on May 15, 2012. By email, ALJ Walwyn indicated that this "response" should be considered as reply comments on the APD. CAW will address Water Plus's request for party status in a separate pleading.

² DRA falsely claims that the APD relies largely on representations made in ex parte meetings instead of the record. (DRA Comments, p. 1.) Tellingly, DRA does not provide a single example to support its outrageous claim. Review of the APD easily disproves DRA's allegation, as the APD consistently cites to the record and CPUC policy and precedent to support its conclusions and recommendations.

³ Malfeasance is an affirmative act that is wrongful or illegal. (*Jewell v. United States*, 548 F.3d 1168 (8th Cir. Ark. 2008).) There is **nothing** on the record to support such a claim.

⁴ DRA Comments, p. 2. DRA applies the surcharge as a flat dollar amount per CCF.

⁵ See CAW Comments, pp. 4-5.

⁶ \$7,631,186 Project annual surcharge ÷ \$48,359,000 2012 Monterey revenue requirement = 15.78%. (APD, Appendix 2, Table 2.1.)

⁷ Excluding surcharges. (See DRA Comments, p. 3.)

⁸ DRA Comments, pp. 3-6.

⁹ DRA Comments, pp. 4-6.

water diverted at Los Padres Dam¹⁰ – a fact DRA conveniently ignores. The SCD is also an authorized point of diversion for water for ASR and CAW may withdraw water at the SCD during high-flow periods and emergencies.¹¹

The CPUC has held that facilities of only limited or emergency use are still considered “used and useful.” For example, a hydroelectric dam was “used and useful” even though it served only 0.03% of total peak load and was “not necessary to provide electricity to California customers.”¹² Additionally, utility assets that serve back up or emergency functions, even if not relied on regularly, are commonly found to be used and useful utility assets.¹³ The SCD is a utility asset that serves as a back up for system management and reliability in the event of an emergency – in addition to its current use as a redirection. As such, the SCD “is used and useful in providing water service.”¹⁴

C. Recovery of Historical Costs

The historical costs tracked in the memo account, which the APD approves, are compliance costs. It is well established that a utility must comply with the rules and regulations of other state agencies¹⁵ and compliance costs are generally recoverable.¹⁶ CAW incurred the historical costs to comply with Division of Safety of Dams (DSOD) directives.¹⁷ To deny recovery of compliance costs here would constitute grave legal error.

1. Buttressing

The APD correctly found that CAW’s pursuit of dam buttressing “was prudent, reasonable and appropriate.”¹⁸ DRA argues that this is legal error because CAW did not address the concerns of the National Oceanic and Atmospheric Administration’s National Marine Fisheries Service (NMFS), as well as those of DSOD.¹⁹ DRA ignores, however, the extensive evidence of CAW’s actions to address NMFS’s concerns. CAW spent years working with NMFS and others and hundreds of thousands of dollars on studies to develop a feasible dam removal

¹⁰ CAW Exh. 1, Schubert Direct, pp. 4-5; CAW Exh. 4, Schubert Rebuttal, pp. 3, 34.

¹¹ CAW Exh. 4, Schubert Rebuttal, pp. 34-35. The record shows under certain circumstances, the SCD would be the **only** option available in an emergency. RT 347:19-348:15 (Schubert/CAW).

¹² D.07-03-037, *Application of PacifiCorp For Approval of the Sale of the Upper Beaver Hydroelectric Project to the City of Beaver, Utah*, 2007 Cal. PUC LEXIS 407 *14.

¹³ D.05-12-020, *Application of Apple Valley Ranchos Water Company for Authority to Increase Rates*, 2005 Cal. PUC LEXIS 533, *65; D.94-10-044, *Application of Southern California Edison Company For Authority to Encumber Certain Fuel Oil Pipeline and Storage System Facilities*, 1994 Cal. PUC LEXIS 683, *12; D.01-02-059, *Application of Southern Edison Company for Authority to Sell Its Fuel Oil Pipeline Facilities*, 2001 Cal. PUC LEXIS 138, *3

¹⁴ See Pub. Util. Code § 789.1(e), cited by DRA. DRA Comments, p. 6.

¹⁵ *Orange County Air Pollution Control Dist. v. Public Utilities Com.*, 4 Cal. 3d 945, 950-951 (Cal. 1971), 1971 Cal. LEXIS 371.

