

Decision **PROPOSED DECISION OF ALJ WALWYN** (Mailed 11/10/2011)

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

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.

Application 10-09-018  
(Filed September 22, 2010)

(See Appendix 4 - Service List for Appearances)

**DECISION AUTHORIZING CALIFORNIA-AMERICAN WATER COMPANY TO  
IMPLEMENT THE CARMEL RIVER REROUTE AND SAN CLEMENTE DAM  
REMOVAL PROJECT**

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**DECISION AUTHORIZING CALIFORNIA-AMERICAN WATER COMPANY TO  
IMPLEMENT THE CARMEL RIVER REROUTE AND SAN CLEMENTE DAM  
REMOVAL PROJECT**

**1. Summary**

We approve today California-American Water Company's (Cal-Am) request to implement the Carmel River Reroute and San Clemente Dam Removal Project (Project) in partnership with the California State Coastal Conservancy and the National Marine Fisheries Service. We also authorize ratepayer recovery of Cal-Am's funding portion of the Project, \$49 million, to be paid through a volumetric surcharge on customers' bills over the next 20 years.<sup>1</sup>

The goal of the Project is to eliminate the San Clemente Dam's (Dam) seismic safety hazard, provide comprehensive restoration of the natural character and function of the valley bottom, and restore steelhead fish passage. This will be accomplished by permanently bypassing a portion of the Carmel River by cutting a channel between the Carmel River and San Clemente Creek, upstream of the Dam. The bypassed portion of the Carmel River will be used as a disposal site for the accumulated sediment and the Dam will be removed.<sup>2</sup>

In this decision we also address Cal-Am's request for rate recovery of approximately \$26 million for costs incurred over the last decade in pursuing a proposal to buttress, or thicken, the existing dam structure. We find that Cal-Am did not act prudently in proposing this option to address the dam's seismic

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<sup>1</sup> While Cal-Am did not provide for a sufficient depreciation reserve when the Dam was in utility service, we find that ratepayers should pay the reasonable costs associated with decommissioning, or retiring, the Dam.

<sup>2</sup> Exhibit 1, Direct Testimony of Mark Schubert at 11.

safety issues as (1) Cal-Am did not properly identify and analyze the relevant risks of this option and (2) Cal-Am did not fully analyze the alternative options recommended since 1999 by its public partners in today's approved Project. Therefore, based on our findings that the Dam has not been a used and useful asset since 2003 and Cal-Am's proposal for dam buttressing would provide neither flood or water storage nor water supply, as well as posing serious environmental risks, we conclude that shareholders rather than ratepayers should be responsible for the costs tracked in the San Clemente Dam memorandum account that are not part of the estimated \$83 million Project costs included in Appendix 1 to this decision.

In approving \$49 million in ratepayer funding for the Project, we find that Cal-Am should be authorized its incremental cost of debt as a carrying charge but not an equity return for its shareholders. We reach this conclusion because (1) the Project will not provide utility service to customers; (2) in the Coastal Water Project proceeding, A.04-09-019, Cal-Am estimates it's ratepayers will face substantial rate increases in the next few years in order to fund Cal-Am's cost of obtaining additional water supply; and (3) granting Cal-Am an equity return would more than double the estimated surcharge being authorized here by 2014 due to the higher equity rate of return as well as the need to include a provision for additional taxes and uncollectibles in the revenue requirement.

An important finding in this proceeding is that Cal-Am has not provided water supply from the Dam to its customers since the 2002/2003 water year and that it misrepresented this fact in two prior proceedings that reviewed the memorandum account and determined the proper carrying charges to apply to the account. In November 30, 2011 opening comments in this proceeding, Cal-Am denies making its earlier assertions and further, quotes 2005 testimony

in a manner that directly contradicts the citing of this testimony in 2005 to establish that water from the Dam was continuing to be supplied to customers; both the pleading here and in 2005 are signed by the same attorney. Based on Cal-Am's actions, we should issue an order to show cause as to why applicant should not be fined or otherwise sanctioned for a failure to comply with Rule 1.1 of the Commission's Rules of Practice and Procedure, and Sections 2107 and 2108 of the Public Utilities Code.

## **2. Procedural Background**

On September 22, 2010, California-American Water Company (Cal-Am) filed this application for authorization to implement the Carmel River Reroute and San Clemente Dam Removal Project (Project) and to recover from its customers the costs associated with the Project over a twenty-year period. Cal-Am asserts that the Project addresses longstanding seismic issues associated with the San Clemente Dam (Dam), provides significant environmental benefits, and due to an innovative public/private partnership, will not cost Cal-Am's customers any more than the least-cost option Cal-Am analyzed for addressing seismic safety concerns.<sup>3</sup>

Cal-Am's partnership on the Project is with the California State Coastal Conservancy (Conservancy) and the National Marine Fisheries Service (NMFS). The Conservancy, established in 1976, is a State agency that protects, restores and enhances coastal natural resources and the public's access and enjoyment of the coast. It does its work largely by providing funding and technical assistance for projects carried out by local governments, other public agencies, and

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<sup>3</sup> Application at 1.

nonprofit organizations. It is providing funding for this Project in order to have the environmentally superior option of Dam removal pursued by Cal-Am; to avoid gifting public funds to a corporation, the Conservancy has limited its funding to costs that exceed Cal-Am's alternative proposal to strengthen the Dam by adding steel-reinforced concrete to the existing structure (Dam buttressing). The NMFS is a federal agency and is participating in the Project due to its concerns that the Dam buttressing alternative's use of sluice gates with a new fish ladder could harm the endangered steelhead fish in the Carmel River.

Cal-Am requests rate recovery for \$49 million in estimated Project construction costs. Cal-Am also seeks review and rate recovery of all costs recorded in the San Clemente Dam memorandum account through October 31, 2010, and the estimated costs from November 1, 2010 through December 31, 2011. Cal-Am proposes to fund this recovery through a Regulatory Asset and San Clemente Dam balancing account, with surcharges to begin on January 1, 2012, and continue over a 20-year period. Cal Am requests to book all costs it incurs into the balancing account and to have the difference between estimated and final costs reviewed and trued-up when the Project is complete.

On October 29, 2010, the Division of Ratepayer Advocates (DRA) and the Monterey Peninsula Water Management District (MPWMD) separately protested Cal-Am's application.

On November 8, 2010, Cal-Am replied to the protests. On November 19, 2010, Cal-Am submitted a supplemental filing on costs tracked in the memorandum account and included a revised proposed procedural schedule to address DRA's staffing concerns. A prehearing conference was held on November 22, 2010 to discuss the proposed scope and schedule for the

proceeding. An Assigned Commissioner and Administrative Law Judge's Ruling and Scoping Memo followed on December 23, 2010.

Public Participation Hearings were held in Monterey and Seaside California on February 7 and 8, 2011, and evidentiary hearings were held in San Francisco on June 8-13, 2011.<sup>4</sup> The record was submitted on July 20, 2011, with the filing of reply briefs.

### **3. History of the Project**

The Dam is a 106-foot high concrete arch dam located approximately 18.5 miles from the Pacific Ocean on the Carmel River. It was constructed in 1921 and has been operated by Cal-Am since 1966. Historically, the Dam provided water for Cal-Am's customers by diverting the surface flow of the Carmel River at the Dam; however, due to sediment build-up and endangered species concerns, the San Clemente Reservoir last acted as a diversion point and supplied water to customers during the 2002-2003 Water Year.<sup>5</sup>

In 1980, Cal-Am was required by the Division of Safety of Dams (DSOD), an agency under the California Department of Water Resources, to evaluate the ability of the Dam to safely pass the Probable Maximum Flood and withstand the Maximum Credible Earthquake. Based on the evaluation, DSOD directed Cal-Am in 1992 to improve the Dam so that it would meet current seismic safety

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<sup>4</sup> A late-filed motion to intervene was filed by the Planning Conservation League Foundation (PCLF) on May 25, 2011 and granted the same day. PCLF served rebuttal testimony on May 25th and participated in evidentiary hearings and briefing. On June 6, 2011, PCLF filed a Notice of Intent (NOI) to seek intervenor compensation. By Administrative Law Judge (ALJ) ruling dated August 4, 2011, PCLF was found ineligible to seek intervenor compensation in this proceeding due to the untimeliness of its NOI filing.

<sup>5</sup> See March 28, 2011 data response provided by Cal-Am at Exhibit 23, Attachment 2-3.

standards. Also in 1992, two species present in the Carmel River watershed, the South-Central California Coast steelhead and California red-legged frog, were listed as candidates for study pursuant to the Federal Endangered Species Act of 1973, as amended. The red-legged frog was designated as “threatened” in 1996, followed by the steelhead in 1997.<sup>6</sup> In developing its proposal to resolve the seismic safety issue, Cal-Am needed to address potential adverse affects to these species, particularly the listed steelhead, under both a state Environmental Impact Report (EIR) and a federal Environmental Impact Statement (EIS) permitting process.

