

Decision **PROPOSED DECISION OF ALJ ROCHESTER** (Mailed 5/25/2010)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for Authorization to increase its Revenues for Water Service in its Larkfield District by \$648,100 or 23.38% in the year 2010; and by \$140,200 or 4.07% in the year 2011 and to increase its Revenues for Water Service in its Los Angeles District by \$7,886,200 or 41.29% in the year 2010; and \$1,100,000 or 4.09% in the year 2011 and to increase its Revenues for Water Service in its Sacramento District by \$17,537,800 or 51.29% in the year 2010; and \$5,339,800 or 10.25% in the year 2011.

Application 09-01-013
(Filed January 23, 2009)

And Related Matters.

Application 09-05-008
Application 09-07-002

DECISION ADOPTING THE 2010 AND 2011 REVENUE REQUIREMENT AND RATES FOR CALIFORNIA AMERICAN WATER COMPANY IN THE LARKFIELD, LOS ANGELES, AND SACRAMENTO DISTRICTS, AND RESOLVING THE DRY CREEK DEVELOPERS SPECIAL FACILITIES FEE AND PENSION BALANCING ACCOUNT ISSUES

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DECISION ADOPTING THE 2010 and 2011 REVENUE REQUIREMENT AND RATES FOR CALIFORNIA AMERICAN WATER COMPANY IN THE LARKFIELD, LOS ANGELES, AND SACRAMENTO DISTRICTS, AND RESOLVING THE DRY CREEK DEVELOPERS SPECIAL FACILITIES FEE AND PENSION BALANCING ACCOUNT ISSUES

1. Summary

This decision authorizes a revenue requirement for the Larkfield, Los Angeles, and Sacramento districts of California American Water Company. The revenue requirement for the Larkfield District of California American Water Company is \$3,079,900, a 7.23% increase for the 12 months beginning July 1, 2010. The revenue requirement for the Los Angeles District is \$25,850,700, a 26.99% increase beginning January 1, 2010. The revenue requirement for the Sacramento District is \$45,438,300, a 24.27% increase for the 12 months beginning July 1, 2010.

The overall increases include the purchased water, purchased power and pump taxes expense of \$474,500 for the Larkfield District, \$8,735,700 for the Los Angeles District and \$4,498,500 for the Sacramento District. The costs for purchased water, purchased power and pump taxes is a direct pass through to customers and was estimated in California American Water Company's general rate case application, but calculated for this decision based on current costs. The purchased water, purchased power and pump taxes expense accounts for 15.4%, 33.8% and 9.9% of the overall revenue requirement in the Larkfield, Los Angeles and Sacramento districts respectively.

Under the adopted rates the average residential customer with average water use will experience a bill increase of 3.06% in the Larkfield District, 3.99%, 36.78% and 17.61% in the Los Angeles District sub-systems of Baldwin Hills, Duarte and San Marino, respectively, and 19.21% to 21.11% in the Sacramento

District. The range of rate increase percentages in the Sacramento District represents the difference between metered and unmetered customers. The rates for all districts will be adjusted for 2011 and 2012 consistent with the existing water company rate case plan (Decision 07-05-062).

This decision adopts the partial settlement, available online at <http://docs.cpuc.gov/efile/MOTION/111662.pdf>, between California American Water Company and the Division of Ratepayer Advocates. In addition, this decision adopts California American Water Company's California Corporate Franchise Tax and the Domestic Production Activity Deduction calculation methodologies. The rates in this decision reflect the impacts of Decision 10-06-003 issued on June 4, 2010, in response to Cal Am's petition to modify Decision 09-07-021. This decision also grants California American Water Company's motion to strike portions of the opening brief of the City of Duarte.

This proceeding is closed.

2. Background

The Commission regulates water service provided by Class A water utilities pursuant to Article XII of the California Constitution and the Public Utilities Code.¹ For Class A water utilities, Pub. Util. Code § 455.2, as implemented in Decision (D.) 04-06-018 and updated in D.07-05-062, provides for a general rate case proceeding every three years.

California American Water Company (Cal Am) is a Class A water company with seven districts: Coronado, Felton, Larkfield, Los Angeles,

¹ A Class A utility is defined as an investor-owned water utility with over 10,000 service connections.

Monterey, Sacramento, and Village. This general rate case proceeding involves the Larkfield, Los Angeles and Sacramento districts.

The Larkfield Water Company was constructed and granted a certificate of public convenience and necessity in 1959. It was merged into Citizens Utilities Company of California (Citizens) in 1995, which was then acquired by American Water Works, Inc., Cal Am's parent company, in 2002.² The Larkfield District provides water service to an unincorporated portion of Sonoma County about four miles north of the City of Santa Rosa, California. The service area includes the Larkfield and Wikiup subdivisions which lie along the eastern boundary of U.S. Highway 101 and the community of Fulton which is located west of U.S. Highway 101. An interconnected distribution system serves the three areas of the district which provides water to approximately 2,400 customers. The mix of water provided to Larkfield District customers consists of well water and water purchased from the Sonoma County Water Agency.

There are approximately 28,000 customers in the Los Angeles District. The district has three physically separated subsystems, the largest being San Marino. The other two are the neighboring Duarte subsystem and the geographically farther Baldwin Hills subsystem.³ The district is served by wells and irrigation water utilizing Cal Am's groundwater rights and by purchases from municipal wholesalers. The San Marino and Duarte subsystems use primarily

² The transaction was authorized by the Commission in D.01-09-057.

³ The San Marino service area is ten miles northeast of downtown Los Angeles in the San Gabriel Valley, and the Baldwin Hills service area is centrally located in an unincorporated area of Los Angeles County southwest of downtown Los Angeles and just a few miles east of the Los Angeles International Airport.

groundwater while the Baldwin Hills subsystem uses approximately 50% purchased water from the Metropolitan Water District and the West Basin Municipal Water District.

In 1928 the North Sacramento Light and Water Company was purchased by Public Utilities California Corporation. The name was changed to Citizens Utilities Company of California (Citizens) in 1949. Over the years, through a series of mergers and acquisitions Citizens grew to encompass the ten distinct water systems that now comprise the Sacramento District.

In January 2002 Cal Am's parent company, American Water Works, Inc., acquired Citizens. The Sacramento District provides water service to areas north, east and south of the City of Sacramento. It also includes an area west of the City of Roseville in Placer County and the smaller communities of Isleton and Walnut Grove located southwest of the City of Sacramento. The ten water systems are now operated as one. The ten systems are Antelope, Arden, Isleton, Lincoln Oaks, Parkway, Rosemont, Security, Suburban, Walnut Grove and West Placer. The Sacramento District serves almost 58,000 customers.

3. Procedural Background

On January 23, 2009, Cal Am filed its general rate case Application (A.) 09-01-013. A protest to the application was timely filed by Mark West Community Services Committee on February 13, 2009, and by the Division of Ratepayer Advocates (DRA) on January 30, 2009. A prehearing conference was held on March 25, 2009. By ruling on July 13, 2009, the Administrative Law Judge (ALJ) granted motions by the City of Duarte and the City of Bradbury for party status.

On April 23, 2009, the assigned Commissioner and ALJ issued a scoping memo setting the procedural schedule for A.09-01-013. The Commission held

five public participation hearings, in Windsor, Monrovia, Inglewood, Walnut Grove, and Rancho Cordova on June 4, 8, 9, 10, and 11, 2009, respectively. There were afternoon and evening sessions at all locations except Walnut Grove where only an evening session was held. All public participation hearings were well attended, except for Inglewood where only one person was present. The discussion was robust, with most speakers expressing concern over rate increases in light of the poor economy and its impact on ratepayers. At the Monrovia public participation hearing, in addition to the comments on the size of the rate increase, many parties expressed concern over the Los Angeles District's regionalized rate structure for the San Marino, Duarte and Baldwin Hills systems.

An August 10, 2009 ALJ ruling consolidated A.09-01-013 with A.09-05-008, the application for an order authorizing the adjustment of the Dry Creek special facilities fees. On August 19, 2009, an ALJ ruling consolidated these proceedings with A.09-07-002, Cal Am's application for a balancing account to track pension and other post-retirement benefit costs.

Evidentiary hearings were scheduled for November 2 - 6, 2009. Settlement negotiations were started on October 20, 2009, and continued through November 5, 2009. At a brief evidentiary hearing on November 6, 2010, the parties informed the ALJ that most items had been settled and the parties were willing to forego extensive evidentiary hearings, have the witnesses' prepared testimony and other exhibits received into the record without cross examination, and submit the case on briefs. The ALJ directed the parties to submit the settlement agreement no later than December 4, 2009, in order to maintain the proceeding schedule. Cal Am and DRA requested one week extensions of time for submitting the settlement on December 4 and December 11, 2009. The ALJ

granted both requests and set the final deadline for submission of the settlement agreement as December 18, 2009.

