

WATER/FLC:jrb

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

WATER DIVISION

RESOLUTION NO. W-4601  
June 15, 2006

**R E S O L U T I O N**

**(RES. W-4601), SUSPENDS GOLDEN STATE WATER COMPANY'S REQUEST TO WITHDRAW WATER SERVICE UNDER CONTRACT TO THE CALIPATRIA STATE PRISON AND ORDERS GOLDEN STATE WATER COMPANY TO NEGOTIATE RATES WITH THE CALIPATRIA STATE PRISON, OR ELSE FILE BY APPLICATION.**

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**SUMMARY**

This Resolution suspends Golden State Water Company's (Golden State, SCWC, or the Company) Advice Letter (AL) No. 1206-W and orders the Company to negotiate a tariff rate with Calipatria State Prison (Prison) as discussed in its last General Rate Case decision. If the negotiation fails, Golden State is authorized to file an application to determine just and reasonable rates for the Prison.

**BACKGROUND**

Golden State filed AL No. 1206-W on January 5, 2006 to withdraw water service under contract to the Prison, which is controlled by the Office of the Secretary, California Department of Corrections and Rehabilitation (the Department or CDCR) and to provide service under tariffed rates. Golden State claimed the filing was authorized by its last General Rate Case Decision (D.) 06-01-025, January 12, 2006. The dicta in that decision states in part:

"5.19 Contract to Serve the Calipatria Prison

"The Department purchases about 40% of the output of SCWC's Calipatria water treatment plant, and is by far SCWC's largest customer in Region III.

"As discussed elsewhere in today's decision, SCWC has recently constructed a significant upgrade to this plant. SCWC and the Department discussed but were unable to resolve modifications to the Department's charges to recover the costs of the plant upgrade.

“In its application, SCWC included service to the prison at the unmodified prices pursuant to the contract. ORA in its report opposed retaining the special contract rate for the prison and recommended that the prison pay the otherwise applicable tariff rate, which results in \$428,463 in additional annual revenue for SCWC.

“Shortly after ORA submitted its report, the Department intervened in this proceeding. In its closing brief, the Department explained that it had been excluded from any discussions with SCWC regarding the type of plant or extent of upgrades to be made, and that SCWC simply expected the Department to pay a share based on its usage. The Department stated that the cost estimates it has received from SCWC have “escalated at every turn” and no “meaningful cost data” has been forthcoming. The Department was similarly dissatisfied with SCWC’s cost presentations in this proceeding, expressing surprise at the “obfuscation and lack of clarity in the submittal for the financial costs of the proposed new Calipatria plant.” The Department estimated that it could construct a water treatment plant to meet the prison’s needs for about \$3 million. Extrapolating from that estimate, the Department suggested that a reasonable cost for SCWC’s Calipatria plant would be about \$7.5 million. The Department supported, however, ORA’s recommendation that about \$10 million should be included in rate base. The Department made no specific recommendation regarding any changes to the rate it pays.

“In the overall stipulation, SCWC agreed with ORA that absent an alternative agreement, the prison should pay the otherwise applicable tariff rate.<sup>1</sup> In its reply brief, SCWC specifically requested for the first time that the Commission permanently suspend the prison’s discounted tariff. SCWC, however, provided no legal analysis supporting its authority to make such a request in this docket.

“We are in no position to consider SCWC’s tardy request to suspend the Department’s tariff in today’s decision. SCWC should use the same process and notice requirements that it had used to seek approval, namely the advice letter process, to seek suspension of this special contract.

ORA and the City of Claremont also requested that shareholders be responsible for any revenue requirement “shortfall” caused by

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<sup>1</sup> SCWC did not agree to the ratemaking treatment for the change in revenue from the prison.

implementing changes to the prison rate. We agree. SCWC has done a poor job of dealing with this issue. The Department is SCWC's largest customer and is openly threatening to leave the system. SCWC should have resolved this issue well before it filed the application. A customer that comprises 40% of the usage must be handled carefully, and the balance between striking a special deal and losing a major customer is a delicate one. Such questions should not be recognized for the first time in rebuttal testimony. The record in this proceeding leaves the impression that SCWC is defaulting the issue to the Commission without a thorough analysis of the risks and a comprehensive plan to address any impacts. The Department currently pays almost \$1 million each year. Losing a customer of this size could substantially reduce operating revenues. We do not intend to insulate SCWC from any operating revenue consequences of its delay in resolving this delicate balance.