As the Project proponent, Cal-Am proposed and supported Dam buttressing as its preferred project throughout two EIRs and one EIR/EIS. Cal-Am briefly explored dam removal as an option in the early 1990s, but in its 1995 Preliminary Feasibility Study for DSOD it did engineering studies only on seven dam reinforcing options and a “no action” option. DSOD accepted this study when it initiated a California Environmental Quality Act review.<sup>7</sup>

A draft EIR was first issued by DSOD for review on December 23, 1998. In a letter dated February 12, 1999, the NMFS, filed comments stating that (1) in the Draft EIR the selection of alternatives was compromised by flawed or omitted analyses, and (2) a dam removal alternative would be far more beneficial than the preferred alternative.<sup>8</sup> A year later, the NMFS wrote the U.S. Army Corps of Engineers, with a copy to Cal-Am, that the environmental documentation Cal-Am intended to provide to satisfy the Corps’ obligations under federal

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<sup>6</sup> See Exhibit 23, Attachment 4-6 at 1, and Exhibit 4 at 47.

<sup>7</sup> See Exhibit 4 at 14-15.

environmental regulations, specifically the National Environmental Policy Act, was inadequate because “Cal-Am failed to fully develop a dam removal alternative.”<sup>9</sup>

Due to extensive public and agency comments, the DSOD issued a second EIR, referred to as the Recirculated Draft EIR (RDEIR) in 2000. After receiving further critical comments, DSOD withdrew the RDEIR in 2002. With no pending EIR process, DSOD chose to direct Cal-Am in 2002 to undertake interim dam safety actions, which included (1) installing an emergency seismic monitoring system and developing an emergency action plan, and (2) lowering the level of the reservoir behind the Dam through annual water drawdowns. Cal-Am fully implemented these measures by June 2003 and continues them to the present.

A combined EIR/EIS process, designed to meet both federal and state environmental review requirements, was initiated by DSOD in 2004 with the U.S. Army Corp of Engineers. During the scoping process, a new alternative, dam removal, was added. The San Clemente Dam Seismic Safety Project Draft EIR/EIS was released in 2006. It included the Carmel River Reroute and Dam Removal as Alternative 3. In December 2007, DSOD certified the Final EIR/EIS, and in February 2008, the DSOD confirmed that Alternative 3 would alleviate the dam safety deficiencies.

Since 2000, the Conservancy has funded studies to explore dam removal options. After the 2006 draft EIR/EIS included the reroute and removal option as an alternative, the Conservancy in 2007 funded over \$700,000 in studies to

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<sup>8</sup> See Exhibit 23, Attachment 2-5 at 2.

<sup>9</sup> *Id.* at Attachment 2-6 at 4.

further evaluate the feasibility of this alternative to achieve both safety and ecological objectives and to evaluate design changes.<sup>10</sup> After the reroute and removal project was confirmed as a feasible alternative to Dam buttressing in 2008, the Conservancy and NMFS engaged Cal-Am in a dialogue about implementing the project. Cal-Am abandoned these discussions in February 2009 due to concerns regarding the availability of state funding to assist with the project. However, the effort resumed in January 2010, and Cal-Am and various federal, state, and local officials signed the San Clemente Dam Removal Project Collaboration Statement, attached to the application as Appendix 3. In collaboration with the Conservancy and NMFS, Cal-Am developed the Project contained in this application.

#### **4. Authorization of the Project**

The Project enjoys wide support at the federal, state, and local level because it is the environmentally superior option for addressing the seismic and flood safety concerns of the existing Dam.

The project management team is composed of Cal-Am, the Conservancy, and NMFS. The Conservancy has also assembled a Technical Review Team comprised of a variety of experts from, among others, NMFS, the Bureau of Reclamation, the U.S. Fish and Wildlife Service, the California Department of Fish and Game, the Monterey County Water Resources Agency, the Regional Water Quality Control Board, the Carmel River Steelhead Association, U.C. Berkeley, and private engineering firms. The Technical Review Team, paid

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<sup>10</sup> Exhibit 3, Chapman testimony at 4.

for by the Conservancy, will provide guidance and assistance throughout the process.

The Conservancy is responsible for the required technical studies and design work and will meet regularly with its Technical Review Team. The Bureau of Reclamation will assist the project by conducting a Design, Cost Estimating and Construction review process and NMFS and the Conservancy will assist Cal-Am on permitting and community outreach. If actual construction costs are lower, the cost savings will be allocated between Cal-Am and the Conservancy.

The construction portion of the Project includes relocating approximately 370,000 cubic yards of sediment accumulated behind the Dam on the San Clemente Creek arm of the reservoir to the Carmel River arm of the reservoir and removing the Dam. A portion of the Carmel River will be permanently bypassed by cutting a 450-foot long channel between the Carmel River and San Clemente Creek, approximately 2,500 feet upstream of the dam. The bypassed portion of the Carmel River will be used as a sediment disposal site for the accumulated sediment. The rock spoils from the channel construction will be used to construct a diversion dike at the upstream end of the bypassed Carmel River channel.<sup>11</sup>

The Project is anticipated to start in 2012. After all permitting, compliance and preliminary engineering activities are final, the Project will take approximately three years for construction work to be completed.

When the Project is complete, the federal Bureau of Land Management (BLM) has given a preliminary commitment to accept donation of the land

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<sup>11</sup> Exhibit 8, Application at 15.

surrounding the Project for long term management in a manner that will provide the public with opportunities to recreate and enjoy the Carmel River corridor while restoring critical habitat for endangered species. This commitment includes a requirement that after the Project is completed, there be a two year monitoring of the significant design components of the Project (i.e. river diversion channel, diversion dam condition, stabilization of sediment basin in the Carmel River). Cal-Am and the Project management team are required to assist BLM in establishing an endowment which will provide BLM with funding for law enforcement and management presence in the area.<sup>12</sup>

All parties to this proceeding agree that Cal-Am must address the seismic and flood safety issues of the current Dam and that the Project is the best alternative to do so. Based on the discussion above, we should authorize Cal-Am to implement the Project, in partnership with the Conservancy and NMFS. Further, given this broad-based support for the Project, there are relatively few disputed issues for us to resolve. We now turn to these issues, which largely concern ratepayer cost responsibilities for the Project.

## **5. Resolution of Disputed Issues**

The primary issues to be decided in determining ratepayer responsibilities for the cost recovery requested by Cal-Am are: (1) whether the San Clemente Dam is a used and useful utility asset; (2) whether Cal-Am pursued its Dam buttressing alternative in a prudent manner that meets our standards for cost recovery of the San Clemente Dam memorandum account; and (3) what level of funding and under what terms should ratepayers provide cost recovery for the

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<sup>12</sup> See August 2, 2010 BLM letter to Cal-Am, Exhibit 7.

Project. In addition to these cost recovery issues, there is a dispute regarding some of the land appurtenant to the Project. We also resolve this land issue in today's decision. We address the issues in the order listed above.

### **5.1. San Clemente Dam is Not Used and Useful**

Cal-Am asserts that the existing San Clemente Dam is a used and useful utility asset because (1) it is available as a source of water supply to customers due to existing water permits, (2) it can be used for water supply to customers in emergencies, and (3) it holds in place approximately 2.5 million cubic yards of accumulated sediment, thereby minimizing downstream impact to fishery and frog habitat and to property owners.<sup>13</sup> Cal-Am also argues that the Dam buttressing it has pursued is a viable option, and that under this alternative it would create a used and useful asset upon which it would be authorized an opportunity to earn a reasonable rate of return.<sup>14</sup>

DRA asserts that the Dam is not used and useful because (1) the Dam has not provided any water to Cal-Am's ratepayers since 2003 and (2) today is a sediment-laden, environmentally harmful peril to endangered species and the community that lives downstream. In addition to providing no operational value to Cal-Am, DRA argues the Dam must be removed (at a huge expense) to prevent further harm to the environment and reduce the risk to the area downstream of the facility.<sup>15</sup>

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<sup>13</sup> See July 7, 2011 Opening Brief at 50-51.

<sup>14</sup> *Id.* at 54.

<sup>15</sup> See DRA's July 20, 2011 Reply Brief at 5.

PCLF asserts that the Dam should be considered used and useful because its retention of sediment reduces the threat of loss of life and property in downstream areas during flood events.

In assessing whether the Dam is used and useful today, we first look to Cal-Am's testimony. In response to a DRA data request, Cal-Am's engineering witness states that the utility "ceased using San Clemente Dam as a diversion point in the 2002-2003 water year" and "currently the San Clemente Dam does not provide any services related to water supply."<sup>16</sup> In discussing how the Dam could be used for emergency purposes, the same witness testified the Dam is not currently available to serve as a water supply source in an emergency but could possibly be used within 24 hours of an extreme emergency if a pump could be brought in and connected, and if the water quality was acceptable for drinking.<sup>17</sup>

We find that the Dam is not now used and useful, and has not been used and useful for many years. Specifically, the definition of a used and useful utility asset is one that provides direct and ongoing benefits to customers and, as discussed above, the San Clemente Dam has not done this since the 2002/2003 water year, which ended September 30, 2003. We also find that the Dam does not provide any benefit as an emergency water source because it is not presently connected to do that, and Cal-Am has more readily available options for use in emergency situations.<sup>18</sup> While the Dam is holding back a large amount of

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<sup>16</sup> Exhibit 23, Attachment 4-2.

<sup>17</sup> Transcript, Volume 5 at 345-6.

<sup>18</sup> See Exhibit 23 at 7-2 and DRA's opening brief at 29.

sediment, the sediment is due entirely to the presence of the Dam and Cal-Am's sediment management practices.<sup>19</sup>

Therefore, we conclude that the San Clemente Dam has not been a used and useful asset for ratemaking purposes since 2003.

