

Decision **PROPOSED DECISION OF ALJ THOMAS** (Mailed 6/10/08)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of CALIFORNIA WATER SERVICE COMPANY (U60W), a corporation, for an order authorizing it to increase rates charged for water service in its Chico District by \$6,380,400 or 49.1% in July 2008, \$1,651,100 or 8.5% in July 2009, and by \$1,651,100 or 7.9% in July 2010; in its East Los Angeles District by \$7,193,200 or 36.5% in July 2008, \$2,034,800 or 7.6% in July 2009, and by \$2,034,800 or 7.0% in July 2010; in its Livermore District by \$3,960,900 or 31.2% in July 2008, \$942,200 or 5.6% in July 2009, and by \$942,200 or 5.4% in July 2010; in its Los Altos-Suburban District by \$5,172,500 or 30.5% in July 2008, \$1,189,100 or 5.4% in July 2009, and by \$1,189,100 or 5.1% in July 2010; in its Mid-Peninsula District by \$5,435,100 or 23.7% in July 2008, \$1,634,200 or 5.8% in July 2009, and by \$1,634,200 or 5.5% in July 2010; in its Salinas District by \$5,119,700 or 29.8% in July 2008, \$3,636,900 or 16.3% in July 2009, and by \$2,271,300 or 8.7% in July 2010; in its Stockton District by \$7,474,600 or 29.0% in July 2008, \$1,422,400 or 4.3% in July 2009, and by \$1,422,400 or 4.1% in July 2010; and in its Visalia District by \$3,651,907 or 28.4% in July 2008, \$3,546,440 or 21.3% in July 2009, and by \$3,620,482 or 17.6% in July 2010.

Application 07-07-001
(Filed July 3, 2007)

(See Appendix D for List of Appearances.)

**DECISION APPROVING SETTLEMENT AGREEMENT BETWEEN
CALIFORNIA WATER SERVICE COMPANY AND DIVISION OF RATEPAYER
ADVOCATES, AND RESOLVING DISPUTED ISSUES**

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**DECISION APPROVING SETTLEMENT AGREEMENT BETWEEN
CALIFORNIA WATER SERVICE COMPANY AND DIVISION OF RATEPAYER
ADVOCATES, AND RESOLVING DISPUTED ISSUES**

1. Summary

This decision approves a settlement of this California Water Service Company (Cal Water) General Rate Case (GRC) between Cal Water and the Division of Ratepayer Advocates (DRA). It also resolves a few disputed issues that remain among Cal Water, DRA, and two other intervenors, Arthur Mangold (Mangold) who raised issues pertinent to Cal Water's Mid-Peninsula district, and Jeffrey Young (Young), who focused on the Redwood Valley/Coast Springs district. The final intervenor, the City of Los Altos (Los Altos), did not actively oppose the settlement, and did not raise disputed issues.

The settlement results in rate increases that are lower than those proposed; reduces Cal Water's request to add new employees by almost half; increases conservation to a level consistent with the Commission's Water Action Plan directive to enhance water conservation programs in California; phases in rate increases for the Salinas and Visalia districts at issue in this case; and accomplishes several other changes that enhance ratepayer benefits.

Two disputed issues remain between Cal Water and DRA. We find in Cal Water's favor on the first, and grant its request to increase per-lot special connection facilities fees in the Chico, Salinas and Visalia districts so new customers pay their share of costs to connect them to the system. DRA's proposal to revamp the way we calculate such fees, while interesting, should be raised in the context of a rulemaking so that all interested parties may participate.

On the second issue, health care escalation, we find that our existing method of calculating increases is sound, as DRA asserts, and reject Cal Water's proposal to use a new index for such increases.

We by and large reject the claims asserted by Mangold and Young.

This proceeding is closed.

2. Background

In its application, Cal Water filed for water rate increases in all of its 24 California Districts. In eight of those districts – Chico, East Los Angeles, Livermore, Los Altos, Mid-Peninsula, Salinas, Stockton and Visalia (collectively, the Eight Districts) – Cal Water sought rate increases attributable to increases in expenditures in those districts, as well as to increases in Cal Water's General Office expenses. In the remaining 16 districts, Cal Water sought rate increases attributable only to General Office expense increases.

DRA participated actively in all aspects of the proceeding. Young intervened with regard to the allocation of General Office expenses in the Redwood Valley district; Mangold intervened with regard to the Mid-Peninsula district; and Los Altos intervened with regard to issues in its own district. Administrative Law Judge (ALJ) Thomas granted each of these parties' motions to intervene, limiting their participation to the issues in their districts.¹

The Commission sponsored Public Participation Hearings covering the Eight Districts listed above, and took public comment with regard to the

¹ The Leona Valley Town Council initially intervened, but later withdrew from the proceeding. Since it did not actually participate, the ALJ ruled that it was ineligible for intervenor compensation in the proceeding. Leona Valley is a community in unincorporated Los Angeles County.

proposed rate increases. The Commission also received communications by letter and e-mail from members of the public wishing to weigh in on the proposed rate increases.

The assigned Commissioner and ALJ determined that the following issues were within the scope of the proceeding:

- 1) Appropriateness of all rate increases;
- 2) Necessity to phase in rate increases to mitigate rate shock;
- 3) How Cal Water's authorized and actual rates of return have matched up in recent years;
- 4) Cal Water's accounting for and provision of unregulated services for, without limitation, municipal water district billing contracts, placement of antennae on Cal Water property, and the Extended Service Protection (ESP) program;
- 5) Whether the infrastructure upgrades Cal Water proposes (including new customer service centers) are reasonable;
- 6) The appropriateness of Cal Water's vehicle retirements schedule(s);
- 7) Cal Water's water quality in the Eight Districts;
- 8) Cal Water's water conservation/efficiency plans, to the extent not covered in the Commission's generic water conservation investigation, Investigation (I.) 07-01-022;
- 9) Institutional advertising cost allocation;
- 10) Health care, workers' compensation, and employee benefit cost increases;
- 11) Impact of prior settlements on later requests related to settled matters;
- 12) Appropriateness of proposed new employee hiring;

- 13) Allocation of costs attributable to Sarbanes-Oxley² compliance and other Sarbanes-Oxley matters;
- 14) Use of varying year periods to forecast future revenues, costs and other activity, rather than the same period for each forecast;
- 15) Cal Water's proposed changes in per-lot special facilities fees and fire flow testing fees;
- 16) Appropriateness of Cal Water's asset/infrastructure upgrade planning for the future;
- 17) Extent to which Cal Water is working to control costs;
- 18) Appropriate cost allocation to developers;
- 19) Matters raised in the ALJ's rulings issued in this case; and
- 20) Other matters deemed within the proceeding's scope by the Assigned ALJ and/or Commissioner.³

Prior to hearings, DRA and Cal Water announced they had reached a settlement of most of the disputed issues that remained between them after their testimony was served. (The pre-settlement testimony also resolved several disputed issues that arose from Cal Water's initial application.) Therefore, the case went to hearing only on the issues remaining in dispute between DRA and Cal Water, and on issues not part of the settlement that Young and Mangold raised. The hearings occurred during the week of February 11, 2008.

After hearings, DRA and Cal Water submitted a motion seeking approval of their settlement,⁴ and all parties except Los Altos briefed the few issues

² Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stats. 745.

³ The Cal Water-DRA settlement address issues 1, 2, 4, 5, 6, 7, 8, 10, 12, 13, 15, 16, and 18 from the Scoping Memo, which we discuss individually in this decision.

⁴ *Joint Motion of the California Water Service Company and the Division of Ratepayer Advocates to Approve Settlement Agreement*, filed March 12, 2008, as supplemented by

Footnote continued on next page

remaining in dispute. This decision approves the settlement agreement and resolves each of the disputed issues.

3. The Cal Water-DRA Settlement's Provisions on Key Issues

The key issues in dispute between Cal Water and DRA and resolved in their settlement agreement include the following:

1. **Rate increases.** The settlement results in lower rate increases than Cal Water initially proposed in each of the Eight Districts at issue here. Cal Water's application proposed the following increases:

Application

District	July 1, 2008 Proposed Increase, (\$1,000)	% Increase	July 1, 2009 Proposed Increase, (\$1,000)	% Increase	July 1, 2010 Proposed Increase, (\$1,000)	% Increase
Chico	\$6,380.4	49.0%	\$1,651.1	8.5%	\$1,651.1	7.8%
East Los Angeles	\$7,193.2	36.5%	\$2,034.8	7.6%	\$2,034.8	7.0%
Livermore	\$3,960.9	31.2%	\$942.2	5.7%	\$942.2	5.4%
Los Altos	\$5,172.5	30.5%	\$1,189.1	5.4%	\$1,189.1	5.1%
Mid-Peninsula	\$5,435.1	23.7%	\$1,634.2	5.8%	\$1,634.2	5.5%
Salinas	\$5,119.7	29.7%	\$3,636.9	16.2%	\$2,271.3	8.7%
Stockton	\$7,474.6	29.0%	\$1,422.4	4.3%	\$1,422.4	4.1%
Visalia	\$3,651.9	28.1%	\$3,546.4	20.9%	\$3,620.5	17.3%

Amendment to the Joint Motion of the California Water Service Company and the Division of Ratepayer Advocates to Approve Settlement Agreement, filed April 1, 2008 (jointly, Motion; all citations herein are to the Amendment filed April 1, 2008).

The settlement between Cal Water and DRA seeks Commission approval of the following increases,⁵ most of which are lower than those in Cal Water's application:

Settlement, plus Cal Water position on lot fees

District	July 1, 2008 Proposed Increase, (\$1,000)	% Increase	July 1, 2009 Proposed Increase, (\$1,000)	% Increase	July 1, 2010 Proposed Increase, (\$1,000)	% Increase
Chico	\$4,305.2	33.0%	\$812.3	4.7%	\$730.9	4.0%
East Los Angeles	\$5,258.3	25.9%	\$774.7	3.0%	\$687.0	2.6%
Livermore	\$3,099.2	25.2%	\$608.4	3.8%	\$555.5	3.4%
Los Altos	\$3,821.6	21.7%	\$844.3	3.9%	\$775.9	3.5%
Mid-Peninsula	\$4,083.9	17.8%	\$551.7	2.0%	\$456.1	1.7%
Salinas	\$5,109.3	29.7%	\$2,855.7	13.2%	\$757.2	3.1%
Stockton	\$4,107.3	15.9%	\$887.6	2.9%	\$771.6	2.5%
Visalia	\$3,584.6	27.4%	\$3,232.7	20.4%	\$875.8	4.6%

Note: 2009 and 2010 increases are estimated. Escalation increases are adjusted based on recorded changes in CPI.

Note: First year Salinas increase includes phase-in surcharge of 0.0955 per ccf.⁶ This surcharge would be for 3 years.

Note: First year Visalia increase includes phase-in surcharge of 0.0818 per ccf. This surcharge would be for 3 years.

2. **New employees.** The original GRC application sought to add 148 new employees at the General Office level.⁷ Cal Water's existing General Office workforce is 239 employees, so the increase would be more than 60 percent. The settlement allows for the addition of 59 new employees at the General Office level over 3 years, a still considerable increase of 39 percent, but a far lower number than the 148 employees Cal Water originally proposed.⁸

⁵ The table assumes that we adopt Cal Water's position on one of the disputed issues not covered by the settlement.

⁶ One ccf is equal to one hundred cubic feet.

⁷ Cal Water's General Office functions are support functions that benefit all of its water districts. Cal Water thus allocates costs incurred at the General Office level out to the districts in accordance with a "four factor" methodology described later in this decision.

⁸ Settlement § 3.2.3.2.

