

Decision **PROPOSED DECISION OF ALJ O'DONNELL** (Mailed 8/19/2008)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Apple Valley Ranchos Water Company (U346W) for Authority to Increase Rates Charged for Water Service by \$3,767,000 or 22.73% in 2009, \$186,510 or 0.90% in 2010, and \$280,000 or 1.32% in 2011.

Application 08-01-002
(Filed January 2, 2008)

Fulbright & Jaworski, L.L.P., by David A. Ebershoff, Attorney at Law, and Edward N. Jackson, for Apple Valley Ranchos Water Company, applicant.

Geraldine Kim, Attorney at Law, for Division of Ratepayer Advocates.

**DECISION ADOPTING TEST YEAR 2009 REVENUE REQUIREMENT
FOR APPLE VALLEY RANCHOS WATER COMPANY**

1. Summary

By this decision, Apple Valley Ranchos Water Company (AVR) is authorized a Test Year 2009 revenue requirement of \$20,088,400, an increase of 17.86%. Rates will be adjusted for 2010 and 2011 consistent with the existing water company rate case plan, Decision (D.) 07-05-062. The adopted rate of return for the test year is 9.14% including a 10.15% return on equity. This decision adopts a settlement, included herein as Attachment A, between AVR and the Division of Ratepayer Advocates. The settlement resolves most of the contested issues.

The contested issues concern whether the ratebase treatment adopted in D.05-12-020 for Wells 33 and 34 to allow 25% of their cost in ratebase should continue, and whether four specified projects should be allowed in ratebase in

this proceeding or addressed by advice letters when completed. The Commission finds the ratebase treatment of Wells 33 and 34 adopted in D.05-12-020 should be discontinued prospectively and the four specified projects should be included in rate base in this proceeding.

This proceeding is closed.

2. Background

AVR, a wholly-owned subsidiary of Park Water Company, requests in this general rate case (GRC) application a rate increase sufficient to increase its revenues by \$3,767,000 (22.73%) for 2009. AVR estimates that the rate increases for 2010 and 2011 will be \$186,510 (0.90%) and \$280,000 (1.32%), respectively.

A prehearing conference was held on February 22, 2008. As a result of the prehearing conference, the assigned Commissioner issued a scoping memo and ruling on February 26, 2008 setting forth the issues, and schedule and other matters necessary to move the application forward. Evidentiary hearings were held on May 12-13, 2008. Public participation hearings were held on April 10 and 29, 2008. Opening and reply briefs were filed on June 16, 2008 and June 30, 2008, respectively. AVR and the Commission's Division of Ratepayer Advocates (DRA) filed a joint motion to approve a settlement on June 20, 2008. The application was submitted on June 30, 2008.

3. The Settlement

The settlement addresses all issues except the ratebase treatment of Wells 33 and 34 and advice letter treatment of four capital projects discussed later in this decision. The settlement also indicates the uncontested issues in this proceeding.

Rule 12.1(d) of the Commission's Rules of Practice and Procedure provides that:

The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

This is the standard of review for this settlement. Since AVR and DRA are the only parties, the settlement is an all-party settlement.

AVR provided an application and exhibits that explained its request for a rate increase in detail. DRA provided its analysis of the application indicating that it agreed with some of AVR's estimates and disagreed with others. The settlement indicates that most of the differences were resolved by use of more recent data, correction of calculation errors, one party's acceptance of the other's estimates or calculation methodologies, and compromises between the parties. The overall result lies between the initial positions of the parties. Thus, the settlement is reasonable in light of the whole record.

The settlement does not violate any statute or Commission decision or rule. Thus, the settlement is consistent with law.

The settlement is unopposed. It is proposed by AVR and DRA. AVR represents the interests of its shareholders. DRA represents the interests of AVR's ratepayers. Thus the settling parties fairly represent the affected interests. The settlement, combined with our resolution of the disputed issues, results in rates that are sufficient to provide adequate reliable service to customers at reasonable rates while providing AVR with the opportunity to earn a reasonable return. Thus, the settlement is in the public interest and is adopted.