"SCWC's Region III test year and escalation years analysis shall show the prison taking service at its projected usage levels at the otherwise applicable Region III tariff rate, unless and until the Commission approves a different rate for the prison.<sup>2</sup> In this way, SCWC will bear any shortfalls caused by delay in implementing a new rate for the prison." (D.06-01-025, pages 60-63)

Rates for the Prison are not addressed in the Findings, Conclusions or Ordering Paragraphs, other than to accept the settlement, which is calculated based on charging the Prison tariffed rates.

Golden State's comments on the proposed decision are characterized as follows:

"10. Calipatria Prison Contract

"SCWC identified no factual or legal errors in the proposed decision, but described the result as "unfair." SCWC is responsible for ensuring that it provides reasonable service to the prison. ORA contended that exempting the prison from any costs of the new water treatment plant was unreasonable, and the proposed decision adopted ORA's position. Should SCWC negotiate, and the Commission approve, an alternative

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<sup>2</sup> When the Commission approves a different rate, it shall address any on-going revenue deficiency.

tariff rate for the prison, any revenue requirement deficiency must be documented and addressed.” (D.06-01-025, page 76)

## **NOTICE AND PROTESTS**

The advice letter was sent to the standard service list. On January 26, 2006 the Department filed a protest to the advice letter. It stated that the advice letter “violates a contractual right of CDCR and is unfair...” It claims that the contract requires both parties to agree to any changes and that any movement toward charging the Prison tariffed rates “does not address the significant contribution CDCR paid to get service to the prison when it was built.”

In its response to the protest, dated January 31, 2005 (sic), Golden State wants the advice letter “decided upon its merits.” It claims that the rates for the prison were “actually litigated and decided in... Decision 06-01-025.” It states that “the Commission imputed GSW’s revenue recovery by including the Department of Corrections at the Region III tariff.”

## **DISCUSSION**

Water Division reviewed this advice letter as required by Decision 05-01-032, January 13, 2005.<sup>3</sup> In that decision the Commission disposes of problematic advice letters by saying when they raise “material factual issues requiring evidentiary hearing, the Industry Division will reject the advice letter without prejudice.” Although this filing raises material factual issues, this advice letter should not be rejected at this time.

If Golden State had followed the recommendations in the decision, it would have worked out its differences with the Prison by negotiation, as water utilities normally do for special contracts.<sup>4</sup> It would then file this advice letter, as directed by the Decision, to replace the existing contract with the renegotiated one. Since the Decision contains no Ordering Paragraphs or Finding and Conclusions relating to the Prison rate, to claim the issue has been resolved in D.06-01-025 is to ignore the obvious. Additionally, while

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<sup>3</sup> In Rulemaking 98-07-038, July 13, 1998, Rulemaking for the purpose of revising General Order 96-A regarding informal filings at the Commission.

<sup>4</sup> “If the utility has contracts to provide water, assume that the utility can renegotiate the same percentage increase for those contracts as for tariffed service (footnote omitted).” Standard Practice U-3-SM, Standard Practice For Preparing Results Of Operation Reports For General Rate Increase Requests Of Water Utilities Other Than Major Companies, paragraph 41.

it might be a small percentage of Golden State's revenues, the additional amount of money the Prison would have to pay is not inconsequential and does not qualify as an increase "that is minor in nature" as allowed in General Order 96-A, Section VI.<sup>5</sup> Golden State's position is unsupportable.

The protest by the Prison raises issues of equity and cost allocation that are not resolvable by the advice letter process. Consequently, if not resolved by negotiation, Golden State should make its request by application.

The Water Division opines that part of the reason Golden State feels, as described in its comments to the comment draft of this resolution, that it is in a "catch-22" or is being asked to do something when it has already "been there, done that," is that it has not understood the decision. As the provider of service, Golden State bears the burden of proving what rate is just and reasonable for the Prison to pay. Rather than wasting the Commission's time bemoaning its failures as a negotiator, Golden State could have presented testimony on that final day on what was a reasonable cost basis for setting rates for the Prison. It needed to do this because, while DRA and the Company propose that the Prison pay the tariffed Region III rates in the stipulation, they never made a factual case as to why. The Prison, by testimony from Mr. Franey, admits it "will pay our fair share" but doesn't define what that is. Golden State wants the remaining ratepayers to pay the revenue shortfalls incurred because, it says, the Prison contract rates can not be renegotiated. This Commission, as stated in the Decision, wants Golden State to negotiate a new contract rate and file it by advice letter. This Commission also wants the Company to quit fixating on its problems and develop some solutions.