3. **Conservation budget.** The parties agreed to a conservation budget consistent with Cal Water's last GRC decision, Decision (D.) 07-12-055, *mimeo.*, p. 35,⁹ where budgets are based on Cal Water's revenues. The settled conservation expenses will also be subject to a one-way balancing account that caps the amount of total spending over two years, but allows for the limited carryover of funds to the second year. Cal Water will refund to ratepayers any unspent funds not subject to the carryover provision.
4. **Water quality.** DRA and Cal Water ask the Commission to make a finding that Cal Water's Eight Districts meet all applicable water quality standards.
5. **Pilot process for infrastructure planning.** In its application, Cal Water proposed a surcharge, or "Infrastructure Investment Surcharge Mechanism" (IISM) to fund long term infrastructure investment. DRA and Cal Water agreed that the IISM proposal needs work and may be denied at this time. They agreed to a pilot project allowing Cal Water interim recovery of rate base offsets, with reasonableness reviews, to mitigate Cal Water's concern about regulatory delay.¹⁰
6. **Additional Commission review of infrastructure projects.** DRA and Cal Water agreed that 23 of the utility's proposed capital projects will be excluded from the company's revenue requirement until they are completed, in service and reviewed by the Commission. Cal Water will be required to file rate base offset advice letters after completing each project.
7. **Workers' Compensation issues.** The parties agreed to DRA's recommendation that Cal Water's workers' compensation revenue requirement be calculated based on the "PayGo" method already used by the Commission.

⁹ Settlement § 4.2.2.9.

¹⁰ Under the pilot, Cal Water will continue to file for rate base offsets using the Tier 3 advice letter process under General Order 96-B. The change will be that each such advice letter will be effective immediately, but subject to refund with interest if necessary when the Commission issues a Resolution on the advice letter. Cal Water will ask for review of the pilot process in the next GRC filing. Settlement § 5.2.

8. **Postretirement Benefits Other than Pensions (PBOPs).** The parties agreed on the amount of PBOP costs and recovery of a PBOP regulatory asset in the future.
9. **Other issues.** The parties also agreed to:
 - a. limit ratepayer funding of certain meals, dues and moving expenses for Cal Water employees;
 - b. give rate relief to certain Livermore customers who pay rates based on 1-inch connection necessary for fire protection, and Cal Water will identify customers in other districts eligible for the same treatment; and
 - c. phase in rate increases for the Visalia and Salinas districts to mitigate rate shock.

The Scoping Memo for this proceeding also raised additional issues that the Settlement does not address because the parties' positions were not in dispute after they filed their testimony. These issues include the following:

10. **Vehicle replacements.** The parties agreed that Cal Water will replace vehicles less often than proposed in the application, and in accordance with D.07-12-055, except for certain vehicles purchased before that decision was issued.
11. **Unregulated businesses.** The Commission raised concerns about an unregulated offering, Extended Service Protection (ESP), in Cal Water's last GRC, so the Scoping Memo included the issue. The Commission's issues with the ESP program are the subject of a post-D.07-12-055 process and therefore we need not address them here.¹¹

¹¹ The ESP service was a \$4.95/month protection plan that guaranteed the company would quickly repair or replace a customer's water line if it broke between Cal Water's meter, generally located at the street curb, and the customer's house. In response to D.07-12-055, Cal Water discontinued the program as of February 25, 2008. Ex. 49 at 1 (Ferraro Supplemental Testimony). It is in the process of re-applying to offer the program, but that application will be handled separately from this case.

4. Analysis of Key Settlement Provisions

In this section, we analyze the key settlement provisions in light of the Commission requirement that in order to be approved, settlements must be "reasonable in light of the whole record, consistent with law, and in the public interest." Commission Rule 12.1(d).

4.1. Rate increases

Settlement

As noted above, the settlement represents a compromise from rate increases that were in the 20-30% range in the original application (with the 59.1% increase proposed for the Chico district an anomaly). The rate increases in the settlement (including increases reflecting our decision adopting Cal Water's position on lot fees, as discussed later in this decision) are noted again below for reference:

Settlement, plus Cal Water position on lot fees

District	July 1, 2008 Proposed Increase, (\$1,000)	% Increase	July 1, 2009 Proposed Increase, (\$1,000)	% Increase	July 1, 2010 Proposed Increase, (\$1,000)	% Increase
Chico	\$4,305.2	33.0%	\$812.3	4.7%	\$730.9	4.0%
East Los Angeles	\$5,258.3	25.9%	\$774.7	3.0%	\$687.0	2.6%
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Stockton	\$4,107.3	15.9%	\$887.6	2.9%	\$771.6	2.5%
Visalia	\$3,584.6	27.4%	\$3,232.7	20.4%	\$875.8	4.6%

Note: 2009 and 2010 increases are estimated. Escalation increases are adjusted based on recorded changes in CPI.

Note: First year Salinas increase includes phase-in surcharge of 0.0955 per ccf. This surcharge would be for 3 years.

Note: First year Visalia increase includes phase-in surcharge of 0.0818 per ccf. This surcharge would be for 3 years.

These increases remain substantial, and we are not unmindful of the impact they will have on customers. However, we are also concerned that the

infrastructure of water utilities we regulate, including Cal Water's, is aging and will require significant infrastructure planning and investment in future years. Cal Water must begin now to construct these upgrades so that the utility continues to serve customers safely and reliably.

It is also impossible to ignore that health care and retirement expenses will increase as the Baby Boom generation reaches retirement age and health care costs nationwide continue to balloon. Much of Cal Water's rate increase relates to these unavoidable expenses. While Cal Water will ask its retirees to bear more of its health care costs in the future, in a competitive economy such as California's, it cannot escape the obligation to provide benefits to its employees and retirees.

Finally, Cal Water must add a number of new employees to comply with various regulatory requirements. New water quality requirements and the Sarbanes Oxley Act of 2002 account for many of the new proposed hires.

This is the first decision adopted after the Commission's new rate case plan decision, D.07-05-062. That decision directed Class A water utilities to engage in several new initiatives designed to carry out the Commission's Water Action Plan requirements of (1) safe, high quality water; (2) highly reliable water supplies; (3) efficient use of water; and (4) reasonable rates and viable utilities, and the Plan's objectives to: (1) maintain the highest standards of water quality; (2) strengthen water conservation programs to a level comparable to those of energy utilities; (3) promote water infrastructure investment; (4) assist low income ratepayers; (5) streamline Commission regulatory decision-making; and (6) set rates that balance investment, conservation, and affordability. We would expect to see rate increases of some magnitude in the early GRC applications filed after our rate case plan went into effect.

It is our hope that the rate of increases will abate as time passes, but we cannot ignore that the state's water systems are aging and will require long-term planning and many upgrades to extend their usefulness in the 21st century. Water is our most basic commodity, and infrastructure is expensive to maintain and upgrade. We will scrutinize rate increases for reasonableness, but we cannot ignore the long-term needs of the water systems of the utilities we regulate.

We find the rate increases in the settlement agreement to be reasonable in light of the foregoing considerations.

4.2. New Employees

Settlement

The settlement agreement allows Cal Water to hire 59 new employees at the General Office level (17 employees over DRA's pre-settlement recommendation). As noted above, Cal Water's existing General Office workforce is 239 employees, so the increase is a considerable 39 percent over current numbers.

The following is a table the parties provide of the requested General Office staffing additions pursuant to the settlement:

Table 1 - General Office Incremental Positions

Job Title	Department	Year Included in Rates
Conservation Manager	Conservation	2008
Communication Specialist	Corporate Communications	2008
Administrative Asst. - Torrance Engineering	Engineering	2008
Electrical (SCADA) Technician	Engineering	2009
GIS Technician	Engineering	2009
Hydraulic Modeling Engineer	Engineering	2009
New Business Technician	Engineering	2009

Job Title	Department	Year Included in Rates
SCADA Computer Systems Operator	Engineering	2009
Electrical/Mechanical Technician	Field Maintenance	1 included in 2008, 4 in 2009
Travelling Meter Mechanic	Field Maintenance	1 included in 2007, 1 in 2009
Audit Coordinator	Finance/ Accounting	2009
Budget Analyst	Finance/ Accounting	2009
Corporate Cashier	Finance/ Accounting	2009
Cost Accountant	Finance/ Accounting	2008
Director of Finance	Finance/ Accounting	2007
Financial/Business Systems Analyst	Finance/ Accounting	2008
Revenue Accountant	Finance/ Accounting	2008
Senior IT Auditor	Finance/ Accounting	2009
Senior Tax Accountant	Finance/ Accounting	2009
Mobile Telecommunications Specialist	Information Systems	2009
Safety Trainer	Operations	2009
Diversity Supplier Manager	Purchasing/Stores	2009
Rate Case Manager	Rates	2008
Cross-connection Inspector or Flushing Foreman	Special Programs	8 included in 2008, 11 in 2009
Trainee	Special Programs	5 included in 2009
Administrative Staff Clerk	Water Quality	2008
Assistant Chemist	Water Quality	2009
Environmental Affairs Project Manager	Water Quality	2009
Quality Assurance/Quality Control Officer	Water Quality	2008
Water Quality Project Manager	Water Quality	1 included in 2007, 2 in 2009

The settlement also allows Cal Water to add approximately 22 additional employees at the district level,¹² according to the following table:

Table 2 - District Payroll Additions

District	Payroll Additions	Year
Chico	CSR 2	2008
	CSR 3	2008
	UW/Relief CPO	2008
	Operation Maintenance Worker	2008
E. Los Angeles	Administrative Assistant	2008
	1/2 CSR	2008
	CPO	2008
	Serviceperson/Inspector	2008
Visalia	1/2 New Business Supervisor	2008
	CSR 3	2008
	CSR 3	2008
	Operation Maintenance Worker	2008
	Operation Maintenance Worker	2008
<u>Flat to Meter Conversion</u>		
Chico Based Group	Field Supervisor	2008
Chico (62.4%)	Foreman	2008
Marysville (32.1%)	OMW	2008
Willows (5.5%)	1/2 CSR 3	2008
Visalia-Based Group	1/2 Field Supervisor	2009
Visalia (89%)	Foreman	2009
Selma (11%)	OMW	2009
	Serviceperson/Inspector	2009
	1/3 CSR 3	2009

Discussion

At the General Office level, the settlement represents a compromise in virtually every area of Cal Water's business. While we might scrutinize each position for reasonableness, we decline to micromanage Cal Water's business at

¹² Settlement § 4.2.1.2.

this level of detail. We agree that the new positions are focused in areas where Cal Water has increased responsibilities going forward – in the area of conservation; accounting and internal controls (to implement the rigorous requirements of Sarbanes-Oxley); the company's unidirectional flushing and cross-connection programs (discussed later in this decision); and water quality. We also agree that Cal Water's proposed new trainee program, albeit much smaller than proposed in the application, is a meaningful approach to training the next generation of water managers as the Baby Boom generation retires.

We expect Cal Water to fill these positions promptly. As DRA pointed out in pre-hearing testimony, to the extent Cal Water does not fill positions we authorize, it can be an indication that the positions were not necessary. Cal Water adequately explained why previously requested positions were not filled, but it should continue to do so. DRA may and should weigh in on this issue in the next GRC if it finds that Cal Water is not doing a good job of filling positions we authorize. We also appreciate that the settlement phases in hiring of the General Office positions so that the process of hiring them is more orderly.

The district level employee additions are also reasonable. The 22 positions Cal Water requested in its initial application was a modest request, and the settlement, while not a reduction, reflects the fact that the initial request was reasonable. Cal Water will also phase in the new positions over 2008-09 to mitigate rate impacts.

Thus, we find that the settlement is reasonable as to the number of employees added both at the General Office level and in the districts.