On January 19, 2010, opening briefs were filed by Cal Am, DRA, the Mark West Area Community Services Committee and the Cities of Duarte and Bradbury. Reply briefs were filed on February 3, 2010. The case was submitted on February 3, 2010.

4. The Settlement

On December 18, 2009, Cal Am and DRA filed a joint motion for adoption of the settlement agreement addressing most issues in the proceeding.

The settlement describes in detail the parties' initial positions, areas of disagreement and the final resolution of each item. Settlement was achieved a number of ways; the parties agreed on a particular issue at the outset, new or corrected information was provided altering one party's initial position, or a compromise position was agreed upon by the parties. The settlement includes all but two disputed issues relating to taxes; the California Corporate Franchise Tax and the Domestic Production Activities Deduction tax calculations. Those issues are discussed and resolved later in the decision. The following section summarizes the final settlement.

4.1. Number of Customers and Water Production

Cal Am and DRA agree on the average number of customers in each district for each of the years in the rate case cycle.

Although DRA and Cal Am both use the New Committee Method to estimate consumption, DRA disagrees with Cal Am's application of the methodology to calculate sales figures in all three districts. The parties also initially disagreed on how to calculate non-revenue water in the Larkfield District and the Duarte system of the Los Angeles District. Non-revenue water is

the difference between production water delivered from various sources in a distribution system and the metered water sales. Ultimately the parties use the DRA estimate for Larkfield and agree on 13% non-revenue water for the Duarte system of the Los Angeles District.

The table below presents the parties' settlement on the number of customers and the total water production based on water sales and supply in each district for the years 2010 and 2011.

Table 1

Year/Item	Larkfield	Los Angeles	Sacramento
2010 Customers	2,411	27,800	57,812
2011 Customers	2,431	27,843	57,942
2010 Water Production in Kccf*	558.8	10,846.0	20,243.4
2011 Water Production in Kccf	563.0	10,859.6	20,187.0

* 100,000 Cubic Feet

4.2. Revenues

The parties agree that all metered revenues should be determined based on the Commission's standard rate design. The parties also agree that the latest tariff rates should be used when calculating present rate revenues and the present rate revenue figures should be updated for the final tables included in this decision to reflect tariff changes authorized since the application was filed.

The table below presents the parties' settlement on total present revenues for each district. The table also provides the parties' positions on proposed revenues for 2010, which vary because of the parties' disagreement on how to calculate the California Corporate Franchise Tax and Domestic Production

Activities Deduction. The tax calculation issues are discussed later in this decision.

Table 2

Item	Larkfield	Los Angeles	Sacramento
Settled Present Revenues	\$2,872,300	\$20,356,200	\$36,565,300
Cal Am Proposed Revenues	\$3,051,000	\$23,820,000	\$45,720,000
DRA Proposed Revenues	\$3,029,000	\$23,520,000	\$45,080,100

The settlement recommends that the Commission order Cal Am to file its upcoming statewide general rate case, which is due July 1, 2010, under the Rate Case Plan, in two phases, with a Phase I addressing revenue requirement and a Phase II addressing rate design issues raised in this proceeding.

The settling parties recommend that in Phase I, the recommended revenue requirement phase of Cal Am's upcoming statewide general rate case, Cal Am will report on certain items. Some of the reportable items were required by D.08-11-023 for the Larkfield District and D.08-06-002 for the Los Angeles District.

The reportable items for the Larkfield District are:

- Consider 5-tier increasing block rates, collect data on multi-unit apartment buildings and making metered-consumption data on apartment building customers available to DRA;
- Meet and confer to determine data needed to consider further conservation rate design proposals for non-residential customers;
- Track billing and usage data for analyzing customer response to conservation rates and programs and meet regularly to discuss data;

- Meet to discuss pilot program adjustments if disparate impact on ratepayers or shareholders result;
- Demonstrate due diligence in obtaining least-cost mix for water sources; and
- Begin monthly billing of customers after notifying the Director of Division of Water and Audits, follow applicable rules and guidance provided by the Division of Water and Audits and notify customers of the billing change.

Among the reportable items for the Los Angeles District are:

- Data related to moving the district to monthly billing;
- Meet and confer to determine data needed to consider further conservation rate design proposals for non-residential customers;
- Report on the top 100 residential users in each service area;
- Feasibility, costs and benefits of water revenue adjustment mechanisms focused on conservation impacts;
- Develop a monitoring and data collection program to analyze customer response to conservation rates and programs and meet regularly to discuss data;
- Meet to discuss pilot program adjustments if disparate impacts on ratepayers or shareholders result; and
- Demonstrate due diligence in obtaining least-cost mix for water sources.

In the settlement, the parties recommend that the Commission direct Cal Am to include updates and analyses on the above referenced meet and confer sessions and data collection in the recommended revenue requirement Phase I of the upcoming general rate case. The parties also recommend that Cal Am be required to include in the recommended Phase I any rate design ideas it is considering for inclusion in the recommended Phase II.

The settling parties recommend that the current rate design be maintained for this proceeding, but that Cal Am should propose rate design changes based

on analysis developed between now and the proposed Phase II rate design portion of the next general rate case.

On April 1, 2010, Cal Am submitted a request to delay filing the rate design portion of its upcoming statewide general rate case until the end of the year. On April 13, 2010, the Executive Director granted Cal Am a limited extension to August 1, 2010, to serve the rate design portion of its upcoming statewide general rate case. The extension letter stated that the procedure and schedule for finalization and consideration of Cal Am's rate design proposal will be addressed in the general rate case proceeding.

4.3. Operating Expenses

The following table depicts the parties' settlement on operating expenses for each of the districts. The parties differ on the amount of customer account uncollectibles for each district because of the parties' disagreement on how to calculate the California Corporate Franchise Tax and Domestic Production Activities Deduction. The tax calculation issues are discussed in Section 9 of this decision and the final uncollectibles amount are calculated based on the method adopted in this decision.

Table 3

Item	Larkfield	Los Angeles	Sacramento
Payroll	\$322,700	\$1,738,900	\$3,146,100
Purchased Water	\$322,100	\$4,494,100	\$2,280,000
Purchased Power	\$82,900	\$2,026,400	\$2,218,500
Water Treatment Chemicals	\$34,200	\$139,300	\$633,700
Cal Am Uncollectibles	\$21,900	\$170,700	\$327,700
DRA	\$21,700	\$168,600	\$323,100

Uncollectibles			
Misc. Source of Supply	\$22,100	\$17,100	\$179,500
Misc. Transmission and Distribution	\$68,000	\$368,800	\$484,700
Other Operating Expenses	\$61,700	\$156,600	\$499,200

4.4. Maintenance Expenses

The parties agree to a level of tank painting costs for 2010 and also agree that Cal Am should file a Tier 2 advice letter for the additional amortization of related tank painting expenses completed in 2010. For other maintenance expenses, the parties agree to use the inflation adjusted historical five-year average suggested by Cal Am, adjusted downward somewhat as recommended by DRA. The following table includes the maintenance expenses for each district for 2010 and 2011.

Table 4

Item	Larkfield	Los Angeles	Sacramento
2010 Tank Painting	\$8,100	\$62,800	\$126,200
2011 Tank Painting	\$8,100	\$62,800	\$126,200
2010 Capped Tank Painting Costs	\$109,000	\$846,500	\$769,000
2011 Capped Tank Painting Costs	\$11,300	\$85,800	\$77,300
Other Maintenance Expense	\$35,800	\$568,700	\$902,000

4.5. Administrative and General Expenses

The following tables depict the parties' settlement on Administrative and General Expense items. There are multiple items within this expense category

and in some cases their treatment is based on specific expenses for individual districts or shared costs among the districts. The tables represent the expenses according to the method of allocation to the districts. The pension and benefit, and conservation expense items are discussed separately as the settlement includes provisions that require individual treatment.

Table 5 (Shared Expenses)

Item	Larkfield, Los Angeles, Sacramento
Consulting Fees	\$30,000
Legal Fees	\$586,500
Shared Service Center Labor ⁴	\$169,400
Company Labor	\$167,300
Witness Training	\$17,200
Miscellaneous ⁵	\$301,400
Cost of Capital Application	\$137,900

⁴ The Shared Service Center of American Water Works Service Company provides accounting, financial, rate case and other support to the operating and non-operating companies within the parent company at cost, based on the time spent to perform the requested services.

⁵ The miscellaneous expense includes the costs for printing the proposed and final application, printing and mailing notices to all customers at an approximate cost of \$0.75 per customer and fees to publish notices in local newspapers.