4. Unresolved Issues

There remain two unresolved issues:

- Ratebase treatment of Wells 33 and 34; and
- Advice letter treatment of specified plant additions.

5. Ratebase Treatment of Wells 33 and 34

In its last GRC, AVR projected construction of three new wells in 2005, 2006 and 2007. AVR and DRA reached a settlement regarding the ratemaking treatment of the wells. The Commission concluded, based on the record, that 75% of the wells would be used to support new customers and 25% would serve existing customers. In D.05-12-020, the Commission modified the settlement to allow 25% of the cost of the new wells to be included in ratebase. The Commission also modified AVR's Rule 15 to provide a connection fee to recover costs of facilities such as wells, tanks and treatment facilities necessary to serve new customers. The connection fee would be considered customer advances for construction (advances). AVR filed an application for rehearing of D.05-12-020 asserting the adopted treatment of the new wells was not what the settlement intended. In D. 06-06-039, the Commission denied rehearing on the treatment of the wells.

AVR implemented the ratemaking treatment of the wells by including 100% of the cost of the wells in plant in service and imputing advances equivalent to 75% of the cost of the wells. Only Wells 33 and 34 were actually constructed.

5.1. Positions of Parties

In this application, AVR requests that the ratemaking treatment of the wells be modified so that only the actual advances would be booked. AVR claims that this treatment is what was intended in the previous settlement.

AVR claims the treatment of the wells was unreasonable because one of the wells was constructed in 2005, before the change in Rule 15 was adopted, and it could not collect advances for the well. AVR also asserts the treatment is unreasonable because the assumption that 25% of the output of the wells would

be used to serve existing customers was a generic assumption and not applicable to any particular new well.

DRA opposes any change to the ratebase treatment previously adopted for these two wells.

5.2. Discussion

D.05-12-020, as modified by D.06-06-039, found reasonable at the time a particular ratemaking treatment for the wells at issue. However, it departed from the Commission's more usual treatment of ratebase additions and was not specifically determined to be the Commission's policy for all future new wells. Thus, it is reasonable to review the adopted treatment based on the current record to determine whether a different treatment is warranted prospectively.

In 2006, AVR had to declare Well 20 inactive due to excessive sanding. In addition, Well 27 had to be switched to standby use only due to high arsenic levels. Thus, AVR lost the use of the equivalent of one well, which means at least one of the two new wells actually built (Wells 33 and 34) acts as a replacement for the lost wells that formerly served existing customers. As a result, it appears that the Commission's assumption that 25% of these new wells would be for existing customers is no longer valid.

In order to correctly allocate the costs of new wells between new and existing customers, the Commission would have to make such a determination for each new well in GRC proceedings and reevaluate the determination in subsequent proceedings. This determination is difficult at best. A way to ensure that new customers pay the appropriate portion of new well costs is through advances. In D.05-12-020 the Commission imposed fees designed to accomplish this. For these reasons, conventional ratemaking treatment for these wells is adopted prospectively. Under such treatment, the recorded costs of the wells are

booked to plant in service. Actual advances and depreciation are booked accordingly.

6. Advice Letter Treatment of Plant Additions

6.1. Positions of Parties

There are four proposed plant additions for which Apple Valley requests ratebase treatment and DRA proposes that they be added to ratebase by advice letter filing when they are completed. The proposed additions are:

1. Desert Knolls Tank #1 coating;
2. Mockingbird Booster Pump Station;
3. Main extension from Mockingbird Booster Pump Station to Kiowa Road; and
4. Well 24 redevelopment and rehabilitation.

Desert Knolls Tank #1 needs a new protective coating. AVR represents that a new epoxy interior coating and exterior painting would cost \$300,000. AVR proposes to utilize a solid polyurethane interior coating instead of the epoxy coating. The combined cost of the polyurethane interior coating and exterior painting would be \$500,000. AVR states that the polyurethane interior coating would last 30-40 years, whereas the epoxy coating would last about 10 years. AVR initially proposed to expense \$300,000 of the cost over 10 years and capitalize the remaining \$200,000. However, AVR subsequently agreed with DRA that the entire amount should be capitalized.