4.3. Conservation Budgets

Settlement

DRA and Cal Water agree to conservation budgets that are significantly higher than the expenditures Cal Water has made on conservation activity in prior years. The following are the application and settlement budgets:

Conservation Budget comparison						
	A	B	C	D	E	F
DISTRICT	DRA Two Year Budgets			Cal Water Two Year Budgets		
	2008-'09	2009-'10	2 year total	2008-'09	2009-'10	2 year total
Chico	\$ 29,703	\$ 30,371	\$ 60,074	\$ 172,700	\$ 180,316	\$ 353,016
East LA	\$ 38,483	\$ 39,348	\$ 77,831	\$ 246,200	\$ 252,124	\$ 498,324
Livermore	\$ 108,259	\$ 111,693	\$ 219,952	\$ 150,100	\$ 155,208	\$ 305,308
Los Altos	\$ 108,096	\$ 111,526	\$ 219,622	\$ 223,100	\$ 228,634	\$ 451,734
Mid Pen	\$ 108,922	\$ 111,371	\$ 220,293	\$ 309,100	\$ 316,640	\$ 625,740
Salinas	\$ 64,234	\$ 65,678	\$ 129,912	\$ 226,500	\$ 232,877	\$ 459,377
Stockton	\$ 175,837	\$ 179,790	\$ 355,627	\$ 337,400	\$ 345,582	\$ 682,982
Visalia	\$ 74,543	\$ 76,219	\$ 150,762	\$ 195,500	\$ 206,360	\$ 401,860
TOTAL	\$ 708,077	\$ 725,996	\$ 1,434,073	\$ 1,860,600	\$ 1,917,740	\$ 3,778,340

Conservation Expense Cal Water/ DRA Settlement

DISTRICT	2008-2009	2009-2010	2 year	max. carry over
Chico	\$ 137,373	\$ 137,373	\$ 274,746	\$ 35,271
East LA	\$ 195,838	\$ 195,838	\$ 391,676	\$ 50,283
Livermore	\$ 119,396	\$ 119,396	\$ 238,792	\$ 30,656
Los Altos	\$ 177,463	\$ 177,463	\$ 354,926	\$ 45,565
Mid Pen	\$ 245,871	\$ 245,871	\$ 491,742	\$ 63,129
Salinas	\$ 180,168	\$ 180,168	\$ 360,335	\$ 46,259
Stockton	\$ 268,382	\$ 268,382	\$ 536,764	\$ 68,909
Visalia	\$ 155,509	\$ 155,509	\$ 311,018	\$ 39,928
TOTAL	\$ 1,480,000	\$ 1,480,000	\$ 2,960,000	\$ 380,000

The settlement includes one-way balancing account treatment that requires Cal Water to refund all but the “max carry over” amounts shown in the table above if it does not spend its full budget.

Protest

Mangold is concerned that the settlement simply sets budgets for conservation programs without providing for forecast and measurement of savings and other conservation planning. He is also concerned that the settlement endorses a "one size fits all" approach that sets conservation budgets at a percentage of revenue in a district, rather than tailoring budgets to needs within a particular district.

Discussion

The budget in the settlement agreement - \$1,480,000 for the Eight Districts for 2008-2009 and 2009-2010 - is somewhat lower than the \$1,860,398 Cal Water proposed in its application for 2007-08.¹³ Because Mangold focuses on the Mid-Peninsula district, we will do so as well to illustrate how the settlement increases conservation budgets. The following are comparison figures for the Mid-Peninsula district:

Cal Water Conservation Budget/Expenses¹⁴						
Application (proposed for 2007-08) Mid- Pen ¹⁵	Settlement Mid-Pen 2008-09 ¹⁶	2002 Expense Mid-Pen	2003 Expense Mid-Pen	2004 Expense Mid-Pen	2005 Expense Mid-Pen	2006 Expense Mid-Pen
\$309,085	\$245,871	\$25,588	\$26,961	\$35,824	\$46,441	\$75,929

As one can see from the foregoing table, both the application and the settlement represent considerable budget increases from prior years.¹⁷ The

¹³ Ex. 45, p. 2 (Conservation Programs, Testimony of David Morse).

¹⁴ *Id.*

¹⁵ Settlement, p. 23.

¹⁶ Ex. 201, p. 3-13 (DRA Mid-Peninsula Report).

increases in other districts are comparable, as demonstrated in the two tables above showing the initial proposals of both Cal Water and DRA, and the settlement amounts.

Nonetheless, we approve the settled increase in water conservation budgets. One of the objectives of our 2005 Water Action Plan was to increase water conservation programs to levels comparable to those of energy utilities.¹⁸ The Water Action Plan proposes several measures to accomplish this goal, including greater consumer education on how to reduce water use, implementation of the California Urban Water Conservation Council's¹⁹ "Best Conservation Management Practices," rate design to encourage conservation, and possible decoupling of water utility sales from earnings. All of these goals are aimed at increasing water conservation by customers of water utilities such as Cal Water. *See also Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities, I.07-01-022 (Water Conservation OII).*

In view of the Water Action Plan's goal to increase water conservation, we would expect to see significant increases in water utility conservation budgets. By the same token, we need to be realistic about a water utility's ability to spend

¹⁷ In protesting Cal Water's initial water conservation proposals, DRA opposed calculating budgets based on a percentage of Cal Water's water revenues, and, as they explain in Appendix B to this decision, the settled amounts are not based on such a percentage.

¹⁸ Water Action Plan, Dec. 15, 2005, p. 7, available at ftp://ftp.cpuc.ca.gov/PUC/hottopics/3water/water_action_plan_final_12_27_05.pdf.

¹⁹ The Council coordinates statewide urban water conservation.

new conservation funding wisely if it has had small budgets in the past. Prior to entering into its settlement with Cal Water, DRA raised this concern:

[Cal Water] has historically under-spent in the Mid-Peninsula District with regards to conservation expenses. Compared to the last CPUC adopted conservation budget of \$91,600 for 2005-2006, [Cal Water] has under-spent in the Mid-Peninsula District by \$31,500.²⁰

Cal Water's conservation budget in the Mid-Peninsula will increase significantly - from \$75,929 in 2006 to \$245,871 in the 2008-2009 fiscal year. Standing alone, this increase would give us pause given Cal Water's past history of under-spending. However, the settlement also builds in a reporting process and other accountability measures to ensure that Cal Water spends the money budgeted on cost effective conservation. Cal Water will, consistent with the decision in its last GRC, provide a measurement and evaluation proposal within 90 days, and Cal Water will also file conservation reports in accordance with D.07-12-055.²¹

In order to implement this provision of the settlement agreement, we will require the following: Ninety days after the decision in this application, Cal Water shall file with the Commission's Division of Water and Audits a new conservation budget based on the DRA/Cal Water conservation program budget settlement. In addition, Cal Water shall include a measurement and evaluation

²⁰ Ex. 201, p. 313.

²¹ That decision requires the following reporting:

Cal Water shall file a conservation budget and measurement and evaluation proposal for each district within 90 days of the effective date of this decision and then make ongoing reports and budget proposals on at least an annual basis. D.07-12-055, *mimeo.*, p. 13.

proposal. Subsequently, on an annual basis Cal Water shall file a measurement and evaluation report with DRA and the Division of Water and Audits. We leave it to the Divisions' discretion how to respond to the reports, although we expect the Water Conservation OII to result in further conservation reporting requirements. The first measurement and evaluation report shall include conservation program activities for 2008/2009. The first measurement and evaluation report shall be filed on September 1, 2009.

On March 18, 2008, Cal Water submitted a "Conservation Budget and Measurement and Evaluation Report" for its conservation activities in connection with D.07-12-055, which discusses contents of the measurement and evaluation report. Cal Water shall, with its measurement and evaluation proposal for the districts at issue in this proceeding, use the March 18, 2008 submission as a basis for its proposal, and include any changes ordered in connection with D.07-12-055/A.06-07-017 *et seq.* and incorporated after the March 18, 2008 submission. Cal Water may also modify its March 18, 2008 measurement and evaluation report if it sees fit, as long as the proposal is consistent with any orders made in this proceeding or in any other proceeding related to water conservation, such as I.07-01-022, the Water Conservation OII.

The one-way balancing account treatment DRA and Cal Water have agreed upon will also protect ratepayers in the event Cal Water under-spends its conservation budget in any of the Eight Districts. Any funds not spent over a set amount will revert to ratepayers, subject to the following conditions. First, any unspent funds will be amortized in the next GRC. Second, the maximum carryover for each of the Eight Districts will be limited, as set forth in the final column of the table entitled "Conservation Expense Cal Water/DRA Settlement," above.

However, we must stress that business as usual in the area of conservation is not appropriate. We expect Cal Water to enhance its conservation activities as described in our Water Action Plan and our Water Conservation OII. Thus, we expect to see Cal Water spend at or near budgeted levels on sound conservation measures for the Eight Districts at issue, and will monitor its action to make sure such conservation occurs.

4.4. Water Quality

Settlement

Cal Water and DRA ask that the Commission make a finding that Cal Water meets all applicable water quality standards in the Eight Districts.

The settlement agreement states that

DRA made an extensive examination of Cal Water's testimony and exhibits and concluded in its reports that Cal Water meets state and federal water standards in seven districts. DRA was not originally able to agree that Cal Water meets standards in the Salinas district. This opinion was based on open issues identified by DRA in an October 29, 2007 Department of Public Health (DPH) inspection report of the Salinas system.²²

After trading data requests and responses about the DPH report, DRA and Cal Water reached agreement that Cal Water is complying with state and federal water quality standards in the Salinas district.

Protest

Mangold asks that we "temper" any finding as to the adequacy of Cal Water's water *quality* in the Eight Districts by a finding that long term water *supply* should be investigated in the Mid-Peninsula district. Mangold's key

²² Settlement § 2.1.2.

concern is that Mid-Peninsula, which receives all of its water from San Francisco's Hetch Hetchy project, must begin to look for other sources as San Francisco's own supply becomes constrained.

Discussion

We agree with Mangold that Cal Water should be engaged in long-term water supply planning in all of its districts, including the Mid-Peninsula district. However, we made provision for water utilities to engage in such planning in our recent rate case plan decision, D.07-05-062, Appendix A, pp. 28 - 29. There, we stated that:

Any water utility filing a GRC on or after July 1, 2008 must submit a long-term, 6-10 year Water Supply and Facilities Master Plan to identify and address aging infrastructure needs.

Thus, Cal Water must engage in long term planning with its first GRC filed after July 1, 2008. We expect any plan it submits with its next GRC for the Mid-Peninsula district to address the water supply concerns Mangold raises. However, Mangold's concern about water supply planning does not militate against approval of the DRA-Cal Water settlement here.

With regard to the DRA-Cal Water settlement request that we find Cal Water's water quality adequate in the Eight Districts, we are reluctant to do so at this time for one key reason. The water rate case plan, D.07-05-062, required the Commission's Division of Water and Audits to retain its own expert to make an independent assessment of water quality in the districts under consideration in a GRC. In a September 14, 2007 ruling, the assigned ALJ directed that such an expert carry out the water quality assessment, but the Division of Water and Audits was unable to retain an expert and therefore did not act on the ruling.

This is the first Cal Water GRC since the Commission issued the Water rate case plan. While DRA-Cal Water agree, pursuant to their settlement agreement here, that there are no material water quality problems in the Eight Districts, we are not prepared to so find without an independent expert evaluation. Indeed, as we noted in D.07-12-055, Cal Water's last GRC decision, DRA's role does not extend to certifying that Cal Water meets applicable water quality requirements:

In its opening brief, DRA addresses the expanded role it intends to take in reviewing the water quality information in each GRC application. *This role, however, will not extend to rendering an opinion on whether or not a utility complies with all water quality regulations.* DRA views its role as evaluating the impact of GRC application proposals and considering the economics of proposed capital investments to assure that ratepayers receive the lowest possible rates, consistent with reliable and safe service levels.²³

Thus, we reject this aspect of the settlement agreement. We do so not because we have evidence of water quality problems, but rather because we lack the necessary documentation to make such a finding. It is our expectation that the Division of Water and Audits will implement the requirement of review by an expert in the next round of GRCs.