¹⁶ D.95-11-035, *Order Instituting Investigation on the Commission's own motion to develop a policy governing utility involvement in the market for low-emission vehicles*, 1995 Cal. PUC LEXIS 978; D.07-05-026, *Application of Pacific Gas and Electric Company (U 39 E) for Review of and Authorization to Recover Unreviewed Transaction Costs Associated with the Planned Divestiture/Market Valuation of Generation Assets*, 2007 Cal. PUC LEXIS 144, *11; D.04-08-053, *Application of the SOUTHERN CALIFORNIA WATER COMPANY (U 133 W) for an order authorizing it to increase rates for water service*, 2004 Cal. PUC LEXIS 605, *16; D.07-03-044, *Application of Pacific Gas and Electric Company (U 39-M) for Authorization, Among Other Things, to Increase Rates and Charges for Electric and Gas Service*, 2007 Cal. PUC LEXIS 173, *76-77; see also Res. W-4885, *Order Authorizing Surcharges to Recover \$5,740,078, or an Increase of 2.62% in Annual Metered Revenue, for Lost Revenues Due to Mandatory Conservation*, December 15, 2011.

¹⁷ The DSOD has comprehensive jurisdiction over the maintenance and operation of dams within California. (Wat. Code § 6076.) DSOD may require owners to perform any and all investigations and studies necessary to safeguard life and property (*Id.* at §§ 6102, 6120) and if DSOD deems that a dam is unsafe, the owner to must obey DSOD directives to remove the danger to life and property (*Id.* at § 6081).

¹⁸ APD, p. 20.

¹⁹ DRA Comments, p. 7.

alternative.²⁰ The delay in developing a viable dam removal alternative was not due to any lack of effort by CAW, but to the complexity of the engineering, technical, and financial issues.²¹ CAW's obligation to meet DSOD's seismic safety concerns meant that it could not commit to a dam removal project until that option's feasibility was confirmed. DRA's claim – that CAW should have rejected buttressing, the lower cost project preferred by the lead agency, and insisted on an unviable dam removal option as its preferred project²² – simply does not make sense.

2. Pre-2002 Costs

DRA falsely claims that the APD approves the pre-2002 costs without a reasonableness review.²³ First, DRA reviewed the pre-2002 costs in an earlier proceeding and agreed that they were reasonable.²⁴ Second, even if it had not, DRA had ample opportunity to review the pre-2002 costs in this case.²⁵ Third, as shown, there is ample evidence in the record to allow the CPUC determine the reasonableness of the charges. Indeed, the APD states that it conducted a “review of the actual invoices.”²⁶ DRA's contention has no merit and should be ignored.²⁷

D. Recovery of Estimated Costs

DRA alleges that the APD provides CAW with more relief than it requested by including estimated costs in the regulatory asset earning CAW's authorized rate of return.²⁸ In the Application, however, CAW noted that most of costs that it seeks to include in the regulatory asset are estimated costs.²⁹ Moreover, CAW has always made it clear that it seeks to earn its authorized rate of return on these costs.³⁰ Furthermore, contrary to DRA's claims, the APD will not provide for recovery of estimated costs without further review or approval from the CPUC.³¹ The estimated costs determine the annual revenue requirement for the Project regulatory asset, but the difference between the

²⁰ CAW Exh. 1, Schubert Direct, pp. 6-11; CAW Exh. 4, Schubert Rebuttal, pp. 11-16; CAW Exh. 1, Chapman Direct, pp. 3-6; CAW Exh. 3, Chapman Rebuttal, pp. 2-4; CAW Exh. 3, Ambrosius Rebuttal, pp. 4-5; PCLF Exh. 39, Minton Rebuttal, pp. 3, 5.

²¹ PCLF Exh. 39, Minton Rebuttal, p. 6; CAW Exh. 1, Schubert Direct, pp. 5-11; CAW Exh. 4, Schubert Rebuttal, pp. 12-16, 40-48, 51-52.

²² DRA Comments, pp. 6-8.

²³ DRA Comments, p. 9-10.

²⁴ RT 569:20-28 (Rauschmeier/DRA); see CAW Exh. 3, Stephenson Rebuttal, Attachment 1; CAW Exh. 36, DRA Response to CAW 3.2, dated May 26, 2011.

²⁵ CAW provided an itemized list, by category, of all of the costs that it had tracked in the SCD memorandum account and a thirty-four-page list, by category, of every invoice and individual charge, with descriptions for 1,114 individual charges (pre-2002 and post-2002), as well as extensive supporting testimony. (CAW Exh. 10, Application Supplement, Appendices A-B; CAW Exh. 5, CAW Supplemental Filing, Appendix 1, Vol. 1 of 2; CAW Exh. 6, CAW Supplemental Filing, Appendix 1, Vol. 2 of 2; CAW Exh. 1, Schubert Direct, pp. 5-11; CAW Exh. 2, Schubert Supplemental Direct, pp. 2-3, 9-16, Appendices A-B; CAW Exh. 4, Schubert Rebuttal, pp. 4-33, Attachments 1-13; CAW Exh. 3, Stephenson Rebuttal, pp. 3-11, Attachments 1-2.) DRA had nearly six months to examine this information. Although CAW offered to provide copies of pre-2002 invoices upon request, DRA did not ask, so CAW included them as a rebuttal attachment in the interest of having a complete record. (See CAW Exh. 10, Application Supplement, p. 8; CAW Exh. 4, Schubert Rebuttal, pp. 11-26, Attachment 4.)