AVR estimates it will cost \$500,000 for the Mockingbird Booster Pump Station. AVR estimates it will cost an additional \$518,175 for 4,900 feet of 16-inch transmission main extension to connect the Mockingbird Booster Pump Station to the main system near Kiowa Road. The station and main extension will delay

the need for a new well by providing excess water from the Jess Ranch Pressure Zone to the rest of AVR's system.

AVR estimates it will cost \$240,000 for rehabilitation of Well 24 and related site improvements.

DRA agrees that the four projects are needed. It states that because the cost estimates are based on historic costs and there are no firm contractor bids or detailed cost estimates, the actual costs are uncertain. DRA recommends that AVR be allowed to file advice letters to seek cost recovery of each of the four projects when they are completed and put into service. Cost recovery would be limited to no more than AVR's estimate

AVR states that its estimates are reasonable and the costs should be included now in ratebase.

6.2. Discussion

The parties agree that the projects are needed. Therefore, the question is whether they should be included in the ratebase in this proceeding or included later by advice letter.

AVR and its parent company have experience with these types of projects. Thus, it is reasonable to base estimates on historic costs. Since these projects are to be built in 2009 or after, it is reasonable that contractor bids are not yet available.

A GRC is used to set rates based on reasonable estimates of the costs the utility will incur in providing service. It is not generally intended to set a specific budget. Actual costs for the test year, including plant additions, may vary.

DRA's recommendation applies only to these four projects. It has no provision for substituting different projects for any of the four proposed projects or for additional projects. If the Commission were to adopt DRA's

recommendation, AVR would be limited to these projects without the ability to make changes in response to changed conditions or opportunities.

DRA's proposed ratemaking treatment may be appropriate where the project costs are uncertain or the need for the project is uncertain. However, that is not the case here. In addition, AVR should have some flexibility in making final decisions on plant additions.

In future GRCs, parties will have the opportunity to review the reasonableness of plant additions, including the costs of these four projects, and recommend ratebase reductions if appropriate. Thus, inclusion of these four projects in ratebase at this time does not preclude removal of unreasonable costs from ratebase in the future. For the above reasons, AVR's cost estimates for these projects are adopted and included in ratebase.

7. Water Quality

DRA reviewed AVR's testimony and information provided by AVR regarding water quality, and discussed AVR's water quality with the staff of the California Department of Public Health. DRA agrees with AVR that its water quality meets all applicable water quality standards. Thus, we find AVR meets all applicable water quality standards.

8. Conclusion

For the reasons discussed above, AVR is authorized a Test Year 2009 revenue requirement of \$20,088,400, an increase of 17.86%. The adopted numbers that lead to this result are summarized in the following attachments to this decision.

- Attachment C shows the summary of earnings at present and authorized rates for domestic service.

- Attachment D shows the summary of earnings at present and authorized rates for irrigation service.
- Attachment E shows the adopted quantities for domestic service.
- Attachment F shows the adopted quantities for irrigation service.
- Attachment G shows the adopted main office expenses and adopted main office rate base.

The following table shows the effect of the adopted rates on a residential monthly bill based on usage.¹

Usage (100 cubic feet)	At Present Rates (\$)	At Adopted Rates (\$)	Increase (\$)	Percent Increase
0	21.46	19.44	-2.02	-9.41
10	36.80	40.61	3.81	10.35
20	52.14	61.78	9.64	18.49
24 (Average)	58.28	70.25	11.97	20.54
30	67.48	82.95	15.47	22.93
50	98.16	125.29	27.13	27.64

9. Comments on Proposed Decision

The proposed decision of the assigned Administrative Law Judge (ALJ) was mailed to the parties in accordance with Public Utilities Code Section 311(d) and Rule 14.3 of the Commission's Rules of Practice and Procedure. Timely comments were filed by DRA and AVR on September 8, 2008. Reply comments

¹ The bill is based on Rate Schedule No. 1, Residential General Metered Service, for a 5/8 x 3/4-inch meter. Commission fees and surcharges are not included.

were filed on September 15, 2008 by DRA and AVR. All comments were considered.