4.5. Infrastructure Planning - Surcharge

Settlement

In its application, Cal Water proposed a surcharge, the Infrastructure Investment Surcharge Mechanism (IISM), to cover the cost of infrastructure upgrades for the Eight Districts. Under the proposal, Cal Water sought to be granted a simplified process for making rate increases using a streamlined

²³ D.07-12-055, *mimeo.*, p. 7 (emphasis added).

advice letter filing limited to GRC-authorized capital improvement projects. Cal Water also requested flexibility to substitute one capital project meeting an infrastructure need with another project. DRA objected to the surcharge on the grounds that Cal Water had not adequately fleshed out the program, and suggested it be re-filed as a stand-alone application.

DRA and Cal Water agreed in settlement on a pilot process to alleviate Cal Water's concern with the delay in implementing rate base offsets resulting from the current Tier 3 advice letter process. Under the settlement, Cal Water's rate base offsets, while still filed under the Tier 3 advice letter process, will be effective immediately, subject to refund with interest if the Commission finds the offset is unreasonable when issuing its Resolution on the advice letter. DRA may continue to protest any such advice letter filing in the usual manner. Cal Water will ask the Commission to review the pilot process in its next GRC filing.

In exchange, Cal Water will drop its IISM proposal from this GRC, but may revive it in its next GRC. Any revision will address, in detail, the concerns and requests for additional information DRA raised in its testimony on the IISM in this proceeding. The parties will also meet with the Division of Water and Audits to discuss the current advice letter process.

Discussion

The Scoping Memo for this proceeding identified infrastructure planning as one of the issues on which to focus. We expect Cal Water to engage in long-range planning to upgrade its infrastructure, and will be interested in seeing Cal Water's more detailed proposal – with responses to DRA's concerns – in the next GRC.

In the interim, we are satisfied that the pilot program is reasonable, given that it gives us the authority to order refunds with interest if a particular rate

base offset is inappropriate. In its next GRC filing, Cal Water's request for review of the pilot process shall do the following, at a minimum: (1) list the rate base offsets in the pilot, with citation to the advice letter and Resolution numbers, description of the item, and dollar impact, (2) identify the issues raised in any protest filed with regard to a particular advice letter, (3) identify any advice letter found to be subject to refund after a review by the Commission, and (4) explain the basis for the refund.

4.6. Additional Commission Review for Infrastructure Projects

Settlement

The settlement provides that 23 of the utility's proposed capital projects will be excluded from the company's revenue requirement until they are completed and in service. Cal Water will be required to file rate base offset advice letters after completing each project. According to the parties' joint motion for approval of the settlement, allowing Cal Water to recover the costs of these projects through a rate base offset advice letter filed after the utility completes each project will balance the interests of the public for rate certainty and the interests of the company in recovering the revenue requirement of its investments.

Discussion

We have approved prior settlements between DRA and Cal Water in which Cal Water agreed to the same rate base offset procedure.²⁴ We do so again here. The list of projects covered by the settlement appears as Appendix A to this decision.

4.7. Workers' Compensation*Settlement*

The parties' settlement with regard to workers' compensation costs reflects the recommendation of DRA to treat workers' compensation expense on a pay-as-you-go (PayGo) basis. Cal Water agrees that it will continue the PayGo method if the Commission orders it.

Cal Water's pre-settlement proposal was to amortize over a seven year period an accrued liability in the workers' compensation account for past injuries. DRA criticized this method because instead of basing workers' compensation costs on the "well-established" pay-as-you-go (PayGo) methodology that is consistently used by the Commission, Cal Water was proposing to change to an accrual basis and to include the amortization of past liabilities for which payments had not yet been made. The Cal Water method would more than triple workers' compensation costs. DRA recommended continuation of the PayGo methodology for recovering workers' compensation insurance costs.²⁵

²⁴ See, e.g., D.04-04-041, Ordering Paragraph 6, and D.07-12-055, Ordering Paragraph 8.

²⁵ Ex. 209, p. 3-27.

Discussion

We agree that Cal Water should continue to use the PayGo method of accounting for workers' compensation insurance costs. Cal Water has not established that a change is warranted, and therefore we agree that the *status quo* should be maintained. We therefore approve the settlement between Cal Water and DRA on this issue.

4.8. PBOPs*Settlement*

Cal Water and DRA settled on postretirement benefits other than pensions (PBOP) costs of \$4.346 million and \$4.602 million for calendar years 2008 and 2009, respectively. The single test year 2008-2009 averages these values. DRA and Cal Water agreed that Cal Water, going forward, should recover from ratepayers and fully contribute into its PBOP independent trusts its accrual of costs incurred pursuant to Financial Accounting Standards (FAS) No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*.

The costs agreed to in the settlement include recovery and funding of Cal Water's deferred accrual of a regulatory asset over a fifteen year period. In agreement with DRA's testimony, Cal Water adjusted its requested PBOP costs to assume that retirees will reimburse 50% of incurred medical costs in the future.

Discussion

We recently authorized Cal Water to recover, over a 15-year period, the past regulatory asset for PBOPs. D.08-03-021; *see also* D.92-12-015 (setting forth a formula for companies to use in calculating their PBOP regulatory asset). However, D.08-03-021 did not deal with how Cal Water should account for

future PBOP obligations. Cal Water's application here sought to increase rates to fund its future PBOP obligations.

DRA initially protested Cal Water's approach to PBOPs, asserting that Cal Water's forecast assumptions were unreasonable because they were out of range with other utilities offering the same benefits and with actual experience.²⁶ DRA also filed a motion for summary adjudication in this proceeding, alleging that the issues Cal Water were seeking to address in this case were already pending in the case that culminated in D.08-03-021, and should be dismissed from this case. The ALJ never ruled on the motion because the parties subsequently reached their settlement. Cal Water and DRA assert that their PBOP settlement is consistent with D.08-03-021.

We find that the settlement is reasonable on the PBOPs issue. DRA was in error when it claimed that the issue of PBOP accrual going forward would be resolved in the proceeding culminating in D.08-03-021, as it now acknowledges. Cal Water and DRA have agreed to PBOP actuarial estimates based upon a review of the assumptions made by Cal Water's actuary and assumptions proposed by DRA. The settlement represents a fair balancing of assumptions about the amount of cost Cal Water will bear in the future, and we therefore approve it.

4.9. Other Settled Issues

The following is a discussion of the other key issues covered by the Cal Water-DRA settlement.

²⁶ Ex. 210, p. MRL-1 (Testimony of Mark Loy).

4.9.1. Limit on Ratepayer Funding of Certain Meals, Dues and Moving Expenses for Cal Water Employees

Settlement

In its application, Cal Water sought to have ratepayers fund certain of its employees' meals, dues, moving and related expenses as part of its "nonspecific" expenses under the Administrative and General Expense category. DRA protested that the amount of the charges was too high, while Cal Water asserted that they reasonably related to their workers' employment. For each of the Eight Districts, the parties settled the matter by adopting DRA's position for company dues, employee dues and community service, and half of DRA's adjustments for meals.

Discussion

While the settlement amounts at issue here are modest, we believe it is important to limit ratepayer funding of certain employee perks and company activities that do not relate directly to their service to ratepayers. While Cal Water may believe it is essential to employee morale and retention, or to its business as a utility, to use ratepayer funding for such activities, we scrutinize such requests carefully. By the same token, we have on occasion stated that such amounts, if reasonable, are recoverable from ratepayers.

SoCalGas states that such items as service recognition dinners, employee picnics/Disneyland, administrative support for employee clubs/activities, employee retirement administration activities and employee communications costs are employee benefits.

...

We do not agree with DRA that these items are a charitable contribution, direct or indirect. These are an employee benefit

which, if reasonable, should be allowed as a ratemaking expense.²⁷

By the same token, the Division of Water and Audits' Standard Practice U-26, entitled "*Adjusting and Estimating Operating Expenses of Water Utilities*" (July 2002), available on the Commission's website at <http://docs.cpuc.ca.gov/Published/Graphics/17098.PDF>, provides the following:

[Water companies'] [d]ues, donations and contributions to charitable and service organizations are generally disallowed [as part of their Administrative and General Expense]. Dues to recognized technical organizations are generally allowed.

In view of the fact-specific nature of our scrutiny of such expenses, we find the settlement – which adopts DRA's position on some issues and half of DRA's reductions on others – to be within the range of reasonableness, and approve it.

**4.9.2. Rate Relief to Certain Livermore Customers
Who Pay Rates Based on 1-Inch Connection
Necessary for Fire Protection**

Settlement

In its application, Cal Water asked for a change to its "fire protection special conditions" for residential customers in its Livermore district. It noted that the City of Livermore had required residential sprinkler systems on all new construction for many years, and that these systems required a 1 inch metered connection. However, customers in that district might not otherwise require a 1 inch meter for their water consumption needs. The 1 inch charge is 250% of the

²⁷ D.90-01-016, 1990 Cal PUC LEXIS 15, at *142.

standard 5/8 x 3/4 inch service. In recognition of the fact that these customers have larger meters than required for water consumption, Cal Water has allowed these customers to pay the 5/8 x 3/4 service charge, plus a small surcharge to cover the additional cost of a larger meter. However, this special condition has been limited to lots of up to 10,000 square feet in area. Thus, Cal Water asked us to remove the 10,000 foot limit.²⁸

The settlement adopts Cal Water's proposal to remove the 10,000 foot lot size limit.²⁹ In addition, DRA asked in testimony that Cal Water take steps to identify customers in the other districts in this GRC who are paying for 1 inch metered service solely to meet fire protection requirements imposed by the local government, and provide customers who request it an opportunity to pay the smaller meter service fee.³⁰

In the settlement, Cal Water agreed to make a proposal in its next GRC to address customers outside the Livermore district.³¹ In advance of that proposal, Cal Water "will research its customer information database, contact cities, and/or conduct sample studies to determine the potential applicability of a '1-inch residential plus fire service' rate in its other districts."³²

Mangold concurs with the settlement, but suggests that Cal Water also review tariffs to determine who has such service. Cal Water does not respond to

²⁸ See Ex. 204, pp. 12-13 (DRA Livermore Report).

²⁹ Settlement § 5.1.1; *Motion*, p. 15.

³⁰ Ex. 204, pp. 12 - 14.

³¹ *Motion*, p. 15.

³² Settlement § 5.1.1.

this suggestion, which we find reasonable and incorporate by this reference into the settlement agreement.

The parties assert that the settlement as to Livermore is in the public interest because it ensures that Livermore customers will pay a metered service charge that is consistent with their actual usage, regardless of lot size. Customers whose usage is commensurate with a 5/8 x 3/4 inch meter connection will pay for such usage.

Discussion

We agree that it is appropriate for Livermore customers – and customers in other districts – to pay rates that reflect their actual usage, even if they must have larger meters to ensure adequate fire protection. We also agree that Cal Water should apply this adjustment to affected customers, if any, in other districts.

Cal Water shall commence its study of other districts within 60 days of the effective date of this decision, and shall present its proposal for other affected districts in the first GRC application filed after the 60 days expire. In addition to the items Cal Water agrees to review in the settlement agreement, it should also review tariff filings to locate customers with 1-inch fire protection service, as Mangold suggests.

In its GRC application, Cal Water shall explain how it will account for the cost under-recovery, if any, related to installing and maintaining large meters for fire protection while collecting rates for smaller meter service.

4.9.3. Phase-In of Rate Increases for the Visalia and Salinas Districts to Mitigate Rate Shock.

Settlement

The settlement includes a provision to phase in the test year increase for the Visalia and Salinas districts. Cal Water will collect the deferred portion of the increases in subsequent years as a surcharge. The parties claim the phase-in will mitigate rate shock to customers in these two districts by enabling customers to adjust to the rate increase over several years and providing them with an opportunity to offset the rate increases by conserving water.

