

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
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May 25, 2010

Draft Resolution W-4832
Agenda ID #9514

TO: All Interested Parties

Enclosed is draft Resolution W-4832 of the Division of Water and Audits. It will be on the Commission's June 24, 2010 agenda. The Commission may act then act on this resolution or it may postpone action until later.

When the Commission acts on a draft resolution, it may adopt all or part of it as written, amend, modify or set it aside and prepare a different resolution. Only when the Commission acts does the resolution become binding on the parties.

Parties to this matter may submit comments on this draft resolution. An original and two copies of the comments, with a certificate of service, should be submitted to:

Division of Water and Audits, Third Floor
Attention: Carolina Contreras
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Parties may submit comments on or before June 14, 2010. The date of submission is the date the comments are received by the Division of Water and Audits. Parties must serve a copy of their comments on the service list on the same date that the comments are submitted to the Division of Water and Audits.

Comments shall be limited to five pages in length plus a subject index listing the recommended changes to the draft resolution, a table of authorities and appendix setting forth the proposed findings and ordering paragraphs.

Comments shall focus on the factual, legal, or technical errors in the draft resolution, and shall make specific reference to the record or applicable law. Comments which fail to do so will be accorded no weight and are not to be submitted.

Persons interested in comments of parties may write to Carolina Contreras or telephone her at (415) 703-5090.

/s/RAMI S. KAHLON
Rami S. Kahlon, Director
Division of Water and Audits

Enclosures: Draft Resolution W-4832
Certificate of Service
Service List

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS
Water and Sewer Advisory BranchRESOLUTION NO. W-4832
June 24, 2010R E S O L U T I O N

(RES. W-4832), NORTH GUALALA WATER COMPANY (North Gualala). ORDER AUTHORIZING A \$2.36 MONTHLY SURCHARGE FOR FIVE YEARS FOR RECOVERY OF \$147,306.10 FOR COSTS OF PARTICIPATING IN A GROUNDWATER CLASSIFICATION PROCEEDING.

SUMMARY

This resolution partially approves North Gualala's Advice Letter (AL) 68, filed on June 4, 2009 and authorizes the recovery of \$147,306.10 recorded in Account 180 – (Deferred Expenses) as *Items in Suspense*¹ through a surcharge of \$2.36 per month per customer for a period of five years to recover legal fees and consultant costs associated with participating in the groundwater classification proceeding held by the State Water Resources Control Board (SWRCB). North Gualala acted reasonably by participating in this proceeding to formally determine the SWRCB's jurisdiction over the water pumped from North Gualala's groundwater Wells Nos. 4 and 5.

This resolution denies North Gualala surcharge recovery of \$273,227.14 for: 1) costs that unnecessarily delayed resolving the fundamental issue of whether the SWRCB had jurisdiction over its wells; 2) costs related to an unsuccessful court challenge to the SWRCB's jurisdiction determination; and 3) expenses incorrectly booked to Account 180.

¹ Uniform System of Accounts for Class B, C, and D Water Utilities describes this account as including "expenses of security issues, bond discount, *items in suspense*, and costs which Commission has authorized the utility to amortize over future periods".

\$80,044.49 of the expenses incorrectly booked by North Gualala to Account 180 may be recoverable as capital expenditures. North Gualala may file a for a ratebase offset to recover those capital expenditures for studies/plans related to an alternate water supply project discussed herein. North Gualala may only do so once it has implemented a solution to its water supply shortage and this request is subject to a reasonableness review that should consider these expenditures' contribution to the implemented solution.

BACKGROUND

North Gualala is a class C water utility serving approximately 1,041 metered customers in Gualala and vicinity and located approximately 15 miles south of Point Arena, Mendocino County. North Gualala supplies its customer base with water pumped from two production wells, Wells Nos. 4 and 5, located in an area known as Elk Prairie on the North Fork Gualala River.