## **5.2. Cal-Am's Pursuit of Dam Buttressing Not Prudent**

Here, we address whether the Dam buttressing proposal that Cal-Am pursued as its preferred alternative through three EIRs was prudent in light of information available to Cal-Am's management. On this issue, we rely on statements in the record from both NMFS and the Bureau of Reclamation that Cal-Am's buttressing project would not provide water supply for its customers, as well as statements from NMFS that Cal-Am's buttressing proposal would endanger steelhead and their critical habitat and therefore not meet federal permitting standards<sup>20</sup>. The Conservancy and NMFS repeatedly tried over the last 10 years to have Cal-Am seriously consider a Dam removal option. For example, in a April 3, 2000 letter to the U.S. Army Corps of Engineers, copied to Cal-Am, NMFS states that Cal-Am has chosen not to seriously consider a Dam removal option, even though several natural resource organizations have set this as a priority for funding and support, and that Cal-Am's proposed seismic retrofit project "does not provide flood storage, hydropower, or water storage."<sup>21</sup>

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<sup>19</sup> For discussion of alternative options, see DRA opening brief at 16 and Cal-Am testimony at Transcript, Volume 5 at 344.

<sup>20</sup> NMFS letters are found in Exhibit 23 as Attachments 2-5, 2-6, 4-4, 4-5, 4-6, and 4-7. See also rebuttal testimony of Joyce Ambrosius at Exhibit 3 and Transcript Volume 3 at 92-155. The Bureau of Reclamation Study is at Exhibit 23, Attachment 7-2.

<sup>21</sup> See Exhibit 23, Attachment 2-6 at 4-5.

Further, in a June 30, 2006 letter to the U.S. Army Corps of Engineers, also copied to Cal-Am, NMFS states:

Our enclosed comments and detailed involvement since 2000 have provided the Corps the assistance necessary to develop and determine environmentally preferable alternatives. As stated in our April 5, 2006 letter, NMFS believes the use of sluice gates as proposed in the Proponent's Proposed Project and Alternative 1 is a fatal project flaw. The Draft EIR/EIS notes San Clemente Dam and Reservoir were never intended for flood control and the San Clemente Dam Seismic Safety Project has neither flood storage nor flood operations criteria. The Draft EIR/EIS also notes San Clemente Reservoir does not provide water storage for the California American Water Company system and the Proponent's Proposed Project will not improve current or future water storage. A dam and reservoir that provides neither flood storage nor water storage, commensurate with the long-term adverse environmental impacts associated with operating and maintaining the dam, make it clear to NMFS that Alternative 2 (dam removal) or Alternative 3 (Carmel River reroute and dam removal) are the environmentally preferable alternatives. Implementation of the Proponent's Proposed Project or Alternative 1 will likely jeopardize S-CCC DPS steelhead and destroy designated critical habitat of S-CCC DPS.<sup>22</sup>

In the May 2011 report titled "Review of Historic San Clemente Dam Reservoir Sediment Management Practices", the Bureau of Reclamation states "California-American Water has requested a ratepayer increase to pay the cost of making the dam safe, but the dam and reservoir would still not provide benefits, unless at least some of the reservoir sedimentation was removed and future sediment accumulation was prevented."<sup>23</sup>

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<sup>22</sup> *Id.*, Attachment 4-7 at 2 and 3.

<sup>23</sup> *Id.*, Attachment 7-2 at 15.

The Bureau of Reclamation states that prudent reservoir management by a dam owner would require monitoring of the reservoir sedimentation; however, it appears Cal-Am did no sedimentation surveys or had any sedimentation management plan from the time it acquired the dam until it performed a survey in 1996. The current Dam through its years of operation has trapped an estimated sediment volume of 1,555 acre feet (2.5 million yards), leaving a remaining reservoir storage capacity of only 100 acre-feet (a small pool near the Dam).<sup>24</sup> At a normal rate of sediment inflow, this 100 acre feet will be gone between 2013 to 2017.<sup>25</sup> To remove the accumulated sediment would be expensive, specifically dredging costs of \$12 to \$30 per cubic yard for the 2.5 million cubic yards of accumulated sediment,<sup>26</sup> and removing it would require 125,000 truck loads at 20 cubic yards per truckload.<sup>27</sup>

Based on the discussion above, we find that the Dam buttressing proposals Cal-Am had pursued since 1999 were at all times imprudent. The proposals could not have provided Cal-Am's customers water supply and would not have satisfactorily resolved safety and environmental concerns.

Moreover, the evidence in this proceeding reveals Cal-Am misled the Commission in two earlier proceedings when Cal-Am asserted that the Dam was currently providing a point of water diversion for customers in the winter

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<sup>24</sup> This is a high estimate of remaining storage capacity. Cal-Am's consultant estimates the Dam had approximately 70 acre-feet of remaining storage in 2008. *See* Exhibit 1, Schubert Direct Testimony, Tab 3 at 6.

<sup>25</sup> *Id.* at 5.

<sup>26</sup> *See* Cal-Am's Opening Brief at 51.

<sup>27</sup> DRA's July 7, 2011 Opening Brief at 40.

months and that the planned buttressing would enable the Dam to be used and useful.<sup>28</sup>

While MPWMD challenged Cal-Am's assertions in both the 2006 general rate case proceeding, (Application (A.) 05-02-012), and the later proceeding to determine carrying costs for the San Clemente Dam Memorandum Account, (A.07-02-023), the issues raised by MPWMD regarding the Dam's used and usefulness were not fully investigated by the Commission. Instead, relying on Cal-Am's assertions, the Commission established the San Clemente Dam Memorandum Account with an interest rate set at the 90-day commercial paper rate in D.06-11-050, and later increased the interest rate for this memorandum account to Cal-Am's authorized rate of return in D.08-05-036.

Our finding here that the Dam has not been a used and useful utility asset for the last eight years (i.e. since the end of the 2002/03 water year), and that the Dam buttressing Cal-Am imprudently pursued would not have returned the Dam to utility service, necessarily affects our determination of ratepayer cost responsibility for Cal-Am's work related to the Dam. We address these cost issues below.

### **5.3. Limitations on Ratepayer Cost Responsibility**

As detailed in the application, Cal-Am has entered an agreement with the Conservancy for a public/private collaboration to meet the estimated cost of \$83 million for the project. Under this agreement, the Conservancy will undertake efforts to secure approximately \$34 million from state, federal, and

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<sup>28</sup> See Decision (D.) 06-11-050, issued December 1, 2006, mimeo at 40-46, Findings of Fact 24 and 25 at 101, Conclusion of Law 3 at 106, and Ordering Paragraph 19 at 111 and D.08-05-036, issued May 30, 2008, *mimeo* at 2 and 4.

private foundation resources and Cal-Am will commit to funding the remaining \$49 million in estimated costs. When the Project's construction is complete, the land will be donated to BLM to be maintained.

DRA supports the Project but does not support requiring current or future ratepayers to pay for the proposed costs because it asserts the costs have been exacerbated and in some cases caused by Cal-Am's mismanagement of the Dam. Its primary reasons for opposing ratepayer funding are: (1) Cal-Am, as the asset owner, did not account for its future obligation to remove the Dam at the end of its service life; (2) Cal-Am imprudently pursued an unviable project alternative, knowing it was unlikely to become the preferred alternative and which eventually resulted in an abandoned project and (3) Cal-Am did not determine feasible alternatives for managing sedimentation during the Dam's useful life and did not effectively manage the sediment, resulting in a more technologically complicated and expensive Dam removal project.<sup>29</sup>

While DRA's primary recommendation is that as a result of the regulatory compact and past management decisions made by Cal-Am, no cost responsibility for the Project should be transferred to ratepayers, it presents an alternative recommendation should the Commission reject this position. As an alternative, DRA recommends: (1) there be an absolute cost cap of the \$49 million on ratepayer responsibility for the Project's current and future liabilities, (2) the ratepayer cost responsibility be offset by the appropriate value of land sold or

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<sup>29</sup> See Exhibit 23 at 7-2 and DRA's Opening Brief at 29.

transferred as part of the Project, and (3) Cal-Am be precluded from earning an equity return on any Project cost responsibilities transferred to ratepayers.<sup>30</sup>

Representatives of the Conservancy and NMFS appeared as witnesses for Cal-Am and supported the Project. PCLF supports ratepayer cost recovery for the proposed Project, with the recommendations that the Commission include a cost cap informed by the updated cost estimate prepared by the Technical Review Team, that shareholders' return on the investment be limited and some adjustment of costs in the memorandum account considered, that there be appropriate reporting requirements, and that Cal-Am be directed to study the physical options for managing the continued sediment accumulation in its upstream Los Padres Dam. PCLF supports ratepayer funding in order for the project to go forward to address public safety issues in a timely manner.

While we share many of DRA's concerns with Cal-Am's actions regarding the Dam, particularly over the last 10-15 years, we believe that ratepayers should pay the reasonable costs associated with decommissioning, or retiring, the Dam. As discussed by both Cal-Am and DRA, a reserve for decommissioning or retiring the Dam was never established; the net book value in ratebase today is \$390,707.79. We want to provide sufficient funds to enable the Dam to be safely decommissioned, and in an environmentally responsible manner, while still ensuring that the ultimate responsibility for properly managing the costs and the Project are Cal-Am's, not its customers.