Table 6 (Individual District Expenses)

Item	Larkfield	Los Angeles	Sacramento
Insurance other than Group	\$51,500	\$328,800	\$590,200
Outside Services	\$1,800	\$36,600	\$37,000
Annual Rate Case Expense	\$20,100	\$217,500	\$467,200
Misc. General Expenses	\$119,100	\$915,000	\$1,831,900
Administrative and General Rents	\$26,200	\$55,100	\$23,900
Other Administrative and General	\$3,800	\$8,900	\$97,100

4.5.1. Employee Pension and Benefits

The request for pension and benefits balancing accounts in A.09-07-002 which was consolidated with the general rate case replaces Special Request #9 in Cal Am's original application. According to the settlement, parties agree that Cal Am will establish two balancing accounts per district to track and recover variations in pension and other post retirement benefits other than pension. The balancing accounts will be used to track the difference between the level of expenses authorized in rates and the actual costs. Cal Am's recovery for ratemaking purposes is capped at the minimum level of Benefit Plan expense calculated according to the Employee Retirement Income Security Act (ERISA) minimum funding levels. For the post retirement benefits other than pension, Federal Accounting Standard 106 will be used to calculate the minimum funding level.

The parties agree that for ratemaking purposes, Cal Am should not change the method of Benefit Plans' accounting for a period of five years after the establishment of the balancing accounts. The proposed effective date of the balancing accounts is the effective date of this decision and the balancing

accounts should track only prospective costs accumulated as of the date the balancing accounts are effective. The parties agree that balancing accounts should be subject to a reasonableness review and recovered via a separate application, an advice letter filing or in a general rate case application. The settlement provides that Cal Am will be allowed recovery only if the amount of under or over collection exceeds 2%. The table below provides the agreed-upon total pension and benefit expenses for the three districts.

Table 7

Item	Larkfield	Los Angeles	Sacramento
Pension and Benefits	\$168,400	\$812,600	\$1,249,500

4.5.2. Conservation Programs

Cal Am agrees to specific recommendations of DRA for the conservation programs in all three districts. The recommendations are:

- A reduced conservation budget;
- Reduced spending for the weather-based irrigation controller Pilot Project;
- One-way balancing account treatment for all conservation programs; and
- Produce and submit a report on conservation program activities to the Division of Water and Audits and provide a copy to DRA at the time of Cal Am's next general rate case filing.

The parties agree that Cal Am should have the flexibility to shift funds among programs in each district within the total settled conservation amount for each district. The exception to this provision is Best Management

Practice 7 – Public Outreach and Education, which would be capped at the settled amount for each district.⁶ If Cal Am’s spending on any program exceeds the levels recommended by DRA, then Cal Am will include a detailed explanation and justification with documentation for the expenditures in its conservation report to the Commission. The settlement includes specific elements that should be included in the conservation report as justification for any excess expenditure.

The table below provides the conservation budget for each district for 2010 and 2011.

Table 8

Item/Year	Larkfield	Los Angeles	Sacramento
Conservation Budget 2010	\$49,551	\$303,439	\$474,532
Conservation Budget 2011	\$49,551	\$303,439	\$474,532

4.6. Allocated Expenses

Allocated expenses are those allocated according to the Commission’s four-factor allocation methodology because they are not easily, directly assignable to a specific operating division. The parties agree on the allocated expenses and the following table summarizes the totals for the three districts.

⁶ The capped annual amounts for Public Outreach and Education for the Larkfield, Los Angeles and Sacramento Districts are \$2,225, \$22,500 \$28,550 respectively, for each of 2010 and 2011.

Table 9

Item	Larkfield	Los Angeles	Sacramento
Allocated General Office	\$193,200	\$2,281,800	\$4,602,800
Acquisition Premium	\$74,600	\$683,100	\$1,771,700

4.7. Utility Plant

4.7.1. Recurring Projects

Recurring capital expenditure projects are normal expenses required to ensure the operational reliability of the water system. The expenditures include mains, valves, pumps, hydrants, tools and office equipment, among other things. The parties agree to a five-year historical average for the Sacramento District and specific dollar amounts for each project in the Larkfield District. The parties did not differ on the expenditure amounts for the Los Angeles District's recurring projects. The parties also agree that the total dollar amount for each district may be used flexibly within each district and among the projects. The cost of the individual recurring projects is contained in Section H of the settlement. The following table provides the total recurring project dollar amounts for each district for 2009, 2010 and 2011.

Table 10

Item/Year	Larkfield	Los Angeles	Sacramento
Recurring Projects 2009	\$293,870	\$3,224,754	\$3,143,313
Recurring Projects 2010	\$517,400	\$2,723,086	\$5,808,523
Recurring Projects	\$468,602	\$2,320,725	\$6,667,939

2011			
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4.7.2. Larkfield District Investment Projects

Cal Am requested major capital improvements for 2010-2011 in its Larkfield District related to its source of supply facilities, and its transmission and distribution main pipeline network. Cal Am withdrew two of its original capital improvement project requests for the Larkfield District with the intent of including them in the next general rate case. The table below provides the total dollar amount for each capital improvement project included in the settlement for the Larkfield District. Two projects include specific recommendations and are discussed individually.

Table 11

Item	Amount
Installation of 6" Main - Wikiup	\$173,429
Water Treatment Plant Drainage Improvements	\$110,000
Water Treatment Plant Production Improvements	\$221,936
Faught Road Well	\$147,082
Well #6	\$211,237

4.7.2.1. Faught Road Well

The parties agree the Larkfield District has a water supply deficit and the Faught Road Well is needed. The parties agree that the prior expenditure of \$147,082 (included in Table 9) for this project should be treated as Construction Work in Progress. Also part of the settlement is an agreement that Cal Am may seek recovery of costs beyond the \$147,082 once the project is used and useful, via Tier 3 advice letter or in its next general rate case filing.

The parties further recommend that the Commission approve a developer special facilities fee in the Larkfield District for the Faught Road Well. The precise amount would be determined using actual costs divided by the actual number of customers served. The daily pumping capacity of the Faught Road Well is divided by 300 gallons per day (which is the assumed usage of Larkfield residents) to arrive at the number of customers served. The actual total cost would be divided among the number of customers served. The current estimate, subject to change, is \$3,426 per customer.

4.7.2.2. Well #6

The parties agree that the \$211,237 associated with Well #6 (see Table 11) is specifically related to the monitoring well. The monitoring well currently provides useful information regarding the status of the aquifer, water quality and engineering evaluation for a future groundwater production well. The parties agree to recovery for a portion of the land where the monitoring well is located and the cost of the preliminary engineering, permitting and construction of the monitoring well would be allowed into rate base in 2009. DRA states that its agreement to allow recovery of certain costs associated with the monitoring well are not to be interpreted as approval of the need for a future production well. The parties agree to defer the issue of construction of Well #6 until such time as Cal Am can justify the need for an additional well.

4.7.3. Los Angeles District Investment Projects

Cal Am originally requested funding for 20 major capital improvement projects in its Los Angeles District. For 15 of the projects, the parties' positions on need, cost and schedule of the projects did not differ. Cal Am subsequently withdrew its request for one capital project and parties reached settlement on the costs associated with Cal Am's four remaining capital project proposals. The

table below provides the total dollar amount for each capital improvement project included in the settlement for the Los Angeles District. Three projects include specific recommendations and are discussed individually.

Table 12

Item	Amount
2,100 Feet of Main in Shenandoah Ave. 2009	\$527,555
Install 10, 100 Feet of 8" Main in Danford Reservoir Gradient	\$1,246,192
Patton Transmission Main 2009 - 2012	\$4,176,738
Patton Well and Treatment Facility 2009 - 2010	\$2,880,865
Fireflow Improvement 2010 - 2011	\$868,534
Pump Equipment Improvement 2009	\$186,300
San Marino - Richardson Well Rehabilitation 2009 - 2011	\$1,384,000
Duarte - Buena Vista Well Rehabilitation 2009 - 2010	\$1,177,889
San Marino - Oak Knoll Circle Well Rehabilitation 2010-2011	\$261,000
Duarte - Lemon Domestic Reservoir Improvement 2011	\$240,000
Baldwin Hills - 1600 Feet of 12" Main in Angeles Vista Blvd.	\$51,012
Baldwin Hills - 1400 Feet of 8" Main in Slauson Ave.	\$482,726
Duarte - 1700 Feet of 8" Main in Oak Shade, Mt. Olive Drive and Spring Point Road 2010 - 2011	\$560,874
Duarte - 650 Feet of 8" Main in Pops Road 2010 - 2011	\$246,728
Duarte - 2200 Feet of 8" Main in South Greenback, East Conata St. and South Fieldview Ave. 2010 - 2011	\$714,804
Duarte - 2700 Feet of 8" Main in South Broderick, South Calmia Road and South El Toro 2010	\$33,923
San Marino - 2000 Feet of 8" Main in Del Mar Blvd. 2009	\$59,333
Los Angeles - Purchase Portable Emergency Generator 2009 - 2011	\$158,714
Baldwin Hills - Olympiad Booster Station Upgrade 2009 - 2011	\$2,365,000

4.7.3.1. Danford Reservoir Gradient

DRA originally recommended capping the amount at the level authorized in the prior general rate case for advice letter recovery. Cal Am asserts that the total cost of the Danford Main project is not capped by the prior advice letter authorization because the cap referred only to the total amount included as part of the 2008 costs and that the increased construction cost is attributable to factors outside Cal Am's control.