As Cal Water explained in its application,³³ the increase for Salinas is significant for 3 principal reasons: (1) capital investment to upgrade aging infrastructure, construct new water supply facilities, and treat wells for nitrates, iron, manganese and other regulated constituents (\$4.2 million revenue requirement); (2) increase in allocation of the cost of company benefits (an increase common to all districts; \$1.6 million); and (3) purchased water costs because Cal Water has added more basin water wellhead treatment facilities (\$0.7 million).

Visalia's increase is due primarily to infrastructure upgrades, including new wells and boosters to ensure adequate supply, replacement of facilities on State Highway 62 due to Caltrans street widening, and compliance with a 2004 state law that requires meters on all service connections by 2025. The revenue requirement attributable to these items is \$5.2 million according to the application. The Visalia district also has increases due to allocation of company

³³ Ex. 44, p. 11.

benefits, and new district payroll (to provide service to the growing customer base, and hire new field and customer service staff).

As Cal Water explained in its application, in order to earn the requested overall return of 8.66%, a 49.3% increase would be required for the Salinas district.³⁴ The phase-in mitigates the impact of this increase significantly. Similarly for Visalia, if the revenue requirement in the application were to be reflected in rates in the first year, ratepayers would experience a 64.9% increase in that year in order for Cal Water to earn the requested overall return of 8.66%.³⁵ Cal Water thus requested a phase-in of rates in its application, and the parties agreed upon the phase-in in the settlement.

Discussion

The Commission has in the past ordered a phase-in of water rate increases to mitigate rate shock.³⁶ Here, Cal Water requested the phase-in on the ground that the rate increase impact would cause rate shock if implemented all in one year. Further, a water company may not increase its rates above the amount noticed to customers,³⁷ and the notice Cal Water gave in Salinas and Visalia assumed a phase-in.

³⁴ Ex. 24, p. 6 (Salinas Results of Operation).

³⁵ Ex. 29, p. 6 (Visalia Results of Operation).

³⁶ See, e.g., D.05-09-004, 2005 Cal PUC LEXIS 356 at *49 (Cal Am Water Company/Felton); D.93-02-012, 1993 Cal PUC LEXIS 68 at *50-51 (Park Water Company/Apple Valley Ranchos); see also D.87-09-038, 1987 Cal PUC LEXIS 207 at *4-5 (Cal Water/Visalia; phase-in required where company "slept on its rights").

³⁷ See, e.g., D.95-08-011, 1995 Cal PUC LEXIS 617 at *6-7 (Twin Valley Water Company; the figure contained in the notice limited the size of the maximum permissible increase).

We find the phase-in to be reasonable, especially given the size of the increases in Salinas and Visalia. The rate shock that would result if we did not approve the phase-in would be significant. Thus, we approve the settlement agreement on this issue, and order the rate phase-in the Cal Water and DRA settled upon, as follows:

District	July 1, 2008 Proposed Increase, (\$1,000)	% increase	July 1, 2009 Proposed Increase, (\$1,000)	% Increase	July 1, 2010 Proposed Increase, (\$1,000)	% Increase
Salinas	\$5,109.3	29.7%	\$2,855.7	13.2%	\$757.2	3.1%
Visalia	\$3,584.6	27.4%	\$3,232.7	20.4%	\$875.8	4.6%

4.10. Vehicle Replacements

The Scoping Memo listed the pace of Cal Water's vehicle replacements as an issue for consideration in this case. When Cal Water initially filed its application, it proposed to replace dozens of vehicles on a schedule adopted by the Commission in D.96-06-034, 1996 Cal. PUC LEXIS 724. DRA proposed longer retirement schedules.

As the case proceeded, Cal Water agreed with DRA that the vehicle replacement schedules the Commission adopted in its last Cal Water GRC decision, D.07-12-055,³⁸ should apply here. Those schedules acknowledge the durability of today's vehicles and provide for replacement less frequently than was the case in the past.

We agree that the updated schedule adopted in D.07-12-055 and D.06-01-025 is appropriate here, and no party now disagrees. Cal Water shall use the new schedules in subsequent GRCs unless the Commission adopts a different schedule.

³⁸ The Commission also applied the longer schedules in D.06-01-025.

4.11. Cost Allocation for Unregulated Contracts

In Cal Water's last GRC, A.06-07-017 *et seq.*, Cal Water's offering of an unregulated service called Extended Service Protection (ESP) was the subject of much discussion. Therefore, the Scoping Memo included an examination of the issue. However, since the assigned Commissioner issued the Scoping Memo, the Commission issued D.07-12-055, providing guidance for Cal Water on how to pursue the issue in light of its finding that the ESP program was not properly offered under the Commission's excess capacity and affiliate transaction rules and Pub. Util. Code § 453(a). (See D.07-12-055, § 5.5.) Cal Water will be filing an application addressing the ESP program as part of its compliance with D.07-12-055, and we therefore need not deal with the issue here.

5. The Cal Water-DRA Settlement Should Be Approved

Settlements are required to pass the following three-part test for approval. They must be (1) reasonable in light of the whole record, (2) consistent with law, and (3) in the public interest. We find that the settlement meets each of these three tests. The settlement is amply supported by a wealth of record evidence on each point. The application and DRA testimony addressed each of the contested issues in detail, the ALJ's rulings asked numerous questions about most of the issues the settlement addresses, and the settlement was the subject of extensive briefing. Thus, the settlement is reasonable in light of the whole record.

The settlement is also consistent with law. The settlement does not call for any provision that violates tariff, rule or other law. No party has suggested that the settlement calls for anything that is not consistent with Cal Water's legal obligations.

Finally, for the many reasons we discuss in connection with specific settlement provisions, the settlement is in the public interest. While the increases are significant and the employee additions numerous, we recognize throughout the decision that water companies must upgrade their infrastructure and comply with water quality, supply, and conservation goals in order to function properly in the 21st century.

Based on the detailed analysis in the foregoing sections of this decision, and the legal elements required of settlements, we find the settlement between Cal Water and DRA should be approved.

6. Issues Not Settled

Cal Water and DRA did not reach settlement on the issues in the list below.

- 1. Per-lot special facilities fees for Chico, Salinas and Visalia districts**
Cal Water proposes special lot fees for new connections. DRA believes the proposal does not place new and existing customers on an equal footing with regard to investment in facilities to provide service, and proposes a method of developing per-lot fees that has new customers pay more than the Cal Water proposal for new facilities.
- 2. Health care escalation factor.** Cal Water proposes to use an escalation factor for health care expenses based on the Employment Cost Index for Health Insurance (ECIHI), used for energy utilities. DRA opposes the ECIHI method, asserting it is higher than the factor mandated by the Commission in D.07-05-062, Cal Water's most recent rate case decision.

Young's issues also were not settled; they are listed below:

- 3. Allocation of General Office expense to Coast Springs area of the Redwood Valley district.** Young opposes the four-factor allocation method generally used by the Commission to allocate General Office expenses in this case. He proposes a three-factor method that eliminates allocation of General Office payroll expense to the district.

- 4. Other General Office issues.** Young raises other issues related to the timing of Cal Water's General Office allocations and related rate increases.

Finally, Mangold raised the following issue not addressed in the Cal Water/DRA settlement³⁹:

- 5. Proposed Wells in Mid-Peninsula District.** Mangold opposes the installation of 3 wells in the Mid-Peninsula district, while the Cal Water/DRA settlement allows them.

We discuss each of these issues in turn below.

6.1. Per-Lot Special Facilities Fees (Cal Water/DRA)

Parties' Positions

In its application, Cal Water proposed changes to the water supply special facilities fees for new connections in its Chico, Salinas and Visalia districts. Cal Water requests per-lot special facilities fees for Chico, Salinas and Visalia of \$1,000, \$1,200, and \$1,100, respectively, per equivalent 1-inch service. The existing fees are \$500 for each district.⁴⁰

According to Cal Water, the intent of per-lot fees is to ensure that existing customers do not subsidize growth, while ensuring an orderly development process. The fees are authorized in Cal Water's Tariff Rules 15 and 16. Cal Water periodically reviews the cost of water supply special facilities associated with

³⁹ We discuss Mangold's objections to the settlement provisions regarding water quality and water conservation in the Section entitled "Analysis of Key Settlement Provisions" above, and do not repeat that discussion here. This section discusses issues where the only dispute is between Mangold and Cal Water.

⁴⁰ Ex. 8, p. 9 (Chico); Ex. 24, p. 9 (Salinas); Ex. 29, p. 10 (Visalia). We note that the Commission has not set per-lot fees for any of the other Eight Districts, so Cal Water does not propose an increase in those districts.

serving growth and proposes changes in its per-lot special facilities fees when necessary. Cal Water states that the change is warranted by increases in the cost of well construction since the last time the charges in these three districts were reviewed by the Commission.⁴¹

DRA objects that Cal Water's current method for developing per-lot fees and recovering infrastructure charges under Rules 15 and 16 does not place new and existing customers on an equal footing with regard to investment in facilities to provide service. Therefore, DRA proposes a new method of developing per-lot fees that requires new connections to pay the difference between the historic and current costs up front in a per-lot special facilities fee for all connections two inches and under in size in the Eight Districts participating in this GRC.

DRA developed its recommended per-lot special connection fees for the Eight Districts by calculating the difference between: (1) the cost of equal facilities for a new customer, and (2) the average embedded cost of facilities for an existing customer. Using its proposed methodology, DRA seeks to implement a comprehensive facilities fee in all Eight Districts ranging from a low of \$5,624 per service connection in Stockton to a high of \$11,271 in Livermore.

DRA also recommends that its proposed per-lot special connection fees be treated as contributions in aid of construction (CIAC) rather than advances. Such treatment will ensure that new and existing customers are placed on an equal footing with an identical cost basis and assigned capacity. Treating the

⁴¹ *Opening Brief of California Water Service Company on Unsettled Issues in Application 07-07-001*, March 7, 2008 (*Cal Water Opening Brief*), p. 4, citing A.04-09-028 (Chico), A.04-09-029 (Visalia) and A.04-09-032 (Salinas).

per-lot fees as CIAC is beneficial to ratepayers because the money does not need to be repaid. If the per-lot fees are treated as advances, then the balance must be repaid over a term of years, with both new and existing customers responsible for repayment of the advance. Therefore, if any portion of the per-lot special connection fees are treated as advances, according to DRA, existing customers will be subsidizing new customers.

Cal Water objects to DRA's proposed methodology principally on procedural grounds. Cal Water asserts that DRA's proposal represents a fundamental change in water Tariff Rules 15 and 16 as well as General Order (GO) 103.⁴² Cal Water states that such a change must take place in the context of a rulemaking applicable to the entire water industry, rather than a GRC. It also notes that we are in the midst of re-examining GO 103 in just such a Rulemaking (R.) 07-12-015. Cal Water also raises several objections to how DRA calculated its fees.

Cal Water also proposes a modification to its Tariff Rule 15 to unitize the costs of installing transmission backbone (12" mains) in the Visalia District.⁴³ Cal Water states it designed this change to improve administrative efficiency in developer transactions in the rapidly-growing Visalia district. Cal Water states it will incorporate language in its tariff that limits the applicability of the unitized transmission fee to new development within a half-mile of the existing system.⁴⁴

⁴² For a general description of Rules 15 and 16 and GO 103, see *Re Revision of GO 103 and Water Tariff Rules 15 and 16*, D.91-04-068, 39 CPUC 2d 594 (1991).

⁴³ *Cal Water Opening Brief* at 4 (citations omitted).

