Decision **PROPOSED DECISION OF ALJ PATRICK** **(Mailed 12/3/2007**)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California-American Water Company for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project to Resolve the Long-Term Water Supply Deficit in its Monterey District and to Recover All Present and Future Costs in Connection Therewith in Rates. (U210W)	Application 04-09-019 (Filed September 20, 2004)

(*See* Decision 06-12-040 for List of Appearances.)

INTERIM DECISION ADOPTING SETTLEMENT AGREEMENT

1. Summary

This decision adopts a settlement between California-American Water Company (CalAm) and Division of Ratepayer Advocates (DRA), whereby CalAm is authorized to recover a total of $9.31 million, as compensation in full for all Coastal Water Project preconstruction costs incurred through December 31, 2006. CalAm will recover these costs from ratepayers through the Special Request 1 Surcharge authorized by Decision (D.) 06-12-040. The settlement adopted today does not affect CalAm's ability to recover preconstruction costs incurred after December 31, 2006 and tracked in the memorandum accounts approved in D.03-09-022. This proceeding remains open to address other related matters.

2. Background

In D.06-12-040, the Commission authorized CalAm's proposed Special Request 1 Surcharge to recover through customer contributions the Coastal Water Project preconstruction costs that CalAm is tracking in the memorandum accounts approved in D.03-09-022. The Commission allowed CalAm to begin collecting customer contributions through Surcharge 1 in January 1, 2007, and continue until the full amount authorized for preconstruction costs is collected. The Commission directed that CalAm's 2005 engineering and environmental costs related to the Coastal Water Project, along with 2006 preconstruction costs, be reviewed for reasonableness for a Commission decision by year-end 2007. Today's decision addresses those issues.

In the earlier phase of the proceeding, CalAm submitted evidence in support of its previously requested engineering and environmental costs incurred through 2005. While the Commission found that CalAm had provided the Commission with a complete showing to support its request for all costs incurred for the Coastal Water Project through 2005, the Commission deferred authorization of $5,670,073 in engineering and environmental costs incurred through 2005 to give DRA time to hire a consultant to assist it in conducting its reasonableness review of these costs. The Commission also directed CalAm to submit its report on the reasonableness of its 2006 preconstruction costs no later than March 31, 2007 (D.06-12-040).

On March 30, 2007, CalAm filed its *Report on the Reasonableness of California-American Water Company's Coastal Water Project Preconstruction Costs Incurred Through 2006,* together with supporting testimony in Exhibits A through F, to renew its request for recovery of the Coastal Water Project engineering and environmental costs incurred through 2005 and to demonstrate

that its engineering and environmental costs, public outreach costs, legal fees and miscellaneous charges incurred in 2006 were prudent and necessary for the Coastal Water Project. On June 11, 2007, CalAm submitted supplemental direct testimony by Thomas J. Bunosky to remove $795,876 of engineering-related expenses from CalAm's request for recovery of costs incurred for the Coastal Water Project through 2006 after DRA brought the duplication to CalAm's attention. CalAm served corrections to its Report and supporting testimony.

On July 10, 2007, DRA submitted its *Audit Report on CalAm's Coastal Water Project 2006 Preconstruction Costs* and its *Review of 2005 and 2006 Preliminary Engineering and Environmental Costs for the Coastal Water Project.* DRA reviewed CalAm's 2006 preconstruction expenses to determine if they were properly accounted for and found no material audit adjustment to the preconstruction costs as reflected in CalAm's June 28, 2007 supplemental testimony. DRA also reviewed CalAm's 2005 and 2006 preliminary engineering and environmental costs to determine if studies were duplicative to those performed by other agencies and if expenses were excessive or reasonable. DRA concluded that while the majority of the studies CalAm performed were not duplicative, CalAm's Aquifer Storage Recovery (ASR) study was duplicative of previous studies performed for the Monterey Peninsula Water Management District (MPWMD) as part of its ASR efforts.

A prehearing conference (PHC) was held on July 12, 2007, and the Parties agreed that evidentiary hearings would not be necessary. A duly noticed settlement conference was held on July 16, 2007. Thereafter, this phase of the proceeding was submitted for decision upon the filing of the *Joint Motion to Adopt*

the Settlement Agreement Between California–American Water Company and the Division of Ratepayer Advocates.

3. The Settlement

CalAm and DRA (collectively the Parties) agreed on a resolution of each of the issues set forth in the Settlement Agreement, attached as Appendix A to this decision, which they submit for adoption pursuant to Article 12 of the Rules of Practice and Procedure. The Parties represent to the Commission that (a) the Settlement Agreement commands the sponsorship of the Parties; (b) the Parties are fairly representative of affected interests; (c) the Settlement Agreement together with the record in this proceeding conveys to the Commission sufficient information to permit the Commission to discharge its regulatory obligations with respect to the Parties and their interests; and (d) the Settlement Agreement is reasonable in light of the entire record, consistent with the law, and in the public interest, thereby satisfying Rule 12.1(d).

Specifically, the Settlement Agreement addresses (1) CalAm's engineering and environmental costs through 2005 deferred by D.06-12-040, and (2) CalAm's preconstruction costs for 2006. The Settlement Agreement provides that CalAm would be authorized to recover a total of $9.31 million for Coastal Water Project preconstruction costs incurred through December 31, 2006.[1] CalAm will recover these costs from ratepayers through the Special Request 1 Surcharge currently in effect, approved by D.06-12-040.

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[1] The $9.31 million amount includes interest charges through December 31, 2006, calculated at the 90-day short-term commercial paper rate. (*See* D.06-12-040, Conclusion of Law No. 8.)