4.7.3.2. Patton Transmission Main

DRA recommended capping recovery at the original figure authorized in the prior general rate case decision, but Cal Am asserted that the cost increases were due to circumstances outside its control. The parties agree to place \$2,135,000 into rate base in 2009. The figure represents the original advice letter cap from the 2006 general rate case settlement. They agree that the remaining balance should be recognized and placed into rate base in three equal amounts of \$680,579 in 2010, 2011 and 2012, timing that coincides with the annual step rate increases. The phase-in of costs, with no accrued interest, is agreed by the parties to be fair and reasonable in light of the significant cost increase concerns raised by DRA.

Cal Am commits to work more closely with DRA in the future on large scale projects where additional costs may be incurred. DRA agrees that the main was completed and placed into service in June 2009.

4.7.3.3. Patton Well and Treatment Facility

DRA originally recommended adjusting the plant balance to reflect the authorized memorandum account cap from the prior general rate case decision. Cal Am asserts that the scope and size of the treatment facility could not be determined before the well was constructed and completed and water quality

testing could be undertaken. For this reason, Cal Am claims the cost overruns are attributable to factors beyond Cal Am's control.

The parties agree to place \$1,642,486 into rate base in 2009 with the remaining amount recognized and placed into rate base when the project becomes used and useful for utility services upon filing a Tier 3 advice letter.

This arrangement is agreed by the parties to be fair and reasonable in light of the significant cost increase concerns raised by DRA.

Cal Am commits to work more closely with DRA in the future on large scale projects where additional costs may be incurred. The parties accept that the Patton Well project will most likely be completed and placed into service during the summer of 2010.

4.7.4. Sacramento District Investment Projects

Cal Am originally requested 30 major capital improvement projects in its Sacramento District. For 19 of the projects the parties' original positions on need and cost of the projects did not differ. Cal Am subsequently withdrew its request for five capital projects and agreed to include two others in its next general rate case. One of Cal Am's withdrawn requests is the Walerga Tank and Booster Project. Cal Am also withdrew its request made in A.09-05-008, which sought an adjustment to the Dry Creek Developer's Special Facilities Fee related to the Walerga project and was consolidated with this proceeding. The parties reached settlement on the costs associated with the four remaining capital project requests. The table below provides the total dollar amount for each capital improvement project included in the settlement for the Sacramento District. Two projects include specific recommendations and are discussed individually.

Table 13

Item	Amount
Elverta Road Bridge Water Main Replacement	\$306,867
Well Rehabilitation 2009	\$250,170
Parkway Purchased Water	\$1,000,000
Standby Power for Various Well Stations	\$191,955
Distribution Monitoring System Improvement	\$771,720
Walnut Grove Permanent Sewer Connections	\$125,000
Interconnection Suburban Water Dist. - Arden	\$500,000
Crowder Lane Control System Upgrades - West Placer	\$54,849
Antelope Road Widening	\$19,533
Elverta Tank and Booster	\$127,742
Parkway Small Main and Backyard Main Replacements	\$1,153,003
Suburban Distribution System Supply Improvement	\$5,149,394
Cook Riolo Tank and Booster - Antelope	\$3,899,055
Sacramento Small Main and Backyard Main Replacements	\$2,832,371
Walnut Grove Well 1 Rehabilitation	\$100,000
Sacramento Meter Conversions through 2011	\$21,940,195
Well Rehabilitation 2010 and 2011	\$1,196,625
Mather Tank Study	\$50,000
2009 - 2011 Sacramento Water Treatment Plant Improvements	\$2,176,582
Suburban 12" Pipeline on Bradshaw	\$300,000
Sacramento SCADA* Upgrades	\$768,750
Sacramento Standby Generators	\$242,000

Jackson Well - Construct Jackson Booster Station Tank	\$6,610,920
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*Supervisory Control and Data Acquisition

4.7.4.1. Sacramento Meter Conversions

The parties agree on the cost (included in Table 13 above), the number of meters to be installed (approximately 13,545) and the average unit cost per meter (\$1,200). The parties agree that cost increases of 20 percent or more above the settlement-established unit cost will require consultation with and review by DRA.

4.7.4.2. Jackson Booster Station Tank

The parties agree on the need, the cost estimate and the work completion schedule for this project. The parties also agree that the entire cost requested by Cal Am for this project should be included in rate base (less developer funding of \$867,633) and that it should be allowed to earn the full rate of return beginning in 2009.

The parties further recommend that the Commission approve a developer special facilities fee in the Rosemont Service Area of the Sacramento District specifically related to the Jackson Booster Station Tank. The precise amount would be determined using actual costs divided by the number of customers served by the project. The daily pumping capacity of the Jackson Booster Station Tank (2,160,000 gallons) is divided by 503 (the assumed gallons per day used by Rosemont low-density residential customers) to arrive at the number of

customers served, which is estimated to be 4,294. The current estimated cost per customer, subject to change, is \$1,808.⁷

4.7.5. Retirements

The parties agree that retirements should be based on Cal Am's proposed percent of plant addition methodology. The table below provides the agreed-upon plant retirement figures for all three districts for 2010 and 2011.

Table 14

Year/Item	Larkfield	Los Angeles	Sacramento
2010 Retirements	(\$15,600)	(\$169,800)	(\$170,800)
2011 Retirements	(\$16,800)	(\$281,100)	(\$187,500)

4.7.6. Weighted Plant Factor

For the weighted plant factor, the parties agree to use factors that include actual data through December 2008 for all three districts. The table below summarizes the results.

⁷ The cost per customer is based on the total cost of the project (\$7,765,967), not the amount agreed upon in the settlement. The figure in Table 13 (\$6,610,920) is the balance of the project costs that have not already been recovered.

Table 15

Item	Larkfield	Los Angeles	Sacramento
% Plant Weighting Factor	44.67%	37.98%	42.17%

4.8. Depreciation Reserve

The depreciation reserve includes annual accrual, contribution depreciation, retirements and weighted average depreciation factor. The parties agree on the forecasted levels of plant additions and, therefore, agree to the forecasted level for annual accrual. There was no dispute between the parties as to the contribution depreciation and the settled retirements figures were based on applying the same methodology used in forecasting plant additions. The retirement figures are summarized in Table 14 above. For the weighted average depreciation factor, the parties agree to use the actual data through December 2008. The table below summarizes, for all three districts, the annual accrual and contribution depreciation for 2010 and 2011, and the weighted average depreciation factor.

Table 16

Item/Year	Larkfield	Los Angeles	Sacramento
Annual Accrual 2010	\$470,600	\$2,724,400	\$8,496,700
Annual Accrual 2011	\$480,700	\$2,766,900	\$9,205,100
Contribution Depreciation 2010	\$8,400	\$203,300	\$278,300
Contribution Depreciation 2011	\$9,300	\$206,100	\$295,900
Weighted Aver. Depreciation Factor	58.39%	58.50%	50.61%

4.9. Rate Base

Rate base includes working cash operational, working cash capital, advances and contributions, and deferred taxes. There were no issues between the parties regarding the figures for working cash operational. The parties agree on the calculation for working cash capital and there was no dispute regarding the amounts for advances and contributions. The parties also agree on the calculation of deferred taxes as the result of their agreement on plant additions summarized earlier. The table below summarizes the elements of rate base for all three districts for 2010 and 2011.

Table 17

Item/Year	Larkfield	Los Angeles	Sacramento
Working Cash Operational 2010	\$34,400	\$188,900	\$921,900
Working Cash Operational 2011	\$124,000	\$190,100	\$1,502,200
Working Cash Capital 2010	\$208,300	\$906,800	\$4,126,800
Working Cash Capital 2011	\$212,800	\$1,006,700	\$4,378,500
Advances and Contributions 2010	(\$2,521,900)	(\$3,806,300)	(\$42,280,700)
Advances and Contributions 2011	(\$2,441,000)	(\$3,712,300)	(\$44,705,900)
Deferred Taxes 2010	(\$654,700)	(\$3,625,900)	(\$775,200)
Deferred Taxes 2011	(\$681,900)	(\$3,811,800)	(\$1,688,600)

4.10. Depreciation Expense

Because of the full settlement on the proposed plant additions, the parties agree on the level of depreciation expense for ratemaking purposes. The table below lists the agreed-upon depreciation expense for all three districts.