²⁶ APD, p. 27.

²⁷ DRA also argues that the APD errs in approving certain historical costs because CAW did not address its qualifications-based selection process (QBS) until rebuttal. (DRA Comments, p. 10.) First, CAW provided information regarding the policy the use of QBS as part of the discovery process. (DRA Exh. 24, CONFIDENTIAL DRA Report, CONFIDENTIAL Attachment 3-13) Second, CAW provided **thousands** of pages of documentation of its costs to DRA as support for its application. No matter how much support is provided, however, it is inevitable that DRA or others will seek additional information or raise new issues. To discount any evidence developed through discovery or rebuttal, as DRA recommends, would make a mockery of the CPUC's process.

²⁸ DRA Comments, pp. 1, 14

²⁹ CAW Exh. 8, Application, pp. 10-11.

³⁰ CAW Exh. 1, Stephenson Direct, p. 13.

³¹ DRA Comments, pp. 10-11.

revenue requirement collected via surcharge and the revenue requirement for the “actual **approved** final costs” will be tracked in a balancing account³² and trued up.³³

E. Cost Cap

DRA argues that the APD commits legal error by allowing CAW the opportunity to recover reasonable costs above the \$49 million cost cap.³⁴ DRA provides little support for its position, other than contending that it is “wrong.”³⁵ DRA ignores the evidence, *including testimony from its own witness*, that CAW could incur reasonable costs above the \$49 million cost cap.³⁶ Moreover, the CPUC has adopted a similar approach for a comparably complex CAW project³⁷ and for projects in other industries.³⁸ Despite DRA’s claims, the APD’s proposal incents CAW to manage the Project responsibly, but avoids unfairly penalizing CAW for costs beyond its control.

F. Rate of Return

Contrary to DRA’s claims of “\$30 million profit,”³⁹ the rate of return is based on CAW’s costs. As CAW explained, “Costs to the corporation are the costs of debt and the expected cost equity shareholders would expect to receive in return..It’s based on the cost that we will incur.”⁴⁰ The APD’s use of CAW’s authorized rate of return is not legal error and is supported by CPUC precedent. For example, removal costs are capitalized,⁴¹ allowing the utility to earn its authorized rate of return on such costs. Since the Project involves removing a plant facility at the end of its useful life, CAW should be able to earn its authorized rate of return on the Project costs. Additionally, if CAW had gone forward with buttressing, the costs would have been capitalized⁴² and CAW would have been entitled to its authorized rate of return. Since it would have earned its authorized rate of return for buttressing, CAW should similarly earn its authorized rate of return on Project costs. Finally, the length of the cost recovery period influences the correct rate of return. When the recovery period is reduced, the rate may also be reduced.⁴³ With the

³² APD, p. 56, Ordering ¶¶ 3.m (emphasis added).

³³ CAW Exh. 1, Stephenson Direct, p. 20.

³⁴ DRA Comments, p. 9; APD, p. 26.

³⁵ DRA Comments, p. 9.

³⁶ RT 481:28-482:29 (Hoglund/DRA); see CAW Exh. 4, Schubert Rebuttal, p. 36.

³⁷ D.10-12-016, *Application of California-American Water Company for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project*, 2010 Cal. PUC LEXIS 548, **94-95.

³⁸ D.10-04-034, *Application of Southern California Gas Company (U904G) to Amend its Certificate of Public Convenience and Necessity for the Honor Rancho Natural Gas Storage Facility*, 2010 Cal. PUC LEXIS 144, *32-*35.

³⁹ DRA Comments, p. 13. DRA also claims, without support, that CAW should not earn its authorized rate of return because CAW’s alleged “failure to properly maintain the dam exacerbated the seismic safety issues.” DRA Comments, p. 12. The record shows, however, that CAW’s maintenance is in keeping with current practices, and that the seismic issues are unrelated to sedimentation. See Exh. 23, Public DRA Report, Attachment 7-2, p. 15.

⁴⁰ RT 297:23-298:2 (Stephenson/CAW).

⁴¹ D.88-01-061, *Investigation on the Commission’s own motion into the methods to be utilized by the Commission to establish the proper level of expense for ratemaking purposes for public utilities and other regulated entities due to the changes resulting from the 1986 Tax Reform Act*, 1988 Cal. PUC LEXIS 102, **37-39; see also D.10-04-034, *Application of Southern California Gas Company (U904G) to Amend its Certificate of Public Convenience and Necessity for the Honor Rancho Natural Gas Storage Facility*, 2010 Cal. PUC LEXIS 144.