As stated above, Golden State is the only party that can resolve the ratemaking treatment for the Prison. In order to assist the Company in that effort, we provide the following primer of steps to be taken: First, Golden State needs to assess the credibility of the by-pass threat by the Prison, and determine what price points are significant in that assessment. Second, Golden State needs to prepare a detailed cost-of-service study addressing all costs, direct and indirect, incurred to provide service to the Prison and provide that study to the Prison. Third, by balancing the costs of service with the costs of bypass, Golden State needs to prepare an offer to the Prison, and negotiate based upon that offer. We offer the services of our Administrative Law Judge Division's mediation experts to the Company and the Prison in this process.

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<sup>5</sup> According to Golden State, if approved, the Advice Letter would result in an increase in its Region III annual revenue of \$428,423 or 0.54%

If the negotiation is successful, Golden State should file a new agreement (Contract or special rate, see below) by supplementing the advice letter, along with, if necessary, the revenue allocation and rate design that sets the rates for the other customers to make up any shortfall from Prison.

If the negotiation is not successful, Golden State may file an application using the comprehensive cost study it prepared for the negotiation to justify a new rate for the Prison, and this Commission will resolve the impasse.<sup>6</sup>

In either case, in the advice letter or in the application, Golden State needs to demonstrate the reasonableness of its negotiation efforts, address the Prison's by-pass threat, and show that the outcome is reasonable for the other customers.

As shown by the fiasco that gave rise to this resolution, contract rates are inherently hard to modify. If the Company does not structure the contract properly it may end up being stuck with out-of-date rates. By far the better solution is to establish a special tariff rate for the Prison. This rate will naturally be recalculated by the Company in each GRC filing, be reviewed by DRA, and the reasonable rates approved by the Commission. The tariff rates would not require protracted negotiation to change, as they would be set on a cost-of-service basis, as are all other tariffed rates, resulting in a quicker and fairer process.

## **COMMENTS**

Public Utilities Code Section 311(g) (1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, the draft resolution was mailed to parties for comments. We summarize those comments below:

Golden State provided comments dated May 15, 2006. In them, Golden State complained that the Commission was placing it in a "catch-22" situation. It maintained that the issue of Prison rates was decided in D.06-01-025 in Golden State's favor. It complained that Golden State had been "discussing changing [the Prison] rate with the

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<sup>6</sup> The Commission has the authority to change contractually agreed upon rates that it deems unjust and unreasonable pursuant to its authority under Public Utilities Code §§451 and 453, as well as its authority under Constitution Article 12 & 14 (authority that states that discriminatory rates are prohibited); Rule 15 of the Rules of Practice and Procedure (discusses application requirements for modifying a rate, among other things); and Rule 23 of the Rules of Practice and Procedure (re Applications for Authority to Increase Rates).

Department of Corrections for 'about ten years,' ...but that the two parties 'just couldn't come to terms.'" Golden State notes that it presented testimony to this effect during the final day of hearings and claims that "they (the Prison?) would take their case to the Commission."

**FINDINGS**

1. Golden State filed AL No. 1206-W, January 5, 2006, to withdraw water service under contract to the Calipatria State Prison (Prison) and provide service to the Prison under tariffed rates.
2. The Office of the Secretary, California Department of Corrections and Rehabilitation (CDCR), filed a protest to the advice letter on January 26, 2006.
3. Golden State replied on January 31, 2006.
4. There are issues of fact and law that need to be resolved before the proper tariffed rates can be set for the Prison, unless these issues are resolved by negotiation.
5. This Commission can terminate an existing contract and establish fair rates for utility service.
6. Decision 06-01-025, January 12, 2006, directed Golden State Water Company to resolve its rates for the Calipatria State Prison by negotiation.

**THEREFORE IT IS ORDERED THAT:**

1. Golden State Water Company's Advice Letter No. 1206-W is suspended for 60 days from the effective date of this resolution.
2. Golden State Water Company shall attempt to resolve its rate dispute by negotiation.
3. If resolved by negotiation, Golden State Water Company shall supplement Advice Letter 1206-W to:
  - a. Substitute the new contract for the existing one; or
  - b. Establish a tariff for Service to Prison at the renegotiated rates.
4. If resolved by negotiation, the supplement shall also modify existing rates to make up for any shortfall in the revenue requirement prospectively.

5. Pending resolution by negotiation, within no more than 60 days after the effective date of this resolution, Golden State Water Company shall file an application to establish cost-based tariffed rates for service to the Calipatria State Prison. The filing shall address the direct costs of serving the prison and a fair allocation of the non direct costs of service.
6. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on June 15, 2006; the following Commissioners voting favorably thereon:

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STEVE LARSON  
Executive Director