Table 18

Item	Larkfield	Los Angeles	Sacramento
Depreciation Expense	\$470,600	\$2,724,400	\$8,496,700

4.11. Taxes Other Than Income

Taxes other than income are comprised of payroll taxes, property taxes and franchise fees. The parties agree on the amount of payroll taxes for each district based on their agreement as to total payroll expense, summarized in Table 3 above.

The parties agree to the level of property taxes based on their agreement on projected plant additions for each district, contained in Tables 10, 11, 12, and 13 above. The final agreement on utility plant resolved initial differences in property tax amounts. The property taxes are forecasted based on a historical ratio of recorded taxes to net plant, less customer contributions and advances. Cal Am applied the historical ratio to projected net plant, less customer advances and contributions. This calculation is similar to that used by county tax authorities and ultimately agreed to by DRA.

Cal Am did not include franchise fees in its revenue requirement request for Larkfield or Los Angeles. For the Larkfield District franchise fees, the parties agree that the franchise fee should be collected as a special surcharge and condition of the tariffs. The parties were unable to reach agreement on the franchise fees for Sacramento, which are subject to the resolution of remaining income tax calculations that are discussed separately in Section 9 of this decision.

The table below summarizes the agreement between the parties for payroll taxes and property taxes for all three districts.

Table 19

Item	Larkfield	Los Angeles	Sacramento
Payroll Taxes	\$24,000	\$123,100	\$231,400
Property Taxes	\$109,600	\$606,100	\$1,546,600

4.12. Income Taxes

The income taxes include state and federal income taxes. Parties were unable to reach agreement on the federal income taxes due to disagreement on how to calculate the California Corporate Franchise Tax deduction and the Domestic Production Activities Deduction. The tax calculations are discussed in Section 9 of this decision.

Parties were able to reach agreement on the present state income taxes as they are not affected by the tax issues that remain in dispute. The table below summarizes the settled present state income tax figures for all three districts.

Table 20

Item	Larkfield	Los Angeles	Sacramento
State Income Taxes - Present	\$27,300	\$6,500	\$9,600

4.13. Net to Gross Multiplier for the Los Angeles District

The parties agree to adopt DRA's proposal of 1.6589 for a net to gross multiplier for the Los Angeles District.

4.14. Special Requests

Cal Am submitted a number of special requests in its original application. Cal Am's special request for a balancing account for pension and benefits was withdrawn due to Cal Am filing an application on that item which was

consolidated with the general rate case. Some of the special requests were withdrawn altogether when the application was supplemented. The remaining special requests are discussed below.

4.14.1. Rate Design

The parties agree to extend the conservation rate design programs including the Water Revenue Adjustment Mechanism and Modified Cost Balancing Accounts for the Larkfield and Los Angeles Districts as set forth in D.08-11-023 and D.08-06-002. The parties also agree to shift \$55,000, which is equal to one half of the non-revenue water costs generated by the Duarte irrigation system, from the revenue collected from all Los Angeles District customers to the portion of the revenue requirement collected specifically from irrigation customers.

4.14.2. Continuance of Los Angeles Distribution System Infrastructure Surcharge Pilot Program

The parties agree that the Distribution System Infrastructure Surcharge should be continued in the Los Angeles District, and that the tariff should be changed to allow the extension. The parties also agree to continue the current 7% general rate case cap and 4% quarterly cap. The proposed Distribution System Infrastructure Surcharge Tariff is Attachment 1 to the settlement and incorporates new annual and case limits and new construction project totals that are also included in the settlement.

4.14.3. Water Quality Memorandum Account

The parties recommend that the Commission approve a memorandum account specifically for tracking the costs associated with Cal Am's compliance with new federal Ground Water Rules. The parties also agree that Cal Am's

request for recovery (a Tier 3 advice letter) should include written justification to substantiate that the costs are incremental costs, not costs already covered within base rates.

4.14.4. Larkfield Franchise Fee

Cal Am does not currently pay a franchise fee to Sonoma County for operating the Larkfield District, but it expects to do so in the future. DRA does not dispute this. Cal Am originally sought a special request to allow the fees to be tracked in a memorandum account. The parties ultimately agreed that a memorandum account is unnecessary, but that Cal Am should be authorized to change its tariffs to allow collection of a special condition franchise fee as a surcharge on all customer bills in the Larkfield District.

4.14.5. After Hours Reconnection Fee

The parties agree that Cal Am's after-hours reconnection charges should be increased from \$15.00 to \$50.00 for the Los Angeles District. The after-hours reconnection charges appear in Tariff Rule 11.C.(1).

4.14.6. Water Contamination Cost Memorandum Account

Cal Am proposed memorandum accounts for all three districts to track increased costs associated with providing clean water when contamination occurs and for its efforts to pursue responsible parties. DRA agreed with the proposal for the Sacramento District in which litigation is underway, but opposed establishing a memorandum account for the Larkfield and Los Angeles districts until litigation is underway in those districts. Cal Am ultimately agreed with DRA's position, but points out that a memorandum account for the Raymond Basin in the Los Angeles district was previously approved by the Commission in D.07-08-030.

4.14.7. Recovery of Balances of all Memorandum and Balancing Accounts

The parties agreed that DRA will perform reasonableness reviews before January 1, 2011, for conservation balancing accounts,⁸ credit card memorandum accounts,⁹ expense balancing accounts for purchased water and power and pump taxes,¹⁰ and revenue true up¹¹ for all three districts. The parties also agree that DRA will perform a reasonableness review for the Santa Rosa Groundwater Study in the Larkfield District.¹²

4.15. Condominium Flat Rates

The parties agree that meters will be installed by December 31, 2010, for all customers in condominium-type complexes who pay a flat rate designed to reflect both indoor and outdoor water use as well as a metered rate via homeowners' association dues for outdoor water use. Customers for whom a meter is not installed by December 31, 2010, will be converted to a new flat rate that is half of the rate authorized in this agreement for lots of 4,500 square feet or less.

5. Additional Settled Issues

5.1. Process Improvements

Cal Am commits to establishing a more effective and possibly less formal manner to communicate and share information and to exchange information

⁸ Balancing accounts authorized by D.08-05-010.

⁹ Memorandum accounts authorized by Advice Letter 640-A.

¹⁰ Expense balancing account authorized by D.03-06-072.

¹¹ Authorized by Advice Letter 699.

¹² Authorized by D.05-09-020.

earlier in the rate case process. Cal Am also agrees to solicit input from and involve the other parties, specifically the Cities of Duarte and Bradbury, more in the deliberations in the upcoming statewide general rate case.

5.2. Cost Overruns

The parties agree that Cal Am should provide quarterly updates to DRA on how certain projects are progressing. This will allow Cal Am to keep DRA informed of developing issues. The parties also agree that Cal Am will provide a project cost variance report in its next general rate case for any capital investment projects over \$100,000 that exceed the authorized budget by 10% or more.

5.3. Duarte /Bradbury Irrigation System

The parties agree to seek long term solutions addressing the issues of costs, the irrigation tariff, non-revenue water and system infrastructure in the next general rate case. The parties acknowledge that the related items included in this settlement are not permanent solutions for the issues.

5.4. Regular Briefings

Cal Am agrees to establish a regular briefing schedule with DRA and the Division of Water and Audits on all of the items included in this section.

6. Other Parties' Positions on the Settlement

Only Cal Am and DRA were signatories to the settlement agreement. The Mark West Area Community Services Committee and the Cities of Duarte and Bradbury participated in initial settlement meetings, but ultimately did not sign the settlement agreement. Only the Cities of Duarte and Bradbury filed responses in opposition to the joint motion by Cal Am and DRA for adoption of the settlement agreement.

The Mark West Area Community Services Committee expressed concern over the settlement process, and the perceived exclusion of the parties whose interests were more discrete than Cal Am and DRA. Cal Am represents the shareholders and DRA represents the ratepayers as a whole, while the Mark West Area Community Services Committee and the Cities of Duarte and Bradbury necessarily represent the specific interests of their respective residents who are Cal Am customers. Although all-party settlements are not required, a process that provides all parties an opportunity to participate in the settlement process is. However, it is essential that all parties put forth the effort to be included as well as inclusive in their approach to settlement negotiations.