⁴² D.06-05-016, *Application of Southern California Edison Company (U 338-E) For Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service in 2006, And to Reflect That Increase in Rates*, 2006 Cal. PUC LEXIS 18,*331.

⁴³ D.11-05-018, *In re Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Rates and Charges for Electric and Gas Service Effective on January 1, 2011*, 2011 Cal. PUC LEXIS 275,*89-*91.

Project's 20-year recovery period, no reduction to the authorized rate of return is justified.

G. Land Transfer

The APD correctly finds that a 77.6 acre parcel on which CAW facilities are currently located should not be lumped in with the 928 acres to be donated to the Bureau of Land Management (BLM) and that the CPUC's existing gain on sale rules will apply to any future disposition of the parcel.⁴⁴ DRA recommends that the 2007 appraisal value of the parcel be used to offset to the cost of the Project.⁴⁵ As the record shows, however, the parcel is unrelated to the Project⁴⁶ and is being used to provide water service,⁴⁷ meaning CAW is unlikely to sell.⁴⁸ Additionally, the CPUC's established guidelines for allocation of gains from the sale of utility real property⁴⁹ will prevent CAW from experiencing the "windfall" that DRA claims.⁵⁰ DRA's (and the RPD's)⁵¹ proposal would constitute legal error since it would circumvent the existing gain on sale requirements.

III. PCLF COMMENTS

PCLF raises the issue of further study of the sediment accumulation at the Los Padres Dam, upstream of the SCD.⁵² CAW is planning to propose a more robust evaluation of the Los Padres Dam in its next GRC⁵³ that will encompass a review of requirements for alternatives and remediation, depreciation, net negative salvage, and cost of removal. CAW therefore supports the recommendation study be noted in the final decision.

IV. CONCLUSION

For the abovementioned reasons, CAW urges the CPUC to disregard DRA's comments and adopt the APD with the clarifying changes discussed in CAW's opening comments.

⁴⁴ APD, p. 39.

⁴⁵ DRA Exh. 23, Public DRA Report, p. 8-6. DRA also claims that removal of the existing facilities would be easy. However, a 1.5 million gallon reinforced concrete water storage tank is hardly "easily moved." Even if a new location could be found (difficult in light of the steep terrain), the tank would have to be demolished and a new tank constructed, triggering the need for permitting. (See RT 342:26-343:1 (Schubert/CAW).) The adjacent facilities would have to be relocated or reconfigured, and additional facilities could be necessary.

⁴⁶ CAW Exh. 37, *California American Water Response to MZX 5-3, Application No.s 08-1-022, 08-01-023, 08-01-024 & 08-01-027*; RT 330:7-9 (Schubert/CAW).

⁴⁷ CAW Exh. 4, Schubert Rebuttal, p. 57; RT 331:17-23 (Schubert/CAW).

⁴⁸ RT 335:24-336:27 (Schubert/CAW).

⁴⁹ See D.06-05-041, *Order Instituting Rulemaking on the Commission's Own Motion for the Purpose of Considering Policies and Guidelines Regarding the Allocation of Gains from Sales*, 2006 Cal. PUC LEXIS 291

⁵⁰ DRA Comments, p. 14.

⁵¹ The RPD directed CAW to include the 77.6 acre parcel as part of the Reroute and Removal Project and credit any monetary value for disposition of the parcel in full to CAW customers. RPD, p. 34.

⁵² PCLF Comments, pp. 2-3.

⁵³ In D.09-07-021, the CPUC approved a settlement agreement that included funding of \$200,983 for a preliminary dredging feasibility study for the Los Padres Dam. (D.09-07-021, *Application of California-American Water Company (U210W) for Authorization to In-crease its Revenues for Water Service in its Monterey District*, 2009 Cal. PUC LEXIS 346, *201-*202.) The study, to be completed in 2012, will include an assessment of existing reservoir conditions and data, sedimentation characterization, and an evaluation of alternative dredging, transportation, and disposal methods. The next GRC application is scheduled to be filed in July 2013, and the new study would be planned to be performed within the three year period of this GRC (i.e., 2015 to 2017). CAW will also seek input from NMFS and Cal Dept. of Fish and Game (CDFG), since CAW would want to insure adequate environmental work is included in the study so that Endangered Species Act compliance and mitigation measures for the steelhead are addressed. Finally, it should be recognized that this study would need to be closely coordinated with NMFS, CDFG, several federal and state regulatory agencies, and other Carmel River stakeholders.

May 21, 2012

Respectfully submitted,

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