⁴⁴ Cal Water/Smegal, 9 Reporter's Transcript (RT) 286:15-287:8. This condition was not contained in Cal Water's initial proposal, but we condition our approval of the new charge on this limitation. See *Cal Water Opening Brief*, p. 5, n.2.

DRA does not directly challenge this 12" main fee, except to the extent that it believes all fees should be set using its recommended new methodology.

Discussion

We start from the principle that those who cause a cost should pay for it. If new service connections cause new costs to Cal Water's system, they should be assessed fees that adequately recoup those costs. Existing customers should not subsidize new development. Thus, on principle, we agree with both Cal Water and DRA that if costs to serve new customers have increased, those customers should fund them.

By the same token, DRA's proposal seeks to obtain a fundamental rewrite of Tariff Rules 15 and 16. Each Class A water company has such a tariff, and we are reluctant to formulate new policy without the input of other large water utilities and affected groups such as those representing communities, homeowners or developers that are not party to this application. While we disagree with Cal Water's blanket statement that we never make policy in connection with individual applications, it is our preference to have all interested parties involved when we propose a major policy change.

A rulemaking is the best venue for the changes DRA proposes, so that other interested parties have the chance to weigh in. Indeed, the Commission has not authorized water supply special facilities fees in any of the Eight Districts other than Chico, Salinas and Visalia, so adding those fees now without the participation of those districts or notice to them of a possible new charge might prove problematic. Our GO 103 proceeding, R.07-12-015, may be such a venue since one of the changes appended to R.07-12-015 is a proposal to eliminate all reference to Tariff Rule 15 from the General Order.

We make no decision regarding the appropriateness of DRA's proposal, but simply find that it would be better considered as part of a broader proceeding applicable to all affected companies and districts.⁴⁵ DRA may seek to have this issue added to the scope of R.07-12-015, although discretion to do so lies with the assigned Commissioner and ALJ for that proceeding.

As for Cal Water's proposal, we assume DRA has no objection to higher per-lot fees in the Chico, Salinas and Visalia districts, since it actually proposes increases that are higher than those Cal Water proposes.⁴⁶ It follows *a fortiori*, therefore, that DRA can live with the fees Cal Water proposes. DRA's witness Bumgardner acknowledged that "DRA did not take exception with the methodology used by Cal Water but we did use a different approach in calculating our number."⁴⁷

We agree with Cal Water that the per-lot fees it requests for Chico, Salinas and Visalia should be increased to \$1,000, \$1,200, and \$1,100. Cal Water has established that its costs of well construction warrant such an increase, and we agree that new customers should bear the costs they cause. Thus, we find in Cal Water's favor on this issue. We also approve the standard 12" main fee for Visalia within a half-mile of the existing system. We agree that it is administratively efficient to charge a uniform fee in this case where the utility has a grid layout and development is occurring rapidly.

⁴⁵ Because we do not adopt DRA's proposal, we also do not decide the merits of Cal Water's challenges to DRA's fee calculation.

⁴⁶ In its brief, DRA estimates the underfunded portion of new facilities to be \$6,464 in Chico, \$11,506 in Salinas and \$6,528 in Visalia. *Opening Brief of the Division of Ratepayer Advocates*, filed March 7, 2008 (DRA *Opening Brief*), Table 1, p. 5.

⁴⁷ 10 RT 322:16-22.

6.2. Health Care Escalation (Cal Water/DRA)*Parties' Positions*

Cal Water proposes a new method for allocating the cost of employee health care in future years. DRA recommends that the Commission continue to use the methodology adopted in 2004 rate case plan decision, D.04-06-018.

Cal Water asserts that the Global Insight Employment Cost Index for Health Insurance (ECIHI) shows that health care costs are escalating at a rate higher than the escalation factor used in the D.04-06-018 rate case plan, and that we should therefore rely on the ECIHI index to estimate future cost increases. Cal Water states that the ECIHI index was used without controversy in an energy utility's case as the basis for post-test year ratemaking estimates of health care costs by all parties in A.05-12-002 (PG&E General Rate Case).⁴⁸ Cal Water also notes that DRA uses other Global Insight data in developing its inflation factors.

Cal Water reasons that it is well known that health care costs have been increasing at rates that exceed the rate of inflation. Cal Water asserts that adoption of the D.04-06-018 methodology would result in a nearly \$1 million under-recovery of health care costs in the first escalation year, with the under-recovery compounded to almost \$2 million in the second escalation year.⁴⁹

DRA objects to Cal Water's proposal on the ground that the Commission's most recent rate case plan decision, D.07-05-062, mandated DRA's proposed methodology. In that decision, the Commission required that water utilities estimate escalation year labor expenses by the most recent labor inflation factors.

⁴⁸ D.07-03-044, p. 161-64.

DRA asserts that health care expenses are labor expenses, and recommends the use of the most recently adopted labor inflation factor, in accordance with D.07-05-062.⁵⁰

DRA also asserts that the ECIHI is used for energy utilities and is inappropriate for use here.⁵¹ It notes that Cal Water advocated for a similar change in the methodology for escalating health care costs in both R.06-12-016/D.07-05-062 and the previous rate case plan proceeding, and that the Commission found that the existing methodology, which utilized DRA's labor inflation factor, was the appropriate method to continue using in class A water utility GRCs. Therefore, DRA asserts, the Commission should reject Cal Water's proposal for the use of a higher escalation factor and adopt DRA's recommendation for health care escalation factor.⁵²

Cal Water does not rebut DRA's assertions in its *Reply Brief*.⁵³

Discussion

We are not persuaded to change the methodology we adopted only a year ago in our latest rate case plan. As we note in the previous section related to the per-lot fee issue, it is more appropriate to examine an issue with broad application in the context of a rulemaking than in a single application.

⁴⁹ *Cal Water Opening Brief*, p. 12.

⁵⁰ Ex. 209, pp. 1-4 to 1-6.

⁵¹ Ex. 1, tab 17, p. 55.

⁵² *DRA Opening Brief*, pp. 8-9.

⁵³ The *Reply Brief of California Water Service Company on Contested Issues*, filed March 14, 2008, makes no mention of the health care escalation issue.

Cal Water's lack of rebuttal to DRA's arguments also makes it difficult for us to assess the merits of Cal Water's assertions.

We therefore adopt DRA's position on this issue, and retain the existing methodology for escalating health care costs.

6.3. Allocation of General Office Expense to Coast Springs Area of the Redwood Valley District (Cal Water/Young)

Parties' Positions

We turn to a discussion of Young's disputed issues. In its application, and in accordance with the D.07-05-062 rate case plan, Cal Water seeks review of General Office expenses for all 24 of its districts (in addition to seeking review of the Eight Districts' specific costs).⁵⁴

Young contends that the Coast Springs area of the Redwood Valley district should not be allocated the General Office expenses based on the four-factor methodology traditionally applied by the Commission to allocate General Office costs to individual water districts. Young objects to use of the four-factor allocation method because using it will cause the rates for Coast Springs to increase by over 25%.

It seemed that something must be amiss if by just increasing the [General Office], the total rate for [Coast Springs] would increase by such a large amount. This is significantly more than the

⁵⁴ D.07-05-062 states that "During our transition to the new [rate case plan], we will review all [General Office expenses] for (1) California Water Service Company with its July 1, 2007 GRC"

increases for the other 15 districts which range from 7.3% to 18.7%.⁵⁵

Young cites D.87468, in which we stated that a two-factor method provided a "more equitable estimate."⁵⁶

The four-factor method relates to the allocation of common office expenses incurred at the corporate level for the benefit of all of a water company's districts. Cal Water allocates these costs to its individual districts based on a four-factor allocation method (direct operating expenses, gross plant, number of customers, and number of employees/payroll). Young suggests that we allocate three of these elements to the Coast Springs district but exclude the fourth factor - number of employees/payroll.

The costs at issue relate primarily to two new programs Cal Water plans to initiate - its unidirectional flushing program and its cross connection/backflow prevention program. In the unidirectional flushing program, Cal Water will perform maintenance on all valves and flush all water mains in the system. Cal Water maintains the program is necessary to safeguard water quality in its distribution system. It began a pilot program in September 2006 in its Los Altos,

⁵⁵ *Opening Brief of Intervenor Jeffrey Young*, filed March 7, 2008 (*Young Brief*), p. 1 (citations omitted).

⁵⁶ "PG&E argues that its utilization of the four-factor method to allocate common expenses is fair and reasonable. PG&E utilized the established four-factor method to allocate certain administrative and general expenses.' The document goes on to say staff recommends a two factor allocation because: 'the four-factor allocation produced distorted results for the Tuolumne Water System of \$10.11 per customer as opposed to a \$5.39 cost per customer for PG&E overall. The staff two-factor allocation resulted in a charge of \$6.09 per customer, a more equitable estimate.'" D.87468, 81 CPUC 800, 803-04 (1977).

Bayshore and South San Francisco locations, and now proposes to expand the program statewide.⁵⁷

The cross connection/backflow prevention program is aimed at testing existing devices annually and repairing and replacing them where necessary.⁵⁸ A cross connection is an unprotected actual or potential connection between a potable water system (water that is safe for drinking) and any source or system containing water or other substance that is not safe, wholesome and fit for human consumption. In the two years prior to submitting its application, Cal Water was cited twice by the California Department of Health Services (DHS) for cross connection/backflow problems.

Cal Water opposes Young's three-factor proposal, noting that Cal Water has used and the Commission has approved the four-factor method for 50 years. Cal Water asserts that the flushing and cross connection programs will benefit Coast Springs just as they will benefit the other districts, and therefore personnel costs related to the program should be allocated to Coast Springs just as they will be to other districts.⁵⁹

In addition, Cal Water notes that the Coast Springs operation is expensive for other reasons:

[T]his small service area, and indeed the entire Redwood Valley region, is under a great deal of supervision by general office staff. It is under a service connection moratorium and has water supply problems. It has been the subject of several independent proceedings at the Commission, requiring the time of regulatory,

⁵⁷ Ex. 7, p. WP5-B2ae (General Office report).

⁵⁸ *Id.*, p. WP5-B2au.

⁵⁹ DRA did not brief the Young issues.

engineering, and water quality staff. Dollar cost increases spread over fewer customers and gallons give the appearance of a disproportionate increase, but in fact merely reflect the actual cost of service in the district. Such impacts do not demonstrate that the four factor allocation method produces “unfair” results but rather that it is more expensive to serve Coast Springs than other districts.⁶⁰

Discussion

We reject Young's proposal. It is true that small districts with few customers over whom to spread increases can experience higher rate increases than districts with many customers. However, Young has not shown that Coast Springs will not benefit from the flushing or cross connection programs or that it should not bear a proportional amount of the personnel costs from the new programs, or from General Office operations as a whole. We note that the DRA-Cal Water settlement will result in lower General Office employee hiring for both programs, so the increases will be lower than proposed in Cal Water's application.⁶¹

We are sympathetic to Young's concerns, but he has not presented us with a principled way of distinguishing Coast Springs from other small districts. While we have occasionally used an allocation method other than the four-factor method (*see* D.87468, cited above), those instances are rare. Without a

⁶⁰ *Cal Water Reply Brief*, p. 11 (citations omitted).

⁶¹ The settlement provides for hiring of 8 cross connection inspectors or flushing foremen in 2008 and 11 in 2009, for a total of 19 new employees. Settlement § 3.2.3.2, Table 1. The original application proposed 26 new employees for the cross connection control program and 15 new employees for the unidirectional flushing program, or 41 new employees. *Cal Water Response to ALJ Thomas' September 11, 2007 Ruling*, filed Oct. 11, 2007, p. 17. Thus, the settlement halves the employee additions for these programs.

justification that goes beyond the assertion that the district is small, we do not find a basis to do as Young requests.