Cal Am has stated its intention to establish a more effective and less formal manner to exchange information and to solicit more input from and involve the other parties, specifically the Cities of Duarte and Bradbury, in the deliberations in the upcoming statewide general rate case. If this commitment is met future settlement negotiations should address the concerns expressed by the Mark West Area Community Services Committee and the Cities of Duarte and Bradbury regarding the settlement process. If there are problems with the process, the Commission expects parties to notify the assigned ALJ in a timely manner.

6.1. The Mark West Area Community Services Committee

The Mark West Area Community Services Committee recommends rescinding D.86-05-064 because it places the maximum number of rate tiers at three although the settlement approved in D.08-11-023 required Cal Am to consider five tiers in the next general rate case, which is A.09-01-013, this proceeding. Cal Am asked for more time to consider the five-tier rate design and has agreed in the present settlement to consider a five-tier rate design in its next

general rate case due to be filed July 1, 2010. Cal Am sought and was granted approval by the Commission's Executive Director to submit its rate design proposal in its upcoming rate case by August 1, 2010. It is not necessary to rescind D.86-05-064, as recommended by the Mark West Area Community Services Committee, in order for Cal Am to consider a five-tier rate design. D.08-11-023 already orders Cal Am to do so.

The Mark West Area Community Services Committee also expresses concern about the source capacity calculation in the Larkfield District which is based on the recently revised General Order 103-A.¹³ The revised calculations for supply capacity in General Order 103-A result in a larger supply deficit for the Larkfield District, although the number of customers in the Larkfield District has not increased. The scope of this proceeding does not include a review of General Order 103-A. The source capacity was calculated according to the general order in effect during the proceeding, as is required.

The Mark West Area Community Services Committee also commented on Cal Am's request for construction of the Faught Road Well and Well #6 in the Larkfield District and the resolution of these issues in the settlement agreement. The Mark West Area Community Services Committee incorrectly characterized the settlement reached on these two projects. The settlement proposes allowing only \$147,082 of prior expenditures on the Faught Road Well to be treated as Construction Work in Progress and seeks approval of a special facilities fee to recover the remaining costs from new customers. As to Well #6, the settlement only allows recovery of certain expenditures related to the monitoring well

¹³ General Order 103-A, which replaced General Order 103, was issued on September 10, 2009.

constructed in 2006 and defers the issue of the new well until such time as Cal Am can justify the need.

6.2. The Cities of Duarte and Bradbury

The City of Duarte filed an opening brief and response in opposition to the joint motion for adoption of the settlement agreement. The City of Bradbury filed a response that joined, and adopted by reference, the City of Duarte's response and opening brief.

The City of Duarte expressed concern with two main areas of the settlement: the proposed percentage of non-revenue water for the Duarte System, and cost overruns for the Danford Reservoir Gradient Main and the Patton Transmission Main, Well and Treatment facility projects in the Los Angeles District. The City of Duarte asserts that the settled upon percentage of non-revenue water for the Duarte system is arbitrary and that the cause of the loss should be addressed prior to imposition of a significant rate increase. The settlement specifically commits to addressing the non-revenue water and other issues in the Duarte system in the next general rate case which is to be filed on July 1, 2010.

Regarding the increased cost of certain projects within the Los Angeles District, the City of Duarte recommends that recovery be capped at the level authorized in the prior general rate case. The explanation of the settlement on these projects is discussed in Section 4 of this decision. We are satisfied with the settlement treatment of these issues.

7. Standard of Review for Settlements

Prior to adopting any settlement, the Commission must be convinced that the parties had a sound and thorough understanding of the application and of all the underlying assumptions and data included in the record. This level of

understanding of the application and development of an adequate record is necessary to meet the requirements for considering any settlement. The requirements are set forth in Article 12 of the Commission's Rules,¹⁴ which provides in pertinent part:

- (a) Parties may...propose settlements on the resolution of any material issue of law or fact or on a mutually agreeable outcome to the proceeding. Settlements need not be joined by all parties; however, settlements in applications must be signed by the applicant....

The motion shall contain a statement of the factual and legal consideration adequate to advise the Commission of the scope of the settlement and of the grounds on which adoption is urged. Resolution shall be limited to the issues in that proceeding and shall not extend to substantive issues which may come before the Commission in other or future proceedings...

- (b) Prior to signing any settlement, the settling parties shall convene at least one conference with notice and opportunity to participate provided to all parties for the purpose of discussing settlements in the proceeding....
- (c) Settlements should ordinarily not include deadlines for Commission approval...
- (d) The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

In short, the settlement must comport with Rule 12.1(d), which requires a settlement be "reasonable in light of the whole record, consistent with the law, and in the public interest." We address below whether the settlement meets

¹⁴ All referenced Rules are to the Commission's Rules of Practice and Procedure (http://docs.cpuc.ca.gov/published/RULES_PRAC_PROC/70731.htm).

these three requirements. The Commission also takes into consideration a long-standing policy favoring settlements. This policy reduces litigation expenses, conserves scarce Commission resources and allows parties to craft their own solutions reducing the risk of unacceptable outcomes if litigated.¹⁵

This is the standard of review for this settlement. Cal Am and DRA are the only parties to the settlement. The Cities of Duarte and Bradbury filed responses in opposition to the settlement. Cal Am filed an application and submitted testimony explaining its request for rate increases in detail. DRA provided its analysis of the application and the Mark West Area Community Services Committee served testimony. All parties agreed to forego evidentiary hearings, but their witnesses' testimony was received into the record and the parties filed opening and reply briefs. The settlement indicates that most of the differences were resolved by use of more recent data, or clarified information, or ultimately through compromise positions between the parties. The settlement does not violate any statute, Commission decision or rule. Thus, the settlement is consistent with law.

Cal Am represents the interests of its shareholders. DRA represents the interests of Cal Am's ratepayers. Thus, the settling parties fairly represent the affected interests. The Cities of Duarte and Bradbury and the Mark West Area Community Services Committee are parties to this proceeding and are also ratepayers. The Cities of Duarte and Bradbury and the Mark West Area Community Services Committee have expressed their concerns regarding certain portions of the settlement. As proposed in the settlement and discussed in

¹⁵ D.05-03-022, at 7-8.

Section 6 above, we find that the settlement adequately addresses the concerns of the Mark West Area Community Services Committee and the Cities of Duarte and Bradbury. Therefore, the settlement is reasonable in light of the whole record.

The settlement results in rates sufficient to provide adequate reliable service to customers at reasonable rates while providing Cal Am with the opportunity to earn a reasonable return. The settlement provides the Commission with sufficient information to carry out its future regulatory obligations with respect to the parties and their interests. Thus, the settlement is also in the public interest.

As discussed in the preceding paragraphs, the settlement has met the standard of review for settlements in that it is reasonable in light of the whole record, consistent with the law and in the public interest. Therefore, the settlement is adopted.

8. Burden of Proof under Statute and Rate Case Plan

The applicant, Cal Am, bears the burden of proving that its proposed rate increases are “justified.” Pursuant to § 454(a), before implementing a rate increase, Cal Am must make a “showing before the Commission,” and the Commission must find that the proposed increase is “justified.”

In adopting the revised Rate Case Plan, the Commission further articulated the required showing for a water utility’s General Rate Case: “The utility’s application for a rate increase must identify, explain, and justify the proposed increase.” Specifically, the application must include testimony, with supporting analysis and documentation, describing the components of the utility’s proposed increase, e.g., results of operations, and plant in service. All significant changes from the last adopted and recorded amounts must be

explained, and all forecasted amounts must include an explanation of the forecasting method.

In considering each remaining disputed issue, we evaluate whether Cal Am's showing meets our standards for justifying a rate increase. As set out below, we resolve the two remaining issues in dispute.

9. Disputed Issues

Cal Am and DRA disagree over how to calculate the California Corporate Franchise Tax and Cal Am's Domestic Production Activities Deduction for use when determining Cal Am's Federal Income Tax expense. DRA's testimony initially pointed out discrepancies in how Cal Am calculated both the California Corporate Franchise tax and the Domestic Production Activities Deduction. Some of the disputed items related to the tax calculations were corrected in the settlement. The following sections discuss the remaining tax items in dispute.

9.1. California Corporate Franchise Tax

Cal Am and DRA disagree on the method to calculate the California Corporate Franchise Tax deduction for federal income tax purposes. The issue is whether the California Corporate Franchise Tax deduction calculations should be based on the prior or current year.

DRA states that changes made in September 2000 to the California Revenue and Taxation Code allow more timely and accurate calculations of the California Corporate Franchise Tax deduction. For that reason, DRA recommends that the California Corporate Franchise Tax deduction be based on the current year, rather than the methodology adopted in D.89-11-058.