In D.06-11-050, Cal-Am estimated that the total cost of the Dam buttressing project, including all costs and Allowance for Funds Used During Construction

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<sup>30</sup> *Id.* at 8-1 and 8-2.

in the memorandum account, was \$47 million, with a completion date of December 2009.<sup>31</sup> This amount is close to the \$49 million contribution the Conservancy has asked be contributed by Cal-Am.

We are comfortable with the Project design as proposed, the recently updated cost estimates, and the oversight of the Technical Team assembled by the Conservancy. Further, we find there is a strong public interest in having this Project be completed in a timely manner. The concerns raised by DRA regarding Cal-Am's management of the Dam over the last 45 years should be carefully considered in our prudence review of the existing memorandum account, not in our commitment to enabling the Project to go forward.

Therefore, based on the record here, as well as DRA's alternative recommendation, we find that a firm cost cap of \$49 million, to include any authorized memorandum account cost recovery and carrying charges, offset by the value of Cal-Am's land donation, and with no equity return for Cal-Am's shareholders, is a reasonable cost responsibility for ratepayers to the proposed Project.

#### **5.4. San Clemente Dam Memorandum Account**

The San Clemente Dam Memorandum Account (Memorandum Account) has its beginnings in Cal-Am's 1993 general rate case (GRC) proceeding, when the Commission approved the inclusion into rate base of \$790,000 and directed all other costs be tracked in a memorandum account. Memorandum account treatment has continued to the present except for the 2002 GRC proceeding, which allowed the costs to be treated as construction work in progress. The

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<sup>31</sup> D.06-11-050, *mimeo* at 40.

Commission transferred these costs back to the memorandum account in the next GRC proceeding based on its findings that the specific project to address seismic safety issues was unclear, as was the Dam's current used and usefulness.<sup>32</sup>

The Commission uses memorandum accounts rather than balancing accounts when the Commission has yet to review or authorize the costs being tracked and the ultimate recovery of costs being tracked is uncertain and will require a full reasonableness review. Cal-Am acknowledged the risks of recovery of this memorandum account in 2007 when it requested a higher carrying cost for the memorandum account based on the ultimate risk of recovery its investors faced:

The declaration explained that regulators may disallow some or all of the San Clemente Dam costs which creates greater risk for recovery of the dam investment than on Cal-Am's previously-approved rate base.<sup>33</sup>

Cal-Am seeks rate recovery here for \$26,802,658 for its initial surcharge. Part of this is tracked in the memorandum account, part is estimated, and part is

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<sup>32</sup> Exhibit 1, Stephenson testimony at 4 and D.06-11-050, issued December 1, 2006, *mimeo* at 40-46, Findings of Fact 24 and 25, Conclusion of Law 3, and Ordering Paragraph 19.

<sup>33</sup> See D.08-05-036 issued on May 30, 2008, *mimeo* at 5. We note here that, without Commission authorization, Cal-Am's management took a different position and reflected the memorandum account in its balance sheet as a regulatory asset in its 2010 10-K Security and Exchange Commission filing, asserting that "it expected the costs to be fully recovered from customers in future rates." See 10-K filing at 83 and 98 and Exhibit 23, Attachment 8-1. The San Clemente Dam memorandum account is different than Cal-Am's Coastal Water Project memorandum account in that the Commission has reviewed and approved recovery of Coastal Water Project pre-construction costs incurred through December 31, 2008 and authorized a current surcharge.

for on-going safety and compliance expenses. Specifically, \$21,724,907 represents costs and interest in the memorandum account through October 31, 2010, \$2,577,751 represents interest that is estimated to accrue between November 1, 2010 and December 31, 2012, and \$2,500,000 represents estimated costs for interim dam safety and environmental measures from November 1, 2010 until the Dam is removed.<sup>34</sup>

Cal-Am requests full recovery for all historical costs in the memorandum account through October 31, 2010, and all estimated costs until the reroute and removal project is complete. It asserts all memorandum costs fall into two categories: (1) costs related to the environmental review and permitting process; and (2) costs for interim environmental and dam safety measures ordered by DSOD. Cal-Am asserts that what these two categories of costs have in common is that neither was discretionary, and “Cal-Am could not have chosen to not incur them.”<sup>35</sup>

In its November 19, 2010, supplemental filing, Cal-Am provided invoices for all costs incurred after 2002, supported by supplemental direct testimony, and in its rebuttal testimony provided invoices for all pre-2002 costs. Cal-Am distinguished the pre-2002 memorandum costs of \$4,406,700 based on its position that DRA had reviewed and agreed to the reasonableness of these costs in Cal-Am’s 2003 GRC proceeding, A.02-04-022.

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<sup>34</sup> Exhibit 8, Application at 12-13. It appears the \$2,500,000 for interim dam safety and environmental measures from November 1, 2010 until the Dam is removed are also included in the estimated Project costs at Appendix 1.

<sup>35</sup> Cal-Am Opening Brief at 18. Cal-Am identifies historical costs as \$6,662,700 for interim dam safety and annual environmental operating costs, plus interest, and the remaining \$15,062, 207 as related to the EIRs.

DRA recommends the Commission approve only \$100,654 of the memorandum account costs for ratepayer recovery. DRA asserts that this amount is the properly tracked expenses for repairs and compliance costs for the Dam structure itself, while the Dam was still used and useful. DRA recommends all other memorandum costs be disallowed.

Specifically, DRA testifies that Cal-Am: (1) failed to provide substantiation for its pre-2002 costs of \$4,406,700, (2) failed to provide evidence of competitive bidding or adequate justification for seven post-2002 contractors (\$3,153,628), and (3) should not recover compliance and maintenance costs for the Dam after it ceased to be used and useful or any costs it incurred in pursuit of the abandoned Dam buttressing project (\$6,298,038).<sup>36</sup> DRA also would disallow \$7,957,270 in interest, company labor and utility plant overhead, and corporate charges on the memorandum account through October 31, 2010, and an additional \$2,577,751 in estimated interest through December 31, 2012.

Based on its audit finding that no competitive bids were sought for this work, DRA also recommends disallowing the \$2,500,000 in estimated costs for interim dam safety and environmental costs for the period November 1, 2010 to the time of Dam removal.

Finally, DRA notes that Cal-Am's \$3,000,000 share of estimated permitting, compliance, and preliminary engineering costs for the Project are part of the

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<sup>36</sup> For pre-2002 costs, the discussion in D.03-02-030, issued on February 13, 2003, supports DRA's assertion that it only agreed to a number for "estimating purposes" and that it was clear the Commission intended to later evaluate whether and how much of the expenditures should be allowed into rates permanently. See mimeo at 42. For the \$6,298,038 in post-2002 costs, DRA testifies that these nine contracts were properly

*Footnote continued on next page*

\$83 million total project estimate.<sup>37</sup> DRA states it has reviewed the scope of activities covered by these expenses and the methods used to determine the estimated costs and has found them to be generally acceptable.

We find the memorandum account disallowances recommended by DRA appropriate based on its audit and also on the Commission's well-established principle that ratepayers are required to bear only the reasonable costs of used and useful plant that provides direct and ongoing benefits, while utility shareholders must bear the full costs incurred in determining the feasibility of a given project which is later abandoned.<sup>38</sup>

The instances of the Commission granting a utility rate recovery for abandoned plant are rare and only done in extraordinary circumstances. The criteria the Commission has used for determining if there are extraordinary circumstances warranting a utility's ratepayers sharing in the costs of abandoned projects are set forth in D.84-05-100, and later cited by the Commission in D.89-12-057 and D.96-09-039. In D.06-11-050, the Commission applied these criteria in granting Cal-Am recovery of the costs it incurred in the abandoned Carmel River Dam project.

In these decisions, the Commission found that in periods of great uncertainty for utility planners, it could be appropriate for ratepayers to bear some of the costs incurred for a project which is ultimately abandoned if the utility demonstrates that it has exercised reasonable managerial skill in

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documented and bid, and therefore are not opposed as part of its audit findings. *See* Exhibit 23 at 3-7.

<sup>37</sup> Exhibit 23 at 5-5.

<sup>38</sup> *See* D.84-09-089, 16 CPUC 2d at 205 and 229.

- (1) identifying, assessing, and to the extent possible, quantifying the risks relevant to its ability and obligation to maintain adequate and reasonable service,
- (2) analyzing projects such that the choice of project reflects an overall strategy to minimize costs, consistent with quality and dependability of service, and
- (3) frequently reviewing its project commitments and overall supply strategy.

The threshold requirement under our criteria is that the abandoned project was planned during a period of dramatic and protracted uncertainty and unusually high risk. We find that Cal-Am had abundant planning information regarding the Dam, and no material uncertainty that could have justified Cal-Am's long and unavailing pursuit of Dam buttressing. Unlike its pursuit of new water supply with the Carmel River Dam project, Cal-Am knew since the 1980s that it had seismic safety issues with the aging Dam. It also knew since the mid-1990s that there were endangered steelhead fish in the river and that it would need to meet state and federal environmental requirements before it could obtain any construction permits.

While we find that Cal-Am does not meet the threshold criterion for consideration of any ratepayer sharing, we will briefly address the other criteria that it would need to meet to justify recovery of costs for the abandoned Dam buttressing project.