6.4. Other General Office Allocation Issues (Cal Water/Young)

Parties' Positions

Young contends that Cal Water is improperly seeking rate increases in all 24 districts related to General Office allocations. He asserts that Cal Water may only obtain such increases via individual advice letters, and that this GRC is not the proper forum for the increases. He also asserts that customers in the 24 districts did not receive notice of proposed rate increases attributable to allocation of the General Office expenses, so such increases may not be ordered here.

Cal Water explains that it is not seeking rate increases attributable to the allocation of General Office expenses in this GRC. Cal Water explains that it instead seeks Commission permission to file advice letters to incorporate the allocated General Office revenue requirement into rates in its 16 other operating districts.⁶² Cal Water states that the rate case plan adopted in D.07-05-062 allows this request: "We anticipate that a utility may seek changes related to General Office in districts not undergoing a GRC review. In such instances, the utility may file an advice letter to implement any Commission-approved rate changes."⁶³

Thus, Cal Water acknowledges that it must next file advice letters to implement the approved rate changes. While this may appear to be a distinction

⁶² Ex. 44, p. 19 (Application).

⁶³ D.07-05-062, *mimeo.* p. 11-12.

without a difference, we agree with Cal Water that the method it has used is proper. Further, D.07-05-062 did not specify which Tier (Tier 1, 2 or 3) a water utility should use to file the referenced advice letters. Therefore, Cal Water has discretion to file under whichever Tier it deems appropriate. We note that all filings under Tier 1 and 2 of GO 96-B, the General Order governing advice letters, are subject to refund until approval by the Division of Water and Audits, a point Cal Water concedes in its comments on the proposed decision.⁶⁴

However, Cal Water requests that the rate increases attributable to General Office go into effect on July 1, 2008. Since this decision does not relate to the advice letters, we decline to grant this request. The effective date of the increases will depend upon the advice letter process Cal Water follows.

Young asserts that the interim rates attributable to General Office allocations should not go into effect for Coast Springs (and, by extension, the other 16 districts that are distinct from the Eight Districts) until July 2009. He cites testimony of Cal Water's witness, Tom Smegal, in support of his position:

The decision 07-05-062, which is the rate case plan decision, allows that the [Cal Water] districts ... which would be delayed beyond the general three-year rate-case cycle would be allowed to put into effect interim rates at the date that they would have received a rate change on the three-year rate-case cycle."⁶⁵

However, the cited language is ambiguous. It could either mean that all 16 districts should have rate increases reflecting General Office allocations with this GRC, or that each General Office allocation should occur when its district is

⁶⁴ *Comments of California Water Service Company on Proposed Decision of ALJ Thomas*, filed June 30, 2008, p. 13.

⁶⁵ *Young Brief*, p. 8, citing 9 RT 255:13-20.

considered individually. The rate case plan decision itself is more instructive on this point; it states:

During our transition to the new [rate case plan], we will review all [General Office expenses] for (1) California Water Service Company with its July 1, 2007 GRC..... *We anticipate that a utility may seek rate changes related to [General Office expenses] in districts not undergoing a GRC review.* In such instances, the utility may file an advice letter to implement any Commission approved rate changes. D.07-05-062, *mimeo.*, pp. 11-12 (emphasis added).

This passage – especially the highlighted portion – indicates the Commission intended to allow water companies to seek General Office expense allocation with its first GRC filed after D.07-05-062 was effective. Thus, it is proper for Cal Water to seek such increases in this GRC, as long as it noticed customers of the potential increase. Notices for all 24 districts appear as part of Exhibit 44, the Application in this case.

Having the rate increases effective on advice letter filing or approval rather than in the future does not put ratepayers in a worse position than they would be if the increases were effective next year. Indeed, allowing them now will prevent rate shock when increases for a greater period are implemented all at once, rather than over a longer period. Thus, we find no impediment to Cal Water seeking to implement the GO increases via advice letter at this time, and we allow Cal Water to file those advice letters forthwith.

6.5. Proposed Wells in Mid-Peninsula District (Cal Water/Mangold)

Parties' Positions

Mangold opposes Cal Water's plan – incorporated into the settlement agreement⁶⁶ – to construct 3 new wells in the Mid-Peninsula district. The district currently receives all its water from the San Francisco Public Utilities Commission's (SFPUC) Hetch Hetchy system, so the wells would add a second water source.

Mangold believes that Cal Water did not show a need for the proposed wells. He also objects to the means of rate recovery for the proposed wells. He is concerned that a determination of whether the wells are used and useful is being delegated to staff as part of an advice letter process. He believes the used/useful determination is for the Commission alone.

DRA responds that Mangold misunderstands the process of approving the wells. DRA states that it has already conducted a reasonableness review, is recommending in the settlement that that wells be constructed, and asking the Commission to approve that recommendation. Thus, the Commission retains the authority to approve the wells.⁶⁷ The advice letter treatment will simply ensure that the well project costs are capped and not put into rates until the well projects are put in service.

Cal Water states that Mangold's objection to Commission approval of the wells is undercut by his own discussion of the district's other source of water, the

⁶⁶ Settlement Agreement § 4.5.6.3.2.

⁶⁷ *Joint Reply of California Water Service Company and the Division of Ratepayer Advocates to the Comments of Arthur A. Mangold*, filed April 24, 2008 (*Joint Reply*), § II.

SFPUC. Mangold characterizes that source as "severely strained" and "subject to mandatory cutbacks" in dry years.⁶⁸ Cal Water points out that local wells can help relieve that strain and provide a cushion in times of any mandatory cutback.

Discussion

We believe Cal Water should begin to explore ways of diversifying its water sources in the Mid-Peninsula district. By its own account, the SFPUC-Hetch Hetchy system is not limitless in its capacity, and it is important that Cal Water engage in long term water supply planning so that it is prepared if it needs to turn to new sources of water.

We are not persuaded by Mangold's objections to the need for the new wells or the process for placing them in rate base. The Tier 3 advice letter review process contemplated for the wells by the settlement agreement requires Commission approval of the advice letters by Resolution. *See* GO 96-B, Water Industry Rule 5 (A Tier 3 advice letter is subject to disposition under General Rule 7.6.2, which provides that Resolutions must be placed on the Commission agenda for action, and that the Commission may modify it in whole or part).⁶⁹ Thus, the Commission retains authority to review, modify and approve the advice letters.

⁶⁸ *Cal Water Reply Brief*, p. 9.

⁶⁹ General Order 96-B is available online at http://162.15.7.24/PUBLISHED/GENERAL_ORDER/64590.htm#P452_57862.

7. 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 comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure.

DRA, Cal Water and Young filed comments. DRA suggested ministerial changes, which we have made. Cal Water made more substantive recommendations, some of which we allow and some of which we deny, as set forth below. We also adopt most of Cal Water's suggested ministerial changes. Young opposed anything but Tier 3 advice letter treatment under GO 96-B for General Office rate increases; we deny this request.

First, Cal Water asks us to make a finding that PayGo treatment is the best outcome for ratepayers. We are not prepared to make this finding, as there is insufficient information in the record on the point. We are comfortable with a settlement on this issue using PayGo treatment, but because the parties did not litigate the issue of which treatment was optimal for ratepayers, we cannot make the finding Cal Water requests. We do make some minor wording changes, however.

Second, Cal Water also asks us to make an affirmative finding that the water quality in the Eight Districts shows no material problems. As we explain in the decision, this is the first decision after the latest rate case plan, and the Division of Water and Audits was unable to make a water quality assessment. Cal Water agrees that "DRA's role does not extend to rendering an opinion on whether or not a utility complies with all water quality regulations."⁷⁰ Thus, we

⁷⁰ *Comments of California Water Service Company on Proposed Decision of ALJ Thomas (Cal Water Comments)*, p. 6.

are not prepared to make such a finding at this time; there simply is not adequate information in the record to opine either way.

Third, Cal Water asks us to extend the deadline for its rate base offset pilot program from June 30, 2009 to the end of the rate case cycle for the Eight Districts. It notes that several of the projects in the pilot will not be constructed until as late as 2011. We agree with Cal Water that we should extend the pilot to the end of the rate case cycle for the Eight Districts. We will review the pilot's results in the next GRC on the Eight Districts.

Fourth, Cal Water asks that the General Office offset filings be Tier 1 (ministerial) advice letters rather than Tier 3 letters requiring Commission approval. We do not specify the Tier Cal Water must use, but give Cal Water flexibility for purposes of this decision only.

Fifth, Cal Water reiterates its request that we adopt its own health care escalation formula. As we say in the decision, this issue was just decided and we are not prepared to change our determination.

8. Assignment of Proceeding

John Bohn is the assigned Commissioner and Sarah R. Thomas is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The settlement represents a compromise from rate increases that were in the 20-30% range in the original application (with the 59.1% increase proposed for the Chico district an anomaly).

2. Under the settlement, regarding rate base offsets, Cal Water will continue to file for rate base offsets under the current Tier 3 advice letter process pursuant to GO 96-B. The change will be that each such advice letter will be effective immediately, but subject to refund with interest if necessary when the

Commission issues a Resolution on the advice letter. Cal Water will ask for review of the pilot process in the next GRC filing.

3. The ESP issue raised in the Scoping Memo is being resolved in a separate proceeding.

4. The infrastructure of water utilities we regulate, including those of Cal Water, is aging and will require significant infrastructure planning and investment in future years.

5. Health care and retirement expenses will increase as the Baby Boom generation reaches retirement age and health care costs nationwide continue to balloon. Much of Cal Water's rate increase relates to these unavoidable expenses.

6. Cal Water must add a number of new employees to comply with various regulatory requirements.

7. New water quality requirements and the Sarbanes Oxley Act of 2002 account for most of the new proposed hires.

8. The original GRC application seeks to add 148 new employees at the General Office level. Cal Water's existing General Office workforce is 239 employees, so the increase would be more than 60 percent. The settlement allows for the addition of 59 new employees at the General Office level over 3 years, an increase of 39 percent, and 17 employees over DRA's pre-settlement recommendation.

9. DRA and Cal Water agree to conservation budgets that are significantly higher than the expenditures Cal Water has made on conservation activity in prior years.

10. One of the objectives of our 2005 Water Action Plan was to increase water conservation programs to levels comparable to those of energy utilities.

11. The settlement builds in a reporting process and other accountability measures to ensure that Cal Water spends the money budgeted on cost effective conservation.

12. Cal Water will, consistent with the decision in its last GRC, provide a measurement and evaluation proposal for its conservation program within 90 days, and will also file conservation reports in accordance with D.07-12-055.

13. The one-way balancing account treatment DRA and Cal Water have agreed upon for Cal Water's conservation program will protect ratepayers in the event Cal Water under-spends its conservation budget in any of the Eight Districts. Any funds not spent over a set amount will revert to ratepayers, subject to the following conditions. First, any unspent funds will be amortized in the next GRC. Second, the maximum carryover for each of the Eight Districts will be limited.

14. Decision 07-05-062 stated that water companies shall begin a new long-term planning effort with its first GRC filed after July 1, 2008.

15. The Water rate case plan, D.07-05-062, required the Water Division (now the Division of Water and Audits) to retain its own expert to make an independent assessment of water quality in the districts under consideration in a GRC. DWA was unable to retain an expert in time for this decision.

16. DRA's role does not extend to certifying that Cal Water meets applicable water quality requirements.

17. The settlement provision that 23 of Cal Water's proposed capital projects will be excluded from the company's revenue requirement until they are completed and in service will balance the interests of the public for rate certainty and the interests of the company in recovering the revenue requirement of its investments.

18. We have approved prior settlements between DRA and Cal Water in which Cal Water agreed to the same rate base offset procedure.

19. Livermore residents pay for water service based on 1-inch meters because the City of Livermore requires sprinkler systems for all residential units. Sprinkler systems require a 1 inch metered connection. Customers in that district might not otherwise require a 1 inch meter for their water consumption needs. The 1-inch charge is 250% of the standard 5/8 x 3/4 inch service.