Through AL 68, filed on June 4, 2009, North Gualala requests authority to recover from its customers, via a five-year monthly surcharge, \$420,533.24 for legal fees and consultant costs incurred over a six year period - from January 2000 through August 2006 - that North Gualala claims were "necessary to defend, under challenge by another state agency (the SWRCB), their right to pump water from its wells and to maintain the Standards of Service required by General Order (GO) 103"². Further, citing Commission direction from Decision (D.) 02-11-004, dated November 7, 2002, North Gualala states that it recorded these costs in Account 180 as *items in suspense* in a sub-account that North Gualala entitled "Contingency Memorandum Account 184".

At the center of North Gualala's request lies a dispute over the nature and source of the water pumped from its production Wells Nos. 4 and 5, with North Gualala contending that the water in question is percolating groundwater for which no water rights permit is needed and disagreeing with the SWRCB's determination that it flows in a subterranean stream subject to that agency's permitting authority.

² GO. 103, III.b (1), relocated to GO 103-A II.2.B.(1) states that all water supplied by any utility shall be "from a source reasonably adequate to provide a continuous supply of water".

Water Supply Source

Between 1965 and 1989, North Gualala diverted surface water from the North Fork of the Gualala River as authorized by an appropriative water-right permit (Permit 14853). This permit authorized North Gualala to divert two cubic feet per second from the North Fork. In 1978, as a response to resolve a protest by the California Department of Fish and Game (DFG), North Gualala agreed to accept limitations on its right to divert water from the river by bypassing (i.e. leaving in the river) set amounts of flow during certain times of the year. These limitations were included as Term 9³ of the permit.

In 1989, North Gualala developed a new water source, production Well No. 4, also currently North Gualala's primary water source. Believing no water from the Gualala River system was drawn by its wells, North Gualala did not secure a permit from the SWRCB for this well. In 1992, the SWRCB informed North Gualala that its extraction from Well No. 4 was illegal, and that it needed to submit a water right application for the well.

North Gualala's Water Right's Defense

While disagreeing with the SWRCB's assertion, on November 1994, North Gualala filed a petition to substitute the authorized points of diversion under water right Permit 14853, to include Wells Nos. 4 and 5. In its petition North Gualala stated it was reserving the right to challenge the SWRCB's conclusions that its wells pumped water from a subterranean stream after conducting additional fieldwork. Concurrently to pursuing the change in point of diversion petition, North Gualala performed the additional fieldwork necessary, also referred to as the "Source of Supply Study", in an effort to confirm whether "water pumped from its Well Nos. 4 and 5 is percolating groundwater for which no water rights permit is needed or a subterranean stream, as SWRCB staff contended"⁴. North Gualala undertook this study between 1996 and 1999, including a technical report filed by North Gualala's consultants with the SWRCB on

³ Term 9 of Permit 14853 states that "for the protection of fish and wildlife, permittee shall during the period: (a) from November 15 through February 29, bypass a minimum of 40 cubic feet per second; (b) from March 1 through May 31, bypass a minimum of 20 cubic feet per second; (c) from June 1 through November 14, bypass a minimum of 4 cubic feet per second. The total stream flow shall be bypassed whenever it is less than the designated amount for that period."

⁴ D.02-11-004, at p. 2.

January 1998, and which contrary to other expert studies of the area, concluded that North Gualala's wells did not fall under the SWRCB's jurisdiction. After reviewing this report and citing other expert studies and analyses of the area, as well as its own investigations, the SWRCB disagreed with North Gualala's conclusions.

In 1999, the SWRCB adopted Order WR 99-09 and Order WR 99-11 (1999 Orders) granting North Gualala's petition to substitute Wells Nos. 4 and 5 for the previous points of diversion, while also requiring North Gualala to: 1) submit a surface flow measurement plan to ensure compliance with Term 9, and 2) prepare a water supply contingency plan to address how municipal water needs would be met if the natural flow of the North Fork fell below the minimum amounts specified in Term 9.

North Gualala submitted the plans required for compliance with the 1999 Orders, but on June 2001 the SWRCB issued Order WR 2001-14 (2001 Order) supporting its staff disapproval of the plans stating they were "deficient" and revisions were necessary. As a response to the 2001 Order, in July 2001 North Gualala filed a complaint for declaratory relief and petition for writ of mandate challenging the 2001 Order. The trial court stayed the case on December 2001 to allow North Gualala to formally petition the SWRCB for a groundwater classification hearing.