As discussed earlier, we find that Cal-Am did not properly identify and analyze the relevant risks of Dam buttressing in pursuing this option, nor did it routinely reevaluate its project. Over the last ten years, Cal-Am ignored the urgings of NMFS and the Conservancy to fully analyze and consider a Dam removal or reroute alternative and it also ignored the warnings of NMFS that a jeopardy opinion could be issued if it continued to pursue the Dam buttressing, especially as proposed with new sluicing gates. It was the Conservancy, not

Cal-Am that did the initial studies and analysis to demonstrate that the proposed Project should be further considered, and while Cal-Am included analysis of a Dam removal and reroute alternative in its last EIR, it was not until 2010 that Cal-Am firmly committed to pursue this alternative.

In conclusion, we find that, with the exception of the \$100,654, and related interest, the remainder of the costs in the San Clemente Dam memorandum account should not be recovered from ratepayers. In reaching this conclusion, we note that the \$326,724 payment to the Conservancy tracked in the memorandum account should instead be included under the \$83 million Project estimate as Cal-Am states this invoice is for preliminary engineering and cost estimate analysis for the Project.<sup>39</sup> In its testimony, Cal-Am states that it is tracking some preliminary Project costs in the memorandum account in order to avoid retroactive ratemaking since Cal-Am has requested that the regulatory asset account, and the related balancing account, not begin until January 1, 2012.<sup>40</sup>

Therefore, the Conservancy costs, and any other memorandum costs that are part of the Project cost estimates in Appendix 1 of this decision, should be transferred to the balancing account we establish in the next section of this decision.

### **5.5. Rate Recovery Mechanisms**

Cal-Am seeks to treat all Project costs as a regulatory asset and to begin recovering the estimated costs through a customer surcharge over a 20-year

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<sup>39</sup> See Exhibit 23 at 3-12.

<sup>40</sup> See Exhibit 8, Stephenson testimony at 17.

period. It requests a balancing account to track the timing of the Project expenditures and the amount recovered in rates and to have the balancing account accrue interest at the utility's authorized rate of return.

Cal-Am also requests the proposed balancing account include any financing costs it incurs because of delays or reductions in grant payments from the Conservancy and that it be allowed to file by advice letter to revise its estimated revenue if there is a significant change in the overall cost of the Project.

Cal-Am asserts that its balancing account proposal will ensure that its customers pay only for the actual costs of the Project, while also protecting the utility in case the Project costs exceed its current estimate of \$49 million. Six months after completion of the Project, Cal-Am proposes to submit an application for review of the final project costs and true up of the balancing account. If actual construction costs are lower than estimated, the cost savings will be allocated between Cal-Am and the Conservancy based on the source of the savings.<sup>41</sup> Cal-Am states it will also provide estimates of the remaining post-construction mitigation, compliance, monitoring and/or operation and maintenance costs in this final Project application.

Finally, Cal-Am requests that after the Commission's review of its final Project application, Cal-Am be authorized to discontinue the customer surcharge and instead include in customers' base rates the annual revenue requirement on

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<sup>41</sup> Savings resulting from design changes or value engineering would be reflected in less funding being contributed by the Conservancy. Savings attributable to favorable market conditions in the construction industry would lower both the Conservancy and Cal-Am's contributions, proportional to their overall dollar contribution to the Project. Exhibit 1, Chapman testimony at 10.

the remaining balance of the regulatory asset and Cal-Am's share of the estimated post-construction costs.

As discussed earlier, DRA's principal position is that as a result of the regulatory compact and past management decisions made by Cal-Am, current and future customers should be made completely immune to the financial impacts of the proposed Project. Should the Commission disagree with this recommendation, DRA offers the following recommendations:

1. Establish an absolute limit via a one-way balancing account of the Project's current and future liabilities that can be transferred to Cal-Am's ratepayers;
2. Offset the costs of any liabilities transferred to ratepayers in the one-way balancing account with the appropriate value of lands to be donated or sold;
3. Preclude Cal-Am from earning an equity return on the balance of Project liabilities that are transferred to ratepayers via the one-way balancing account; and
4. Keep Cal-Am's recovery of the deferred Project expenses in the balancing account outside of base rates in order to avoid the potential for inadvertently allowing an equity return to accumulate on an account balance that is unrelated to any used and useful project or ongoing customer service.

Following the criteria set forth above, and using a 2007 real-estate appraisal report provided by Cal-Am, DRA subtracts from \$49 million (1) the \$19,049,346 appraisal of Phase 1 property in the McVay Report and (2) the \$100,654 in recommended recovery from the San Clemente Dam memorandum account to reach its recommended maximum allowable ratepayer funded Project recovery of \$29,850,654.

Finally, while DRA believes the Commission has ample support from decision precedent and standard practice to uphold the general policy that

deferred expense balances accumulate interest at the 90-day commercial paper rate, if the Commission were to consider other factors in determining a reasonable interest rate or carrying charge on the Project-related deferred expense balance, DRA testifies that the absolute maximum allowable interest rate should be Cal-Am's weighted average cost of debt, as determined in the periodic cost of capital proceedings and including a weighting for Cal-Am's short-term debt.<sup>42</sup>

As discussed in an earlier section, we find DRA's alternative proposal that the Commission establish a firm cost cap of \$49 million for ratepayer cost responsibility, to include any authorized memorandum account cost recovery and carrying charges, offset by the tax benefit from the value of Cal-Am's land donation, and with no equity return for Cal-Am's shareholders, is a reasonable cost responsibility for ratepayer funding of the proposed Project. It is the amount requested by Cal-Am's public partners and will allow the Project to go forward on a timely basis and have construction meet the September 2012 start date requested by the DSOD. It will also provide an incentive for Cal-Am to manage the project costs effectively.

Specifically, we approve here a one-way balancing account and a regulatory asset balancing account for Cal-Am's portion of the Project costs. We also find that Cal-Am should directly credit ratepayers through the regulatory asset account for the cash benefits of all tax savings resulting from this Project

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<sup>42</sup> DRA's alternative recommendation is included in testimony in Exhibit 23 at Chapter 8.

being able to be expensed in the period the actual construction costs are incurred.<sup>43</sup>

We should grant Cal-Am its incremental cost of debt for this Project, as reflected in the Federal Reserve's Statistical Release H-15 for Moody's Baa rated corporate bonds. This is the same statistical release that the Commission uses to determine the current 90-day commercial paper rate, the rate can be updated monthly over the life of the amortization, and it meets the guidelines recommended by DRA. The rate as of October 3, 2011 was 5.27%, as reflected in our amortization table at Appendix 2 of this decision. We propose to set a levelized surcharge amount based on a straight-line amortization of the \$49 million cap less Cal-Am's estimated tax benefit of \$3,250,000 from the fair market value of the donated land. The resulting uniform surcharge, as shown at Appendix 2, is \$5.50/month for a residential customer with average summer usage and \$15.73/month for a large residential customer; this surcharge will be reviewed and adjusted if necessary in each subsequent general rate case proceeding.<sup>44</sup>

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<sup>43</sup> Cal-Am's tax witness testifies that there is a reasonable basis that a deduction for federal tax purposes under Internal Revenue Code Section 162, as ordinary and necessary expenses, in the years in which those expenditures are incurred, for the costs to reroute the Carmel River should be sustained upon an examination or the resolution of related appeals or litigation processes and that Cal-Am should realize cash tax savings related to the costs to demolish and remove the Dam and to reroute the Carmel River in the years that the costs are actually incurred. *See Exhibit 1, testimony of Charles Lennis at 11.*

<sup>44</sup> The surcharge is applicable to all customers in the Monterey District except the Hidden Hills system, which has a provision in its purchase agreement prohibiting allocation of project costs related to the Carmel River.

We agree with DRA and PCLF that Cal-Am's shareholders should not earn an equity return on this Project over the next 20 years.<sup>45</sup> We reach this conclusion because (1) the Project will not provide utility service to customers; (2) in the Coastal Water Project proceeding, A.04-09-019, Cal-Am estimates its Monterey District ratepayers will face substantial rate increases in the next few years in order to fund Cal-Am's cost of obtaining additional water supply; and (3) granting Cal-Am an equity return would more than double the estimated surcharge being authorized here by 2014 due to the higher interest rate as well as the need to include a provision for additional taxes and uncollectibles in the revenue requirement.<sup>46</sup>

We also direct here that Cal-Am remove from ratebase all costs related to the San Clemente Dam. These costs are shown in Cal-Am's testimony as being held under "non-utility property" and are reflected in Appendix 3 of this decision using Cal-Am's removal from the ratebase calculator of \$286,962.

We do not adopt Cal-Am's request that the regulatory asset ever move into ratebase or that there be any type of mechanism or proceeding to allow additional costs to be funded by ratepayers. While Cal-Am's application contains an estimate of an additional \$560,000 for post-construction mitigation measures, we find that the Project cost estimate at Appendix 1 already contains provision for these costs. Cal-Am's portion of any Project cost-savings should be credited to ratepayers in the regulatory asset account and each subsequent GRC

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<sup>45</sup> See PCLF's reply brief at 5: "The unique circumstances surrounding this project call for a resolution that does not enrich shareholders."

<sup>46</sup> See Exhibit 1, Stephenson testimony at 22.

should review the entries and supporting documentation for the balancing account and regulatory asset account.