20. Cal Water's notice of proposed rate increases in Salinas and Visalia assumed the rates would be phased in, and that the full increase would not be felt in the first year.

21. We generally settle policy issues applicable to an entire industry in rulemakings.

22. DRA proposes a new method of charging new water system customers for facilities necessary to provide them service.

23. Those water customers who cause Cal Water to incur costs should pay for them.

24. An increase in the per lot special connection fees Cal Water charges new customers in the Chico, Salinas and Visalia districts is warranted by increases in the cost of well construction since the last time the charges in these three districts were reviewed by the Commission.

25. It will improve administrative efficiency in the Visalia district for Cal Water to modify its Tariff Rule 15 to unitize the costs of installing transmission backbone (12" mains) in the Visalia District. Cal Water states it designed this change to improve administrative efficiency in developer transactions in the rapidly-growing Visalia district. Cal Water states it will incorporate limiting language in its tariff that limits the applicability of the

unitized transmission fee to new development within a half-mile of the existing system.

26. The Commission approved DRA's method of calculating health care escalation costs in its last two rate case plans.

27. The Global Insight Employment Cost Index for Health Insurance (ECIHI) health care escalation index has been applied by the Commission to an electric utility, but not to a water utility.

28. The General Office personnel costs Cal Water seeks to allocate to its water districts relate primarily to two new programs Cal Water plans to initiate - its unidirectional flushing program and its cross connection/backflow prevention program.

29. The unidirectional flushing program and its cross connection/backflow prevention will benefit the Redwood Valley/Coast Springs district.

30. The Redwood Valley region is under a service connection moratorium and has water supply problems. It has been the subject of several independent proceedings at the Commission.

31. We have occasionally used an allocation method other than the four-factor method, but those instances are rare.

32. Having the General Office-attributable rate increases effective on advice letter filing, subject to refund, rather than on July 1, 2009 does not put ratepayers in a worse position than they would be if the increases were effective next year. Allowing the increases now will prevent rate shock when increases for a greater period are implemented all at once, rather than over a longer period.

33. The SFPUC Hetch Hetchy water system is not limitless.

Conclusions of Law

1. The Cal Water/DRA settlement, as modified below, is reasonable in light of the whole record, consistent with law, and in the public interest.
2. We should approve the settlement between Cal Water and DRA, with the modifications set forth below.
3. Cal Water should be engaged in long-term water supply planning in all of its districts.
4. The Cal Water/DRA rate base offset pilot program is reasonable, given that it gives us the authority to order refunds with interest if a particular rate base offset is inappropriate.
5. It is important to limit ratepayer funding of certain employee perks and company activities that do not relate directly to their service to ratepayers.
6. It is reasonable for Livermore customers to pay rates based on 5/8 x 3/4 inch service, plus a small surcharge to cover the additional cost of a larger meter, even though they have 1 inch service due to City of Livermore sprinkler system requirements regardless of lot size.
7. The rate increases for Salinas and Visalia should be phased in to mitigate rate shock.
8. Vehicles should be retired according to the Department of General Services vehicle replacement policy as ordered in D.07-12-055 in this proceeding and in subsequent proceedings, unless the Commission later orders otherwise.
9. DRA's new method of charging new water system customers for facilities necessary to provide them service should be vetted in a rulemaking.
10. We should approve the per lot fee increases Cal Water requests for the Chico, Salinas and Visalia districts.

11. Cal Water has not established that it is appropriate to adopt the Global Insight ECIHI in this proceeding.

12. Young has not established that Cal Water should use a three-factor methodology, rather than a four-factor methodology, in allocating General Office costs to the Redwood Valley/Coast Springs district.

13. Cal Water should be allowed, consistent with the Commission's most recent rate case plan decision, D.07-05-062, to file advice letters implementing General Office cost allocations in its 16 districts not included in this GRC.

14. Cal Water should be allowed to explore the possibility of constructing three new wells in the Mid-Peninsula district.

15. It is appropriate for Cal Water to begin the process of locating an alternate source of water supply in the Mid-Peninsula district to the SFPUC Hetch Hetchy system.

16. Those who request a fire-flow test should pay the cost of performing the test.

17. It is reasonable to charge \$450 for a fire-flow test in Cal Water's Eight Districts in this GRC.

18. The Commission should order Cal Water to include in its preliminary statement a memorandum account for compliance costs associated with the Federal Groundwater Rule as proposed by DRA.

19. The Commission should order Cal Water to modify its Wausau insurance litigation memorandum account to include remediation capital projects in the Chico District.

O R D E R

IT IS ORDERED that:

1. The settlement agreement between California Water Service Company (Cal Water) and the Commission's Division of Ratepayer Advocates (DRA) is hereby approved.
2. Ninety days after the decision in this application, Cal Water shall file with the Division of Water and Audits a new conservation budget based on the DRA/Cal Water conservation program budget settlement. In addition, Cal Water shall include a measurement and evaluation proposal. Subsequently, on an annual basis Cal Water shall file a measurement and evaluation report. The first measurement and evaluation report shall include conservation program activities for 2008. The first measurement and evaluation report shall be filed on March 15, 2009.
3. Cal Water shall use its March 18, 2008 proposal for measurement and evaluation of its conservation activities in connection with Decision (D.) 07-12-055 as a basis for its measurement and evaluation proposal here, and include any changes ordered in connection with D.07-12-055/ Application (A.) 06-07-017 *et seq.* and incorporated after the March 18, 2008 submission. Cal Water may also modify its March 18, 2008 measurement and evaluation proposal if it sees fit, as long as the proposal is consistent with any orders made in this proceeding or in any other proceeding related to water conservation, such as Investigation (I.) 07-01-022, our Water Conservation OII.
4. Cal Water shall enhance its conservation activities as described in our Water Action Plan and our Water Conservation OII. Cal Water shall spend at or near budgeted levels on sound conservation measures for the Eight Districts at

issue in this proceeding (Chico, East Los Angeles, Livermore, Los Altos, Mid-Peninsula, Salinas, Stockton and Visalia).

5. Cal Water shall submit a long-term, 6-10 year Water Supply and Facilities Master Plan to identify and address aging infrastructure needs with its first General Rate Case (GRC) filed after July 1, 2008.

6. The foregoing Water Supply and Facilities Master Plan shall address the water supply concerns Arthur Mangold (Mangold) raises with regard to the Mid-Peninsula district.

7. We decline to find that there are no material water quality problems in the Eight Districts given that our Division of Water and Audits (DWA) was unable to hire an expert to make an independent assessment of water quality in time for this decision.

8. If Cal Water opts to refile for permission to implement an Infrastructure Investment Surcharge Mechanism (IISM), or similar mechanism, it shall address, in detail, the concerns and requests for additional information DRA raised in its testimony on the IISM in this proceeding.

9. In its next GRC, Cal Water shall file a request for review of the rate base offset pilot we approve here. The request shall do the following, at a minimum: (1) list the rate base offsets in the pilot, with citation to the advice letter and resolution numbers, description of the item, and dollar impact, (2) identify the issues raised in any protest filed with regard to a particular advice letter, (3) identify any advice letter found to be subject to refund after a review by the Commission, and (4) explain the basis for the refund.

10. Cal Water shall make a proposal to address customers outside the Livermore district who pay for 1-inch metered service solely to meet fire protection requirements imposed by the local government, and provide

customers who request it an opportunity to pay a smaller meter service fee. Cal Water shall research its customer information database, contact cities, and/or conduct sample studies to determine the potential applicability of a “1-inch residential plus fire service” rate in its other districts. It shall also review its tariffs to determine who has such 1 inch fire protection service. The proposal shall explain how Cal Water will account for the cost under-recovery, if any, related to installing and maintaining large meters for fire protection while collecting rates for smaller meter service.

11. Cal Water shall phase in rate increases for Salinas and Visalia to mitigate rate shock.

12. Cal Water shall retire vehicles according to the Department of General Services vehicle replacement policy as ordered in D.07-12-055. This requirement shall apply to this proceeding and to subsequent proceedings, unless the Commission later orders otherwise.

13. Cal Water may increase the per lot special connection fees it charges new customers in the Chico, Salinas and Visalia districts to \$1,000, \$1,200, and \$1,100, respectively, in accordance with the request in its application.

14. Cal Water may modify its Tariff Rule 15 to unitize the costs of installing transmission backbone (12” mains) in the Visalia District. Cal Water shall incorporate limiting language in its tariff that limits the applicability of the unitized transmission fee to new development within a half-mile of the existing system.

15. Cal Water may, consistent with the Commission's most recent rate case plan decision, D.07-05-062, file advice letters implementing General Office cost allocations in all 24 districts. Cal Water has discretion as to which General Order 96-B Tier to file under, but may file under Tier 1 if it elects for purposes of this

decision only. The rate increases resulting from the foregoing advice letter filing will go into effect under the GO 96-B rules governing the Tier Cal Water elects to use. If it files under Tier 1, the rates will go into effect immediately, subject to refund until approval by the Commission's Division of Water and Audits.

16. Cal Water's request for funding to begin the process of constructing new wells in the Mid-Peninsula district is approved.

17. The rate tables and tariff sheets at Attachment C are adopted.

18. Cal Water is authorized to file in accordance with General Order 96-B, and to make effective on filing, tariffs containing the 2008/2009 test year increases for its Eight Districts. The revised rates shall apply to service rendered on and after the tariff's effective date.

19. On or after May 1, 2009, Cal Water is authorized to file, in accordance with GO 96-B, an advice letter, with appropriate supporting workpapers, requesting an escalation adjustment to be calculated in conformance with the rate case plan (RCP) and Attachment 3. The filing should include an offset for General Office personnel hired in 2009 and the remainder of the Salinas and Visalia rate phase-ins as agreed in the adopted Settlement. In addition, the Salinas growth factor used in the escalation calculations identified in the RCP should be based on the recorded numbers of customers as shown in Paragraph 4.1.1.2.1 of the Settlement. Cal Water should file a lesser increase in the event that the rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending March 31, 2009, exceeds the rate of return found reasonable by the Commission for Cal Water for the corresponding period in A.08-05-002, or the rate of return found reasonable in this case if a decision in A.08-05-002 has not been rendered at that time.

20. On or after May 1, 2010, Cal Water is authorized to file, in accordance with GO 96-B, an advice letter, with appropriate supporting workpapers, requesting an escalation adjustment to be calculated in conformance with the RCP and Attachment 3. The Salinas growth factor used in the escalation calculations identified in the RCP should be based on recorded numbers of customers as shown in Paragraph 4.1.1.2.1 of the Settlement.

21. The surcharge to true-up the interim rates authorized in ALJ Thomas' May 27, 2008 ruling shall be based on the methodology set forth in D.07-12-055 and shall be filed by compliance letter within 60 days of the effective date of this decision.

22. Cal Water is authorized to file Tier 1 advice letters to request amortization of the balancing and memorandum accounts adopted in Paragraphs 5.4 and 5.5 of the Settlement.

23. Cal Water is authorized to file Tier 1 advice letters to adopt a fire-flow testing fee applicable to the districts in this proceeding.

24. Cal Water is ordered to file Tier 1 advice letters within 30 days to include in its preliminary statement: (1) a memorandum account to record costs associated with complying with the Federal Groundwater Rule; (2) a one-way balancing account to record conservation expenses; and (3) modifications to its Wausau Memorandum Account described in the Settlement.

25. Cal Water is authorized to file a Tier 1 advice letter to recover, as a one-time surcharge, the costs of DRA's General Office Audit.

26. We order Cal Water to continue to expense workers' compensation on a PayGo basis and continue to book a regulatory asset for the difference between PayGo and the accrual method.

27. Application 07-07-001 is closed.

This order is effective today.

Dated _____, at San Francisco, California.