Cal Am states that the method adopted by the Commission in D.89-11-058, which uses the prior year's California Corporate Franchise Tax deduction as an estimate for the current year, should continue to be used. Cal Am states that no

change to how the California Corporate Franchise Tax deduction is calculated should occur without a specific proceeding, especially since it is a long-standing practice that impacts other water utilities.

The long-standing methodology implemented by D.89-11-058, and cited by Cal Am as the basis for its calculations, was developed and used because it was the best method to estimate the California Corporate Franchise Tax deduction at the time. However, the 2000 revision to the California Revenue and Taxation Code § 23151(f)(2) now states:

“... for taxable years beginning on or after January 1, 2000, the tax imposed under this section shall be a tax according to or measured by net income, to be computed at the rate of 8.4 percent upon the basis of the net income for that taxable year...”

The taxable year for the California Corporate Franchise Tax is defined by § 23041 as “...the fiscal year for which the tax is payable.”

Although DRA’s argument that changes to the California Revenue and Taxation Code allow for more accurate California Corporate Franchise Tax estimates has merit, in its opening comments on the proposed decision Cal Am notes that this proceeding involves only three of Cal Am’s seven districts. Any changes to the current methodology would result in inconsistent tax calculations among Cal Am’s various districts. For that reason we adopt Cal Am’s position, but require that in the upcoming statewide general rate case, Cal Am provide comparison information on the amount of California Corporate Franchise Tax estimated for each year in its previous three general rate cases and the actual amount of California Corporate Franchise taxes paid for the same time period. The deadline for receipt of the comparison information will be determined by the assigned ALJ.

9.2. Domestic Production Activities Deduction

The calculation of the Domestic Production Activities Deduction is governed by Internal Revenue Service Code Section 199 (Section 199).¹⁶ Section 199 allows a deduction equal to 9% of the lesser of (a) the qualified production activities income of the taxpayer for the taxable year, or (b) taxable income for the taxable year. The domestic production activities deduction reduces Cal Am's federal income tax based on qualifying production activities income. The qualifying production activities income is the excess of the taxpayer's domestic production gross receipts for the tax year divided by the cost of goods sold, other expenses, losses or deductions which are allocable to the domestic production gross receipts.

Internal Revenue Code § 1.199-1(b)(2)(d) provides that a reasonable method of allocation “...includes whether the taxpayer uses the most accurate information available; the relationship between the gross receipts and the method used; the accuracy of the method chosen as compared with other methods, etc. If the taxpayer has the information readily available and can, without undue burden or expense, specifically identify whether the gross receipts derived from an item are domestic production gross receipts, the taxpayer must use that specific identification to determine domestic production gross receipts.” Internal Revenue Code § 1.199-3(1) also provides that “...potable water production activities include acquisition, collection, and storage of raw water (untreated water), transportation of raw water to a water

¹⁶ Section 199 of the Internal Revenue Service Code was added by Section 102 of the American Jobs Creation Act of 2004, and amended by Section 403(a) of the Gulf

Footnote continued on next page

treatment facility and treatment of raw water at such facility. Gross receipts attributable to any of these activities are included in domestic production gross receipts.

Internal Revenue Code § 1.199-4(iii) states that “Gross receipts from storage of potable water after completion of treatment of potable water, as well as gross receipts attributable to the transmission and distribution of potable water are non-domestic production gross receipts.

One difference between Cal Am’s and DRA’s calculation of the domestic production gross receipts is that Cal Am includes water purchased and later resold and water produced (pumped) in its total domestic production gross receipts. The domestic production gross receipts are a primary element for the calculation of the Domestic Production Activities Deduction. DRA’s calculation excludes purchased water from the domestic production gross receipts and includes only water produced by Cal Am.

Cal Am’s calculation of domestic production gross receipts relies on physical plant assets rather than qualifying production activities. DRA’s calculation uses the ratio between the volume of produced water (a qualified production activity) to the total water volume (produced and purchased water). DRA asserts that its methodology is reasonable because the qualified production activity income is proportional to the qualified production activities, meaning that the more water pumped, the higher the allocated production volume. DRA claims this methodology complies with the Internal Revenue Service guidelines because its calculation of the Domestic Production Activities Deduction is based

Opportunity Zone Act of 2005 and Section 514 of the Tax Increase Prevention and Reconciliation Act of 2005.

on the income generated by the estimated qualified production activities, such as producing water, not plant assets as proposed by Cal Am.

Cal Am's approach for calculating the Domestic Productions Activities Deduction is the methodology currently used by all of its districts. As previously discussed, any changes to Cal Am's tax calculation methodology would apply to only three of Cal Am's seven districts and result in inconsistent treatment among the districts. For that reason we adopt Cal Am's current methodology and refer the issue to Cal Am's statewide general rate case where any adopted changes will affect all districts equally.

10. Recovery of Balance in Water Quality Memorandum Account

As provided in the settlement, we authorize Cal Am to file a Tier 1 advice letter to establish a water quality memorandum account to track the costs associated with Cal Am's compliance with new federal Ground Water Rules. A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, the utility preserves the right to seek recovery of these costs at a later date without raising retroactive ratemaking issues.

Unless specified otherwise, the Commission's authorization of a memorandum account does not mean that the Commission has decided that the types of costs to be recorded in the memorandum account should be recoverable in addition to rates that have been otherwise authorized, e.g., in a general rate case. Instead the utility must demonstrate that it is appropriate for ratepayers to pay for those categories of costs in addition to otherwise authorized rates, the utility acted prudently when it incurred those costs, and the level of costs is

reasonable. Thus, Cal Am is reminded that just because the Commission has authorized a memorandum account does not mean that recovery of the costs in the memorandum account from ratepayers is appropriate.

11. Cal Am's Motion to Strike Portions of the City of Duarte's Opening Brief

On February 3, 2010, Cal Am filed a motion to have portions of the City of Duarte's opening brief stricken from the record arguing it constitutes improperly introduced new testimony.

In its opening brief, filed on January 19, 2010, the City of Duarte recommends that the Commission establish an Audit Report for the Duarte distribution system and develop a construction and finance plan to implement any recommendation from such a report.¹⁷ The recommendations were not part of testimony entered into the record by the City of Duarte and as such, no party had an opportunity to cross examine sponsoring witnesses or to comment on the proposals. In addition, the City of Duarte's opening brief did not include any analysis supporting the recommendations.

Rule 13.8(d) of the Rules of Practice and Procedure provides:

Direct testimony in addition to the prepared testimony previously served,...will not be accepted into evidence unless the sponsoring party shows good cause why the additional testimony could not have been served with the prepared testimony or should otherwise be admitted....

The City of Duarte included no explanation why the additional testimony could not have been served as prepared testimony. For this reason Cal Am's

¹⁷ City of Duarte opening brief, at 8, ln. 10-24.

motion to strike lines 10 through 24 of page 8 of the City of Duarte's opening brief, is granted.

12. Rate Impact of Cal Am's Petition to Modify D.09-07-021

On October 7, 2009, Cal Am filed a petition for modification of D.09-07-021 regarding Cal Am's general office allocation methodology applied to all non-regulated operations. On June 4, 2010, the Commission issued D.10-06-003, granting Cal Am's petition for modification which resulted in changes to the general office allocation methodology that affects all Cal Am's districts. The rates adopted in this proceeding for the Larkfield, Los Angeles and Sacramento districts reflect the impact of D.10-06-003

13. Comments on Proposed Decision

The proposed decision of ALJ Linda A. Rochester in this matter was mailed to the parties in accordance with § 311 of the Public Utilities Code and comments are allowed pursuant to Rule 14.3 of the Commission's Rules of Practice and Procedure. Opening comments were filed by Cal Am, Mark West Community Services Committee, and the Cities of Bradbury and Duarte on June 14, 2010, and reply comments were filed by Cal Am and DRA on June 21, 2010. All comments were considered and changes were made as appropriate. Specifically, significant substantive changes were made to Sections 1, 4.14.1, 9.1 and 9.2, and Ordering Paragraphs 3, 12, and 13.

14. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Linda A. Rochester is the assigned ALJ in this proceeding.

Findings of Fact

1. Cal Am and DRA are the only parties to the settlement.

2. Cal Am provided an application and exhibits that explained its request for a rate increase in detail.

3. DRA provided an analysis of the application indicating that it agreed with some of Cal Am's estimates and disagreed with others.

4. The overall settlement results lie between the initial positions of Cal Am and DRA and the settlement resolves some issues raised by other parties.

5. The settlement does not violate any statute or Commission decision or rule.

6. Cal Am represents the interest of its shareholders.

7. DRA represents the interests of ratepayers.

8. The settlement results in rates sufficient to provide adequate reliable service to customers at reasonable rates while providing Cal Am with the opportunity to earn a reasonable return.