In 2001, North Gualala requested Commission authorization to recover \$323,274.67 from its customers for costs associated with the "Source of Supply Study". D. 02-11-004 found North Gualala acted reasonably in undertaking the study, granted North Gualala the authority requested, and also resolved an accounting dispute by designating Account 180 (Deferred Expenses) *items in suspense* as the correct expense account to record the "Source of Supply Study" costs.

The SWRCB held the groundwater hearing in 2002 and issued Order WRO 2003-0004 (2003 Order) concluding that all elements of the four-part test used by the agency to determine if groundwater is a "subterranean stream flowing through a known and definite channel" had been met by the flows under the Elk Prairie - the location of North Gualala's wells - thus the water pumped from North Gualala's wells fell under its jurisdiction and required a water right permit. The SWRCB rejected North Gualala's argument for a petition for reconsideration.

In May 2003, North Gualala sued the SWRCB in the Superior Court, which later ruled that the SWRCB indeed has jurisdiction over the subterranean water flows under Elk Prairie, and over North Gualala's wells. On appeal, the Appellate Court upheld the SWRCB's jurisdiction over the wells. North Gualala further appealed to the California Supreme Court, which on August 30, 2006 denied review of the litigation.

AL 68

North Gualala's dispute spanned a period of over ten years, and in addition to the "Source of Supply Study" addressed in D.02-11-004, North Gualala claims it was required to participate in SWRCB proceedings, in which it did not prevail, and then to engage in an unsuccessful Court challenge to the SWRCB's jurisdiction in order to "defend" its right to pump water from Wells Nos. 4 and 5.

This resolution addresses North Gualala's request to recover from its customers \$420,533.24 for costs it claims were associated with the events described above and incurred after the 1999 Orders through the California Supreme Court's denial of review (January 2000 through August 2006), all of which were recorded under Account 180 *as items in suspense*.

DISCUSSION

D.02-11-004 defined Account 180 as a standard ratemaking account – not a memorandum account - that provides some flexibility that avoids the prohibition on retroactive ratemaking. Only expenses that are "unique costs that do not meet the definitional criteria of any established memorandum account but which do not clearly belong in any standard capital or expense account" may be booked to Account 180 as *items in suspense*. The Commission also found that "upon review of reasonableness, the amounts listed as *items in suspense* may be recovered from ratepayers by a Commission-approved means, such as a surcharge". North Gualala's advice letter request for recovery of costs recorded under Account 180 via a customer surcharge is similar to other water utilities' request for comparable Commission-approved surcharges, such as recovery requests for expenses recorded in established memorandum accounts.

D.02-11-004 also cautioned North Gualala that because Account 180 "is not an identified, special purpose memorandum account, a utility which chooses to list unique cost items as *items in suspense* under Account 180 may wish to seek, in advance by advice letter, Commission authority to do so. Such 'pre-approval' will remove the risk

of the Commission subsequently determining that the broad category or class of costs should have been accounted for differently.”

Contrary to the Commission’s warning, North Gualala chose to record a total of \$420,533.24 incurred throughout a six-year period⁵ as *items in suspense* without ever seeking the Commission’s recommended “pre-approval”. In its request North Gualala claims that D.02-11-004 “covered” the treatment of these costs, which “were not then the subject of cost recovery”. However, contrary to North Gualala’s assertion, D.02-11-004 did not provide direction for, or address, the treatment of the costs now the subject of this resolution. No finding of fact, conclusion, or discussion in D.02-11-004 supports North Gualala’s assertion. It is evident that D. 02-11-004 only addressed how to account for and recover the expenses before the Commission in A.01-10-020⁶, which only included the “Source of Supply Study” whose scope and intent is different from most of the costs addressed herein.