### **5.6. Land Donation**

Cal-Am proposes to donate 928 acres of land surrounding the Dam and reservoir to BLM and to credit ratepayers with the fair market value of the donated property.<sup>47</sup> Cal-Am describes this land as, apart from the dam facilities, being “pristine open space adjacent to the Los Padres National Forest.”<sup>48</sup> A colored map, Exhibit 18, shows the four parcels proposed by Cal-Am, as well as an adjacent 77.6 acres, Parcel 417-051-003-060, recommended by DRA to be included in the Proposed Project.

DRA requests the \$27,490,000 appraised value contained in a 2007 Cal-Am appraisal of land that it owns in the vicinity of the Proposed Project be used as an offset to any regulatory asset authorized in this proceeding. The appraisal identifies this land as a Phase One, containing 1,000 acres and 21 potential building sites, with an appraised value of \$19,950,000 and Phase Two, as covering 2,400 acres and 26 potential building sites, with an appraised value of \$7,540,000. Phase One is the five adjacent parcels shown on Exhibit 18 and Phase Two is land located approximately six miles upstream, near Cal-Am’s Los Padres Dam; the appraisal report is Attachment 8-2 to confidential Exhibit 24.

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<sup>47</sup> Cal-Am’s specific proposal states that the tax benefit of the land donation should be “generally equal” to the fair market value of the donated property, determined on the date of donation, and that this value should be deducted from the regulatory asset, thereby reducing the costs to ratepayers. *See* Exhibit 8 at 19.

<sup>48</sup> *Id.* at 18.

MPWMD requests that a 6.9-acre portion of one of Cal-Am's proposed parcels, Parcel 417-051-004-000, be subdivided prior to any land transfer to BLM and this portion, which houses the current Sleepy Hollow Steelhead Rearing Facility (Sleepy Hollow Facility) operated by MPWMD, be either retained by Cal-Am, transferred to MPWMD, or use given to MPWMD under an irrevocable long-term lease for as long as the facility is operated. The Sleepy Hollow Facility has been operational since 1997 and rescues and rears steelhead that are stranded in the Lower Carmel River; the facility is part of the mitigation measures required under MPWMD's 1990 Water Allocation Program EIR. Since Cal-Am is the largest diverter on the Carmel River, the construction and operation of the Sleepy Hollow Facility is funded by moneys derived from MPWMD's User Fee, which is collected by Cal-Am from its ratepayers.

We first address MPWMD's request. Cal-Am, the Conservancy, and NMFS, the project management team negotiating the land donation with the BLM, have all stated on this record their support for retaining the operation of the Sleepy Hollow Facility. However, as each party testified, the specific means by which this will be accomplished is still under discussion with the BLM. Based on the testimony, we are confident that the Sleepy Hollow Facility will remain a viable operation as long as it is necessary. Therefore, we will direct that the issue be discussed in each quarterly status report until resolved and we will not take any further action here.

Next, we turn to DRA's land proposal. While DRA testifies that the \$27,490,000 should be used as an offset to the regulatory asset, DRA does not recommend the specific amount of land to be negotiated for transfer to BLM. We find that the 1,000 acres identified in Phase 1 of the 2007 appraisal are contiguous and should be considered together as public open space and wildlife habitat.

Cal-Am testifies that it did not include the 77.6 acre Parcel 417-051-003-000 in its application because a 1.5 million gallon concrete water storage tank is located on the property. This tank is approximately 100 feet long and 40 feet wide, and while Cal-Am prefers to own the land where its facilities are located due to maintenance and security concerns, we find these concerns can be adequately addressed with fencing and maintaining the current access road to the tank.<sup>49</sup> We further find that this parcel contains 18 of the 21 potential building sites identified in Phase One of the 2007 appraisal, and if this land is not included in the donated land its commercial value will be enhanced under the Proposed Project and Cal-Am may choose to sell the parcel for this purpose.<sup>50</sup>

Based on the discussion above, we find that the 77.6 acres contained in Parcel 417-051-003-000 should be considered as part of the Proposed Project. Cal-Am may chose to include this land in negotiations with the BLM, otherwise preserve it as open space and wildlife habitat, or sell the land. We direct in this decision that any monetary value received for these 77.6 acres, whether through a tax benefit of the Proposed Project or a later sale or disposition, should be credited in full to Cal-Am's ratepayers.

For the 2400 acres of land in Phase Two of the 2007 appraisal, we find that this land is part of the watershed of the current Los Padres Dam and should continue in that use. Should Cal-Am consider a future sale of any of this land, Cal-Am must first provide 60 days notice to all parties to this proceeding and DRA can pursue any concerns it has at that time.

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<sup>49</sup> See Transcript at 337, 359.

<sup>50</sup> See Exhibit 23 at 8-5.

## **6. Periodic Reporting Requirements**

In addition to reviewing the balancing account and regulatory asset accounts in each subsequent GRC, we also adopt a requirement for Cal-Am to file a quarterly Project status report with the Division of Water and Audits until the Project is complete and transferred to BLM, with copies to the service list of this proceeding. In this report Cal-Am should confirm that it is consistently following its own internal written guidelines for bidding processes, as found in Attachments 3-13 of Exhibit 24, and that it is following the prospective competitive bidding process testified to by Mr. Schubert and working with the Conservancy and NMFS in drafting its requests for proposals and reviewing bids.<sup>51</sup>

We also address here PCLF's recommendation that Cal-Am study the physical options for managing continued sediment accumulation in its Los Padres Dam. We direct that in its next general rate case proceeding, expected to be filed in July 2013, Cal-Am sponsor a study that measures the level and rate of accumulated sediment and that includes potential remediation or management alternatives for addressing the accumulated sediment and includes financial options such as depreciation, net negative salvage value, and cost of removal.

## **7. Comments on Proposed Decision**

The proposed decision of ALJ Walwyn in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure.

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<sup>51</sup> See DRA's recommendations in Transcript, Volume 6 at 503-4.

Comments were timely filed by Cal-Am, DRA, MPWMD, and PCLF, and reply comments were timely filed by Cal-Am and DRA.

We find that Cal-Am's opening comments appear to deliberately mislead the Commission regarding a material finding in this proceeding and to call into further question the assertions it made in two prior proceedings. An important finding in this proceeding is that Cal-Am has not provided water supply from the Dam to its customers since the 2002/2003 water year and that it misrepresented this fact in two prior proceedings that reviewed the memorandum account and determined the proper carrying charges to apply to the account. In November 30, 2011 opening comments, Cal-Am denies making its earlier assertions and further, quotes 2005 testimony in a manner that directly contradicts the citing of this testimony in 2005 to establish that water from the Dam was continuing to be supplied to customers; both the pleading here and in 2005 are signed by the same attorney. Cal-Am's opening comments state:

The PD accuses CAW of misleading the CPUC "in two earlier proceedings when Cal-Am asserted that the Dam was currently providing a point of water diversion for customers in the winter months and that the planned buttressing would enable the Dam to be used and useful. (PD at 16). This serious accusation is not supported by the record.

The PD cites to CPUC decisions in CAW's 2005 general rate case and the 2007 AFUDC application, but fails to cite to any *specific* statements or assertions by CAW in the records of those proceedings. A comparison of the testimony in all three proceedings reveals that CAW has **not** misled the CPUC and has consistently and truthfully described the Dam.

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At the evidentiary hearing in 2005, CAW's witness, Fred Feizollahi, testified that the use of the Dam for this type of diversion had changed around 2003. '(T)he diversion feature of the dam has been

in use and is extensively used **until two years ago** during winter season for extracting water, taking it to the filter plant below the dam, treating the water, and sending it to our customers.’  
(A.05-02-012 RT 888:6-10 (Feizollahi/CAW)).<sup>52</sup>

In contradiction to the above statements, Cal-Am’s opening brief in A.05-02-012, dated October 18, 2005, stated:

But the San Clemente Dam also serves as a major diversion point. Water is diverted at the San Clemente Dam from the Carmel River to the Carmel Valley Filter Plant for treatment prior to distribution to customers. This diversionary use during the winter months produces energy savings to customers to the extent that the diverted water replaces well water that must be pumped uphill to serve customers at higher elevations. (RT 887-888 (CAW/Feizollahi); *see also* RT 890, 892 (CAW/Feizollahi). Reducing reliance on purchased power during the expensive winter months produces savings that are passed on to customers.<sup>53</sup>

Based on the statements made by Cal-Am in this proceeding and in A.05-02-012, both signed by the same attorney, we find that the Commission should require applicant to show cause why it should not be fined or otherwise sanctioned for failure to comply with Rule 1.1 of the Commission’s Rules of Practice and Procedure and Sections 2107 and 2108 of the Public Utilities Code.<sup>54</sup> Therefore, we will open an adjudicatory phase of this proceeding and Applicant

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<sup>52</sup> *See* November 30, 2011 comments on the proposed decision at 6.

<sup>53</sup> *See* Cal-Am’s October 18, 2005 brief at 2-3.

<sup>54</sup> Rule 1.1, titled Ethics provides “Any person who signs a pleading or brief, enters an appearance, offers testimony at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law.”

should file and serve a response to this order to show cause no later than 30 days after the effective date of this order. Parties to this proceeding may file and serve a reply to applicant's response no later than 10 days after the filing. A prehearing conference will be scheduled following the receipt and review of the pleadings.

In response to other comments, the proposed decision is revised to provide details of Cal-Am's position on recovery of the memorandum account (Section 5.4 at 21-22) as well as clarifications and minor edits throughout the decision.