9. The settlement provides the Commission with sufficient information to carry out its future regulatory obligations with respect to the parties and their interests.

10. The parties recommend that the Commission phase Cal Am's next general rate case, with Phase I considering revenue requirement updates and analyses on the meet and confer sessions and data collection referenced in the settlement. The parties also recommend that Cal Am be required to include in Phase I, any ideas it is considering for inclusion in a second Phase II addressing rate design. The extension letter stated that the procedure and schedule for finalization and consideration of Cal Am's rate design proposal will be addressed in the general rate case proceeding.

11. On April 13, 2010, the Executive Director granted Cal Am a limited extension to August 1, 2010, to submit its rate design proposal in its upcoming statewide general rate case.

12. In past general rate cases, because more accurate information was not available, an estimate was used to calculate test year California Corporate Franchise Tax for federal income tax purposes.

13. Changes to California Revenue and Taxation Code may provide more timely and accurate information for the California Corporate Franchise Tax calculation.

14. Any changes to the methodology used to calculate Cal Am's California Corporate Franchise Tax adopted in this decision would apply to only three of Cal Am's seven districts, and result in inconsistent tax calculations among the districts. A review of the California Corporate Franchise Tax is more appropriately undertaken in Cal Am's upcoming statewide general rate case due to be filed July 1, 2010 .

15. Any changes to the methodology used to calculate the Domestic Production Activities Deduction adopted in this decision would apply to only three of Cal Am's seven districts and result in inconsistent tax calculations among the districts.

16. A review of the calculation of the Domestic Production Activities Deduction is more appropriately undertaken in Cal Am's upcoming statewide general rate case due to be filed July 1, 2010.

17. When a utility seeks recovery of costs tracked in a memorandum account, the utility must also demonstrate that the costs are not covered by other authorized rates, it is appropriate for ratepayers to pay for those categories of

costs in addition to otherwise authorized rates, the utility acted prudently when it incurred those costs, and the level of costs is reasonable.

18. D.10-06-003 has been issued in Cal Am's petition to modify D.09-07-021, which impacts the rates in this proceeding.

Conclusions of Law

1. Rule 12.1(d) provides that the Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

2. The settlement is reasonable in light of the whole record.

3. The settlement is consistent with law.

4. The settlement is in the public interest.

5. The settlement should be adopted.

6. The Executive Director's extension to August 1, 2010, for Cal Am to submit its rate design proposal in its upcoming statewide general rate case should be affirmed.

7. Cal Am's methodology for calculation of the California Corporate Franchise Tax should be adopted. The issue of whether to revise Cal Am's methodology for calculation of the California Corporate Franchise Tax should be undertaken in Cal Am's statewide general rate case to be filed July 1, 2010.

8. In its statewide general rate case, Cal Am should provide comparison information regarding the amount of California Corporate Franchise Tax estimated in its previous three general rate cases and the actual amount of California Corporate Franchise Tax paid for the same time periods.

9. Cal Am's methodology for calculation of the Domestic Production Activities Deduction should be adopted. The issue of whether to revise Cal Am's methodology for calculating the Domestic Production Activities Deduction

should be undertaken in Cal Am's statewide general rate case, due to be filed July 1, 2010.

10. Authorization for a memorandum account to track costs associated with Cal Am's compliance with new federal Ground Water Rules should be granted.

11. The final rates adopted in this proceeding should reflect the impact of D.10-06-003, the Commission's decision in Cal Am's petition to modify D.09-07-021, which was issued on June 4, 2010.

O R D E R

IT IS ORDERED that:

1. The joint motion of California American Water Company and the Division of Ratepayer Advocates to approve the settlement is granted, to the extent set forth in this Order.

2. California American Water Company is authorized to file a Tier 2 advice letter no later than October 15, 2010, to request recovery of the additional amortization of costs related to expenses for tank painting completed in 2010. The effective date for the annual Step rate increase shall be January 2011.

3. California American Water Company is authorized to file by Tier 1 advice letter the revised tariff schedules attached to this order as Attachments A, B, and C, and to concurrently cancel its present schedules for such service. This filing shall be subject to approval by the Commission's Division of Water and Audits. The effective date of the revised schedule shall be no earlier than July 1, 2010, and shall apply only to service rendered on or after the effective date for the Larkfield and Sacramento districts. For the Los Angeles District, the effective date of the revised schedule shall be January 1, 2010, and California American

Water Company is authorized to file a Tier I advice letter to recover the difference between the interim and final rates from its Los Angeles Districts customers.

4. For escalation years 2011 and 2012, California American Water Company shall file Tier 2 advice letters in conformance with General Order 96-B proposing new revenue requirements and corresponding revised tariff schedules for each district and rate procedures set forth in the Commission's Rate Case Plan (Decision 07-05-062) for Class A Water Utilities and shall include appropriate supporting workpapers. The revised tariff schedules shall take effect no earlier than July 1, 2011 and July 1, 2012, respectively and shall apply to service rendered on and after their effective dates. The proposed, revised revenue requirements and rates shall be reviewed by the Commission's Division of Water and Audits. The Division of Water and Audits shall inform the Commission if it finds that the revised rates do not conform to the Rate Case Plan, this order, or other Commission decisions, and if so, reject the filing.

5. California American Water Company shall file its 2010 statewide general rate case no later than July 1, 2010, but may omit its rate design proposal. California American Water Company shall serve its rate design proposal in its 2010 statewide general rate case no later than August 1, 2010.

6. California American Water Company shall include in its 2010 statewide general rate case application, updates and analyses on the meet and confer sessions and data collection referenced in the settlement. California American Water Company shall include in its 2010 statewide general rate case application, any ideas it is considering for inclusion in its rate design proposal.

7. California American Water Company is authorized to file a Tier 1 advice letter to establish a balancing account for each district to track and recover

variations in pension expenses. The balancing accounts shall be used to track the difference between the level of expenses authorized in rates and the actual costs. Cal Am's recovery for ratemaking purposes shall be capped at the minimum level of Benefit Plan expense calculated according to the Employee Retirement Income Security Act minimum funding levels. The effective date of the balancing accounts shall be the effective date of this decision and the balancing accounts shall track only costs incurred on or after the effective date of the balancing accounts.

8. California American Water Company is authorized to file a Tier 1 advice letter to establish a balancing account for each district to track and recover variations in post retirement benefits other than pension. The balancing accounts shall be used to track the difference between the level of post retirement benefits other than pension expenses authorized in rates and the actual minimum costs calculated according Federal Accounting Standard 106. The effective date of the balancing accounts shall be the effective date of this decision and the balancing accounts shall track only costs incurred on or after the effective date of the balancing accounts.

9. California American Water Company is authorized to file a Tier 3 advice letter to seek recovery of any costs beyond \$147,082 for the Faught Road Well once the project is used and useful.

10. California American Water Company is authorized to file a Tier 2 advice letter to establish a developer special facilities fee in the Larkfield District for the Faught Road Well. The precise amount of the fee shall be determined using actual costs divided by the number of customers served.

11. California American Water Company is authorized to file a Tier 2 advice letter to establish a developer special facilities fee in the Rosemont Service Area

of the Sacramento District specifically related to the Jackson Booster Station Tank. The precise amount of the fee shall be determined using actual costs divided by the number of customers served.

12. In its statewide general rate case, to be filed July 1, 2010, California American Water Company shall provide comparison information regarding the amount of California Corporate Franchise Tax estimated in its previous three general rate cases and the actual amount paid for the same time period. The schedule for submitting the information shall be determined by the assigned Administrative Law Judge.

13. A review of California American Water Company's calculation methodology for the Domestic Production Activities Deduction shall be undertaken in its statewide general rate case, to be filed July 1, 2010. The schedule shall be determined by the assigned Administrative Law Judge.

14. California American Water Company is authorized to file a Tier 1 advice letter to establish a memorandum account specifically for tracking the costs associated with Cal Am's compliance with new federal Ground Water Rules. California American Water Company is authorized to file a Tier 3 advice letter to request recovery of those costs. The Tier 3 advice letter shall include written justification to substantiate that the costs are incremental costs, not costs already covered within base rates. Authorization of the memorandum account does not guarantee recovery of expenses booked to this memorandum account that have been otherwise authorized in rates or are imprudent or unreasonable.

15. California American Water Company's application is granted only to the extent specified in this decision and is otherwise denied.

16. The rates adopted in this decision reflect the impact of Decision (D.) 10-06-003, the Commission's decision in California American Water Company's petition to modify D.09-07-021, which was issued on June 4, 2010.

17. Application (A.) 09-01-013, A.09-05-008, and A.09-07-002 are closed.

This order is effective today.

Dated _____, at San Francisco, California.