In absence of a “pre-approval”, the Division of Water and Audits (Division) conducted a thorough review of the expenses submitted for recovery which are composed of costs for attorneys, engineers, expert consultants, and legal counsel for CPUC related matters. The Division discovered that these expenses represented a broad class of costs and in order to proceed with a reasonableness review, as prescribed by D.02-11-004, these costs were further classified as follows:

- a) *Compliance with the SWRCB’s 1999 Orders*⁷.
- b) *Participation in the SWRCB’s groundwater classification proceeding.*
- c) *Legal challenge to the SWRCB’s jurisdiction.*
- d) *Alternate water supply project studies/plans.*
- e) *Legal representation before the Commission in A.01-10-02.*⁶
- f) *Miscellaneous costs.*

⁵ From January 2000 through August 2006.

⁶ This proceeding addressed North Gualala’s recovery of the “Source of Supply Study” and led to D.02-11-004.

⁷ The SWRCB 1999 Orders granted North Gualala’s request to include Well Nos. 4 and No. 5 as the points of diversion under Permit 14853.

The Division's investigation and reasonableness review included detailed examination of invoices, court records, consultant documents and reports. The conclusions for each class of costs are discussed below.

Class of Costs

a) Compliance with the SWRCB's 1999 Orders.

North Gualala claims that in its effort to "defend its water rights, under challenge by another state agency" it was required to participate in SWRCB proceedings that resulted in the 2001 Order and seeks to recover \$14,275.88 for those costs. Through its investigation, the Division learned that North Gualala failed to mention that those expenses were incurred in connection with its inadequate attempt to comply with the 1999 Orders, as described below.

While believing that a water right permit was not necessary to pump water from its wells, North Gualala responded to the SWRCB's 1992 assertion to the contrary by filing a petition to change the authorized points of diversion under existing Permit 14853 to include Well No. 4, and later Well No. 5. Due to its uncertainty about the SWRCB's permitting authority, North Gualala reserved the right to challenge the agency over its jurisdiction after performing its own additional field investigation. The consultants retained by North Gualala completed this additional investigation⁸ on January 1998 with a technical report that concluded, contrary to other experts' studies, that the water extracted from North Gualala's wells was percolating groundwater not subject to the SWRCB's jurisdiction. Even though the SWRCB rejected those findings, the agency acknowledge the evident disagreement and gave North Gualala the opportunity to withdraw its petition and to hold a formal groundwater classification hearing⁹ to resolve the issue of the SWRCB's permitting authority.

⁸ Also referred to as the "Source of Supply Study" and addressed in D. 02-11-004.

⁹ The Water Code classifies groundwater to determine when a diversion of groundwater needs a permit from the SWRCB.

Although North Gualala had already obtained the technical information to support its position that a water right permit was not needed, it did not withdraw the petition to include the wells under its existing water right permit and request a groundwater classification hearing, but instead proceeded with the petition. It is this request to proceed with the petition that led to the SWRCB's 1999 Orders, which aside from approving North Gualala's own request, placed additional conditions requiring North Gualala to submit a water supply contingency plan and a flow measurement plan to ensure compliance with Term 9 of the permit.

North Gualala did not challenge any of the findings made in the 1999 Orders and proceeded to develop and file the plans required. The 2001 Order disapproved the plans submitted by North Gualala expressing that they were inadequate. Court records indicate that North Gualala made several submittals to the SWRCB, and that North Gualala refused to make the necessary plan changes for that agency's approval, as North Gualala believed that the terms and conditions set in the permit, particularly Term 9, were not applicable to its wells. However, the logical conclusion is that if the terms and conditions of the permit did not apply to North Gualala's wells, as the company argued, then it should not have felt compelled to prepare the plans which were themselves conditions of the permit. The Appellate Court that later reviewed the case at North Gualala's request, stated that the plan requirements were unmistakably "premised on Term 9's restrictions being fully applicable" to North Gualala's diversions and that North Gualala could not "manifest acceptance of the conditions and then wait until nearly two years later to challenge the premise on which they were self-evidently based".