10. Assignment of Proceeding

John Bohn is the assigned Commissioner and Jeffrey P. O'Donnell is the assigned ALJ in this proceeding.

Findings of Fact

1. The settlement is reasonable in light of the whole record, consistent with law, and in the public interest.
2. AVR meets all applicable water quality standards.
3. D.05-12-020, as modified by D.06-06-039, departed from the Commission's more usual ratebase treatment of new wells and was not specifically determined to be the Commission's policy for all future new wells.
4. It is reasonable to review the adopted treatment of Wells 33 and 34 based on the current record to determine whether a different treatment is warranted prospectively.
5. Since AVR had to declare Well 20 inactive and Well 27 had to be switched to standby-use-only in 2006, AVR lost the use of the equivalent of one well.
6. Since at least one of the two new wells actually built (Wells 33 and 34) acts as a replacement for lost wells formerly serving existing customers, the Commission's assumption that 25% of the new wells would be for existing customers is no longer valid.
7. In order to correctly allocate the costs of new wells between new and existing customers, the Commission would have to make such a determination for each new well in GRCs and reevaluate the determination in subsequent proceedings, which would be difficult and subjective.

8. In D.05-12-020, the Commission imposed fees designed to ensure that new customers pay the appropriate portion of new well costs through advances.

9. The parties agree that the four projects for which DRA proposes advice letter treatment are needed.

10. Since AVR and its parent company have experience with these types of projects, it is reasonable to base cost estimates for the four projects on historic costs.

11. Since the four projects are to be built in 2009 or after, it is not surprising that contractor bids are not available.

12. A GRC is used to set rates based on reasonable estimates of the costs the utility will incur in providing service, and is not generally intended to set a specific budget.

13. Actual costs for the test year, including plant additions, may vary.

14. If the Commission were to adopt DRA's recommended advice letter treatment of the four projects, AVR would be limited to those projects without the ability to make changes in response to changed conditions or opportunities.

Conclusions of Law

1. The settlement should be adopted.

2. The Commission should adopt conventional ratemaking treatment for Wells 33 and 34 prospectively.

3. AVR's cost estimates for the four projects for which DRA proposes advice letter treatment are reasonable and should be included in ratebase.

O R D E R

IT IS ORDERED that:

1. The joint motion of Apple Valley Ranchos Water Company (AVR) and the Division of Ratepayer Advocates to approve a settlement agreement, included herein as Attachment A, is granted.

2. The requirement in Decision (D.) 05-12-020, as modified by D.06-06-039, that 25% of the cost of Wells 33 and 34 be included in ratebase, is removed prospectively.

3. AVR is authorized to file by compliance advice letter the revised tariff schedules attached to this order as Attachment B, and to concurrently cancel its present schedules for such service. AVR is authorized to file by compliance advice letter revisions to its Rules 9, 11, and 15, consistent with the settlement agreement adopted herein. This filing shall be subject to approval by the Commission's Water and Audits Division. The effective date of the revised schedule shall be January 1, 2009 and shall apply only to service rendered on or after that date.

4. Escalation advice letters for 2010 and 2011, including workpapers, may be filed in accordance with General Order (GO) 96-B no later than 45 days prior to the first day of the escalation year. To the extent that the *pro forma* earnings test for the 12 months ending September 30, as adopted in D.04-06-018, exceeds the amount authorized in this decision, the requested increase shall be reduced by the utility from the level authorized in this decision to conform to the *pro forma* earnings test. Advice letters filed in compliance with this decision shall be handled as Tier 1 filings, effective on the first day of the test year. Advice letters not in compliance with this decision will be rejected consistent with GO 96-B.

5. Except as specified herein, Application 08-01-002 is denied.
6. Application 08-01-002 is closed.

This order is effective today.

Dated _____, at San Francisco, California.