## **8. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and Christine M. Walwyn is the assigned ALJ in this proceeding.

### **Findings of Fact**

1. On September 22, 2010, Cal-Am filed this application for authorization to implement the Project.
2. The Project addresses longstanding seismic issues associated with the Dam, provides significant environmental benefits, and, due to an innovative public/private partnership, will not cost Cal-Am's customers any more than the least-cost option Cal-Am analyzed for addressing the Dam's seismic safety concerns.
3. Cal-Am's partnership on the Project is with the Conservancy and the NMFS.
4. On October 29, 2010, DRA and the MPWMD separately protested the application. A late-filed motion to intervene was filed by the PCLF and granted the same day.

5. Public participation hearings were held in Monterey and Seaside on February 7 and 8, 2011, and evidentiary hearings were held in San Francisco on June 8-13, 2011.

6. The Dam was constructed in 1921 and has been owned by Cal-Am since 1966. In 1992, the DSOD directed Cal-Am to improve the Dam so that it could meet current seismic safety standards.

7. In 1992, two species present in the Carmel River watershed, the South-Central California Coast steelhead and the California red-legged frog, were listed as candidates for study pursuant to the Federal Endangered Species Act of 1973. The red-legged frog was designated as “threatened” in 1996, followed by the steelhead in 1997.

8. Cal-Am proposed and supported buttressing, or thickening, the Dam as its preferred alternative throughout two EIRs and one EIR/EIS.

9. A draft EIR was first issued for review on December 23, 1998 by the DSOD. In a letter dated February 12, 1999, the NMFS submitted comments stating that (1) in the draft EIR the selection of alternatives was compromised by flawed or omitted analyses, and (2) a dam removal alternative would be far more beneficial than the preferred alternative.

10. Due to extensive public and agency comments, the DSOD issued a second EIR, referred to as the RDEIR in 2000.

11. After receiving further critical comment, the DSOD withdrew the RDEIR in 2002.

12. In 2002 the DSOD directed Cal-Am to undertake interim Dam safety actions, which included (1) installing an emergency seismic monitoring system and emergency action plan, and (2) lowering the level of the reservoir behind the Dam through annual water drawdowns.

13. A combined EIR/EIS process, designed to meet both federal and state environmental review requirements, was initiated by DSOD in 2004 with the U.S. Army Corp of Engineers. During the scoping process, a new alternative, Dam removal, was added.

14. A Draft EIR/EIS was released in 2006 that included the Carmel River Reroute and San Clemente Dam Removal as Alternative 3. In December 2007, the DSOD certified the Final EIR/EIS, and in February 2008, the DSOD confirmed that Alternative 3 would alleviate the Dam safety deficiencies.

15. Since 2000, the Conservancy has funded studies to explore Dam removal options and after the 2006 Draft EIR/EIS included the reroute and removal option as an alternative, the Conservancy in 2007 funded over \$700,000 in studies to further evaluate the alternative.

16. In an April 3, 2000 letter to the U.S. Army Corps of Engineers, copied to Cal-Am, NMFS states that Cal-Am has chosen not to seriously consider a Dam removal option, even though several natural resource organizations have set this as a priority for funding and support. In a June 30, 2006 letter to the U.S. Army Corps of Engineers, NMFS's again voiced its concern and stated that Cal-Am's Dam buttressing proposal would not improve current or future water storage and would likely jeopardize endangered steelhead and destroy designated critical habitat.

17. After the final EIR/EIS included the Carmel River reroute and Dam removal as a feasible alternative, Cal-Am in 2008 engaged the Conservancy and NMFS in a dialogue about implementing the alternative; Cal-Am abandoned these discussions in February 2009 due to concerns regarding the availability to state funding to assist with the this alternative to Dam buttressing. In January

2010, Cal-Am and various federal, state, and local officials signed a Collaboration Statement to pursue the Project set forth in this application.

18. The Project is anticipated to start construction in 2012 and be completed within approximately three years. When the Project is completed, the BLM has given a preliminary commitment to accept donation of the land surrounding the Project for long term management.

19. All parties to this proceeding agree that Cal-Am must address the seismic and flood safety issues of the current Dam and that the Project proposed in this application is the best alternative to do so.

20. Cal-Am ceased using the Dam as a diversion point in the 2002-2003 water year and currently the Dam does not provide any services related to water supply.

21. The Dam does not provide any benefit as an emergency water source because it is not connected to do that, and Cal-Am has more readily available options for use in emergency situations.

22. The Bureau of Reclamation states that prudent reservoir management by a dam owner would require monitoring of the reservoir sedimentation; it appears that Cal-Am did no sedimentation surveys or had any sedimentation management plan from the time it acquired the Dam in 1966 until it performed a survey in 1996. The remaining reservoir capacity is quite small, 70 to 100 acre feet, and estimated to be completely gone between 2013 and 2017.

23. The cost to remove the accumulated sediment at the Dam would be quite expensive, specifically dredging costs of \$12 to \$30 per cubic yard for the 2.5 million cubic yards of accumulated sediment, and removing it would require 125,000 truck loads at 20 cubic yards per truckload.

24. Cal-Am misled the Commission in two earlier proceedings when it asserted that the Dam was currently providing a point of water diversion for customers in the winter months and that the Dam buttressing proposal would enable the Dam to be used and useful. In its November 30, 2011 opening comments on the proposed decision, Cal-Am denied making its earlier assertions and further, quoted 2005 testimony in a manner that directly contradicts the citing of this testimony in 2005 to establish that water from the Dam was continuing to be supplied to customers; both the pleading here and in 2005 are signed by the same attorney

25. A reserve for decommissioning or retiring the Dam was never established. In D.06-11-050, Cal-Am estimated that the total cost of the Dam buttressing project, including all costs expended to date, was \$47 million, with a completion date of December 2009. This estimate is close to the \$49 million contribution the Conservancy has asked Cal-Am to contribute to the Project.

26. In addition to the \$49 million for Project costs, Cal-Am seeks rate recovery for \$26,802,658 for cost related to its San Clemente Dam memorandum account and its initial surcharge. DRA recommend that the Commission approve only \$100,654, the amount of properly tracked expenses for repairs and compliance costs when the Dam was used and useful.

27. In reviewing the costs Cal-Am requests be recovered through the San Clemente Dam memorandum or in the initial surcharge:

- (a) Cal-Am failed to provide substantiation for its pre-2002 costs of \$4,406,700;
- (b) Cal-Am failed to provide evidence of competitive bidding or adequate justification for 7 post-2002 contracts totaling \$3,153,628;

- (c) Cal-Am included compliance and maintenance costs for the Dam after it ceased to be used and useful and costs it incurred in pursuit of the abandoned Dam buttressing project; these tracked costs total \$6,298,038;
- (d) Cal-Am included \$7,957,270 in interest, company labor and utility plant overhead, and corporate charges related to the above costs through October 31, 2010 and an additional \$2,577,751 in estimated interest through December 31, 2012.
- (e) Cal-Am did not seek competitive bids for \$2,500,000 in estimated costs for interim Dam safety and environmental costs for the period November 1, 2010 to the time of Dam removal.

28. Some of the costs discussed in Finding 30 may be included in the estimated Project costs at Appendix 1 of this decision.

29. The Commission's approval of a firm cost cap of \$49 million for ratepayer recovery of estimated Project costs will allow the Project to go forward on a timely basis and construction meet the September 2012 start date requested by the DSOD. A firm cost cap will also provide an incentive for Cal-Am to manage the Project costs effectively.

30. For the 2,400 acres of land in Phase Two of Cal-Am's 2007 appraisal, this land is part of the watershed of the current Los Padres Dam and should continue in that use. Should Cal-Am consider a future sale of any of the 2,400 acres of land in Phase Two of its 2007 appraisal at Attachment 8-2 of Confidential Exhibit 24, it must first provide 60 days notice to all parties to this proceeding.

31. The Sleepy Hollow Steelhead Rearing Facility currently operated by the MPWMD will remain a viable operation as long as it is necessary.

### **Conclusions of Law**

1. We should authorize Cal-Am to implement the Project, in partnership with the Conservancy and NMFS.

2. The Dam has not been a used and useful asset for ratemaking purposes since 2003.

3. Cal-Am's pursuit of Dam buttressing as its preferred alternative through three EIRs was not prudent in light of information available to its management at the time.

4. The concerns raised by DRA regarding Cal-Am's management of the Dam over the last 45 years should be carefully considered in our prudency review of the San Clemente Dam memorandum account, not in our commitment to enabling the Project to go forward.

5. We find that ratepayers should pay the reasonable costs associated with decommissioning, or retiring the Dam.

6. The Project design as proposed, the recently updated costs estimates attached to this decision at Appendix 1, and the Project oversight of the technical team assembled by the Conservancy are reasonable.

7. A firm cost cap of \$49 million, to include any authorized San Clemente Dam memorandum account (memorandum account) cost recovery and carrying charges, offset by the fair market value of Cal-Am's land donation, and with no equity return for Cal-Am's shareholders, is a reasonable cost responsibility for ratepayers to the Project.