4. Discussion

4.1 Standard of Review

Rule 12.1(d) of the Commission's Rules of Practice and Procedure provides that the settlement must be reasonable in light of the whole record, consistent with the law, and in the public interest for the Commission to approve it. We examine the Settlement Agreement, in light of these three criteria.

4.2 Reasonable in Light of the Whole Record

The Settlement Agreement is reasonable in light of the whole record. The Parties believe their positions as set forth in the Settlement Agreement are just and reasonable. The Parties have agreed that the Commission should authorize CalAm to transfer $9,312,664 of costs incurred for the Coastal Water Project through December 31, 2006 from the authorized memorandum accounts to the Surcharge 1 cost recovery balancing account. As set forth in the Settlement Agreement, this amount reflects a decrease to CalAm's originally requested Coastal Water Project preconstruction costs through 2006, in addition to the $795,876 of engineering-related expenses already removed by CalAm through supplemental testimony. In addition, as part of the Settlement Agreement, CalAm has agreed to provide additional assurances to the Commission and all parties to this proceeding by submitting a report within 90 days of a final Commission decision, that demonstrates that CalAm is not seeking to recover via Surcharge 1 certain costs (Monterey District Labor and related costs for 2006 and beyond) that have been recovered through a general rate case application.

Furthermore, the extensive record supports the Settlement Agreement. As part of this proceeding, CalAm submitted its Report and extensive supporting testimony, which contain an explanation of the costs for which CalAm seeks recovery, and in many cases, supporting invoices or a

description of the specific activity, the service time period, the nature of the work conducted by the vendor, and invoice data.

4.3 Consistent With the Law

The Settlement Agreement is also consistent with applicable law and in the public interest. The Parties believe the preconstruction costs set forth in the Settlement Agreement were properly incurred in the pursuit of a long-term water supply solution to satisfy the regulatory requirements of State Water Resources Control Board Order 95-10 and the Seaside groundwater adjudication, as more fully explained in D.06-12-040. Also, as required by the Commission's Rules of Practice and Procedure, the Parties properly noticed and held a settlement meeting on July 24, 2007.

4.4 In the Public Interest

The Parties agree that resolving this matter short of evidentiary hearings is in the public interest. Should the proceeding continue to full evidentiary hearings on the merits to address the costs incurred by CalAm for the Coastal Water Project through 2006, both parties would need to invest additional time and resources. The Parties believe the Settlement Agreement will serve the public interest by avoiding the uncertainty inherent in litigation and resolving the issues in this proceeding in a manner acceptable to the Parties. Moreover the Settlement Agreement further benefits ratepayers because the Parties will be able to save valuable time and resources that would have been expended (and passed on to customers) to litigate these issues.

In conclusion, we find the settlement to be reasonable in light of the whole record, consistent with the law, and in the public interest.

5. Future Review of Project Costs

As we stated in D.06-12-040 (p. 33), the Commission's review of costs related to the Coastal Water Project, or alternative supply solution, should remain outside the general rate case process. We will review 2007 preconstruction costs for reasonableness in 2008. CalAm should file a new application and issue its report on the reasonableness of its 2007 preconstruction costs, no later than March 31, 2008. DRA should issue its report on these costs no later than June 30, 2008. Thereafter, the Administrative Law Judge (ALJ) should convene a prehearing conference and hold hearings so that a proposed decision on the reasonableness of 2007 preconstruction costs is issued before year-end 2008. (*See* D.06-12-040, Ordering Paragraph 7.)

6. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and Rule 14.3 of the Commission's Rules of Practice and Procedures. Opening comments were filed by DRA and reply comments were filed by CalAm. We have reviewed the comments and made changes to the proposed decision where necessary.

7. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Bertram D. Patrick is the assigned ALJ in this proceeding.

Findings of Fact

1. By D.06-12-040, CalAm was authorized to recover preconstruction costs for the Coastal Water Project through the Special Request 1 Surcharge commencing January 1, 2007.

2. As detailed in the Settlement Agreement, CalAm and DRA agree that CalAm should be allowed to recover $9,312,664 and this amount constitutes the

entirety of CalAm's recovery of Coastal Water Project preconstruction costs incurred through December 31, 2006.

3. Nothing in the Settlement Agreement affects CalAm's ability to recover preconstruction costs incurred for the Coastal Water Project after December 31, 2006, and tracked in the memorandum accounts approved in D.03-09-022.

Conclusions of Law

1. CalAm should be authorized to recover $9,312,664, as compensation in full for all Coastal Water Project preconstruction costs incurred through December 31, 2006. These costs should be recovered from ratepayers through the Special Request 1 Surcharge authorized by D.06-12-040.

2. The Settlement Agreement between CalAm and DRA, is reasonable, consistent with the law, and in the public interest and should be approved.

INTERIM ORDER

Therefore, **IT IS ORDERED** that:

1. The Settlement Agreement between California-American Water Company (CalAm) and Division of Ratepayer Advocates (DRA), attached to this decision as Appendix A, is approved.

2. CalAm is authorized to recover $9,312,664, as compensation in full for all Coastal Water Project preconstruction costs incurred through December 31, 2006, using the Special Request 1 Surcharge authorized by Decision (D.) 06-12-040.

3. CalAm is authorized to transfer $9,312,664 of costs incurred for the Coastal Water Project through December 31, 2006 from the authorized memorandum account to the Surcharge # 1 cost recovery balancing account.

4. CalAm shall submit a report to the Commission and all parties to this proceeding, within 90 days of this decision approving the settlement, that demonstrates Monterey District Labor and related costs, for 2006 and beyond, which CalAm seeks to recover via Surcharge #1, have not been recovered through other mechanisms, such as a general rate case application.

5. This proceeding shall remain open to address other pending matters related to the Coastal Water Project.

This order is effective today.

Dated _____, at San Francisco, California.

A0409019 APPENDIX A Patrick