8. Cal-Am's shareholders should not earn an equity return on the Project because: (1) the Project will not provide utility service to customers; (2) in the Coastal Water Project proceeding, A.04-09-019, Cal-Am estimates that its Monterey District ratepayers will face substantial rate increases in the next few years in order to fund Cal-Am's cost of obtaining additional water supply; and (3) granting Cal-Am an equity return would more than double the estimated

surcharge by 2014 due to the higher interest rate as well as the need to include a provision for additional taxes and uncollectibles in the revenue requirement.

9. A reasonable incremental cost of debt for the Project is the Federal Reserve's Statistical Release H-15 for corporate bonds rated Baa by Moody's. The rate as of October 3, 2011 was 5.27%, as reflected in our amortization table at Appendix 2 of this decision. We find it reasonable to amortize on a straight-line basis \$45,750,000 (the \$49 million cap less Cal-Am's estimated fair market value of the full tax benefit of the donated land) in order to levelize the surcharge over the next 20 years. Cal-Am should update the interest rate each month based on Release H-15 and the surcharge level should be reviewed and adjusted if necessary in each subsequent general rate case proceeding.

10. Cal-Am did not pursue its Dam buttressing proposal in a period of great uncertainty for utility planners nor did it exercise reasonable managerial skill in identifying and assessing the risks of its proposal or properly analyze and assess alternative options.

11. We should adopt the San Clemente Dam memorandum account disallowances recommended by DRA as they are appropriate based on DRA's audit and also on the Commission's well-established principle that ratepayers are required to bear only the reasonable costs of used and useful plant that provides direct and ongoing benefits. Cal-Am does not meet the Commission criteria established for the extraordinary circumstances that would warrant a utility's ratepayers sharing in the costs of abandoned projects as set forth in decisions D.84-05-100, and later cited by the Commission in D.89-12-057 and D.96-09-039.

12. We should authorize rate recovery up to \$49 million for the Project to be funded through a uniform volumetric surcharge on all customers in Cal-Am's

Monterey District except the Hidden Hills subdivision over the next 20 years, beginning on January 1, 2012, and to include:

- a. Establishment of a one-way balancing account and a regulatory asset account;
- b. The regulatory asset account to be credited with the fair market value at the time of sale or donation of Parcels 417-051-003-000, 417-051-004-000, 417-051-005-000, 417-051-011-000, and 417-051-010-000;
- c. The regulatory asset account to be credited with the cash benefits of all tax savings resulting from the Project's costs being able to be expensed for federal tax purposes in the period the actual construction costs are incurred;
- d. The transfer to the balancing account of \$100,654 from the San Clemente Dam memorandum account;
- e. Removal from ratebase all San Clemente Dam assets;
- f. Interest on the balancing account to be calculated monthly based on the Federal Reserve's Statistical Release H-15 for Moody's Baa rated corporate bonds; and
- g. All entries and supporting documents for the balancing account, as well as the level of surcharge, to be reviewed in each subsequent general rate case proceeding.

13. Cal-Am should remove from ratebase all costs related to the Dam. The Dam regulatory asset account established in this decision should never be moved to ratebase.

14. We should not include additional rate recovery for Cal-Am's estimated \$560,000 in post-construction mitigation measures as Appendix 1 contains provision for these costs.

15. Cal-Am's portion of any Project cost savings should be credited to ratepayers through the regulatory asset account.

16. Cal-Am's land parcels identified at Exhibit 18 as Parcels 417-051-003-000, 417-051-004-000, 417-051-005-000, 417-051-011-000, and 417-051-010-000 should be considered as part of the Project and ratepayers should receive credit through the regulatory asset account for any monetary value received, either through sale or through a tax benefit from donation.

17. Cal-Am should discuss the status of the facility in each quarterly status report it files on the Project.

18. All entries and supporting documentation for the San Clemente Dam balancing account and regulatory asset account should be reviewed in each subsequent general rate case.

19. Cal-Am should file a quarterly status report on the Project with the Division of Water and Audits, with copies to the service list of this proceeding, until the Project is completed and transferred to BLM. In this report Cal-Am should provide an account of the Project's progress and confirm that it is consistently following its own internal written guidelines for bidding processes.

20. In its next general rate case proceeding, expected to be filed in July 2013, Cal-Am should sponsor a study that measures the level and rate of accumulated sediment in its Los Padres Dam and that includes potential remediation or management alternatives for addressing the accumulated sediment. The study should include financial options such as depreciation, net negative salvage value, and cost of removal.

21. Exhibit 24 contains confidential information, as described in California-American Water Company's July 7, 2010 motion. Pursuant to General Order 66-C, this exhibit should remain sealed until January 1, 2018.

22. An important finding in this proceeding is that Cal-Am has not provided water supply from the Dam to its customers since the 2002/2003 water year and

that it misrepresented this fact in two prior proceedings that reviewed the memorandum account and determined the proper carrying charges to apply to the account. In November 30, 2011 opening comments in this proceeding, Cal-Am denies making its earlier assertions and further, quotes 2005 testimony in a manner that directly contradicts the citing of this testimony in 2005 to establish that water from the Dam was continuing to be supplied to customers; both the pleading here and in 2005 are signed by the same attorney. Based on Cal-Am's actions, we should issue an order to show cause as to why applicant should not be fined or otherwise sanctioned for a failure to comply with Rule 1.1 of the Commission's Rules of Practice and Procedure, and Sections 2107 and 2108 of the Public Utilities Code.

## **O R D E R**

**IT IS ORDERED** that:

1. California-American Water Company is authorized to implement the Carmel River Reroute and San Clemente Dam Removal Project, in partnership with the California State Coastal Conservancy and the National Marine Fisheries Services, under the terms and conditions set forth below in Ordering Paragraphs 2, 3, 4, 5 and 6.

2. We authorize rate recovery up to \$49 million for the Carmel River Reroute and San Clemente Dam Removal Project (Project) to be funded through a uniform volumetric surcharge on all customers in Cal-Am's Monterey District except the Hidden Hills subdivision over the next 20 years, beginning on January 1, 2012, and to include:

- a. A one-way San Clemente Dam balancing account and regulatory asset account shall be established;

- b. The regulatory asset account shall be credited with the fair market value at the time of sale or donation of Parcels 417-051-003-000, 417-051-004-000, 417-051-005-000, 417-051-011-000, and 417-051-010-000;
- c. The regulatory asset account shall be credited with the cash benefits of all tax savings resulting from the Project's costs being able to be expensed for federal tax purposes in the period the actual construction costs are incurred;
- d. \$100,654 shall be transferred from the San Clemente Dam memorandum account to the balancing account;
- e. All San Clemente Dam assets shall be removed from ratebases;
- f. Interest on the balancing account shall be calculated monthly based on the Federal Reserve's Statistical Release H-15 for Moody's Baa rated corporate bonds; and
- g. All entries and supporting documents for the balancing account, as well as the level of surcharge, shall be reviewed in each subsequent general rate case proceeding.

3. California American Water Company shall file a Tier 2 advice letter for a ratebase offset reflecting the removal of the Dam from ratebase. The San Clemente Dam regulatory asset account established in this decision shall never be moved to ratebase.

4. Should Cal-Am consider a future sale of any of the 2,400 acres of land in Phase Two of its 2007 appraisal at Attachment 8-2 of Confidential Exhibit 24, it must first provide 60 days notice to all parties to this proceeding.

5. California American Water Company shall file a quarterly status report on the Carmel River Reroute and San Clemente Dam Removal Project (Project) with the Division of Water and Audits, with copies to the service list of this proceeding, until the Project is completed and transferred to the Bureau of Land Management. In this report California American Water Company shall provide an account of the Project's progress and confirm that it is consistently following

its own internal written guidelines for bidding processes. It shall also discuss the status of the Sleepy Hollow Steelhead Rearing Facility.

6. In its next general rate case proceeding, expected to be filed in July 2013, California American Water Company shall sponsor a study that measures the level and rate of accumulated sediment in its Los Padres Dam and that includes potential remediation or management alternatives for addressing the accumulated sediment. The study shall include financial options such as depreciation, net negative salvage value, and cost of removal.

7. Within 15 days of the issuance of this decision, California-American Water Company shall file by Tier 2 Advice Letter tariffs to establish the San Clemente Dam one-way balancing account and regulatory asset account, and to close the San Clemente Dam Memorandum account.

8. Exhibit 24 contains confidential information, as described in California-American Water Company's July 7, 2010 motion. Pursuant to General Order 66-C, this exhibit shall remain sealed until January 1, 2018

9. An important finding in this proceeding is that Cal-Am has not provided water supply from the Dam to its customers since the 2002/2003 water year and that it misrepresented this fact in two prior proceedings that reviewed the memorandum account and determined the proper carrying charges to apply to the account. In November 30, 2011 opening comments in this proceeding, Cal-Am denies making its earlier assertions and further, quotes 2005 testimony in a manner that directly contradicts the citing of this testimony in 2005 to establish that water from the Dam was continuing to be supplied to customers; both the pleading here and in 2005 are signed by the same attorney. Based on Cal-Am's actions, we issue an order to show cause as to why applicant should not be fined or otherwise sanctioned for a failure to comply with Rule 1.1 of the

Commission's Rules of Practice and Procedure and Sections 2107 and 2108 of the Public Utilities Code.

10. Applicant must file and serve any additional evidence and legal argument that relates to the violations no later than 30 days after the effective date of this order.

11. Parties may file and serve comment on the applicant's subsequent filing no more than 10 days after the filing.

12. This proceeding is recategorized as adjudicatory.

This order is effective immediately.

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