North Gualala is now seeking Commission authorization to recover costs for inadequately developing the plans mentioned above in response to the 1999 Orders, even though that was inconsistent with North Gualala's position that the wells were not subject to SWRCB jurisdiction. North Gualala claims it was required to participate in the proceedings that resulted in the 2001 Order. However, as described above, the 2001 Order only enforced conditions set by the 1999 Orders, which resulted from North Gualala's own request. Furthermore, the SWRCB gave North Gualala the opportunity to withdraw its application and to hold a groundwater classification hearing that would address the SWRCB's permitting authority. By doing so, North Gualala would have effectively acted towards resolving the fundamental issue underlying its dispute:

whether the SWRCB had jurisdiction over its wells. Instead, North Gualala elected to proceed and accept the terms of the 1999 Order only to later challenge “the premises on which they were self-evidently based.”¹⁰

North Gualala has failed to demonstrate that its actions of selectively and ineffectively complying with the 1999 Orders defended its right to pump water from its wells or contained any ratepayer benefit. Moreover, these actions only unnecessarily delayed resolving the fundamental issue of the SWRCB’s jurisdiction over North Gualala’s wells, thus the ratepayers should not bear the cost of those unnecessary actions.

b) Participation in the SWRCB’s Groundwater Classification Hearing

North Gualala filed a complaint with the Mendocino County Superior Court for declaratory relief and petition for writ of mandate challenging the SWRCB’s 2001 Order. On December 2001 the trial court stayed the case to allow North Gualala to formally petition the SWRCB for a groundwater classification hearing. For this proceeding, which took place between January 11, 2002 and February 19, 2003, North Gualala retained attorneys, consultants, and expert witness in an effort to formally and persuasively present its case to the SWRCB. After conclusion of the hearing, the SWRCB determined that the water pumped from North Gualala’s wells indeed met the criteria for groundwater that falls under its jurisdiction and is subject to all of the permit conditions.

North Gualala identified that the fundamental issue underlying its dispute was whether or not the SWRCB had water rights over its production Wells Nos. 4 and 5, and we agree. If North Gualala were unable to use the wells when stream flows decline below the bypass minimums set in Term 9 of its water right permit, it would be left with insufficient water supplies to serve its customers. Therefore, whether North Gualala had to seek alternate supply sources lay on answering the jurisdictional question. In D.02-11-004 the Commission recognized the importance of answering this question and authorized North Gualala to recover the costs of the “Source of Supply Study”,

¹⁰ *North Gualala Water Company vs. State Water Resources Control Board*, A.109438, First Appellate District, Division One, Court of Appeal of the State of California, filed May 31, 2006

undertaken “in an effort to establish, before the SWRCB, whether water pumped from its Wells Nos. 4 and 5 is percolating groundwater for which no water rights permit is needed, or a subterranean stream” subject to the SWRCB’s jurisdiction. This is also the purpose of the groundwater classification hearing, with the “Source of Supply Study” being the technical means and the groundwater classification hearing the legal vehicle by which the source of North Gualala’s wells is established before the SWRCB.

The groundwater classification hearing permitted North Gualala to formally present the SWRCB with the technical findings made in its “Source of Supply Study” and to present the arguments supporting its position that the wells did not fall under the agency’s permitting authority. North Gualala acted reasonably by participating in the groundwater classification proceeding.

In D.02-11-004, the Commission recognized that the “Source of Supply Study” costs were “unique” costs that should be booked to Account 180. Similarly, North Gualala’s costs for participating in the groundwater classification hearing are also “unique” costs that do not meet the definitional criteria of any established memorandum account or belong in any standard capital or expense account. These costs are reasonable, properly booked to Account 180 as *items in suspense* and are eligible for recovery from the ratepayers through a surcharge. North Gualala should be allowed to recover \$147,306.10 for costs associated with the groundwater classification proceeding.

c) Legal Challenge to the SWRCB’s Jurisdiction

Background

North Gualala claims that because of the “very large costs necessary to comply with the water supply contingency plan” required by the 2001 Order and its belief that “significant uncertainties regarding the SWRCB’s jurisdiction” over its wells existed; North Gualala challenged the SWRCB’s jurisdiction in Court. The Superior Court denied North Gualala’s petition and sided with the SWRCB. North Gualala appealed to the Appellate Court, which in turn denied North Gualala’s appeal. North Gualala then brought the challenge to the California Supreme Court, which denied North Gualala’s request for review.

Alternatives to Litigation

North Gualala ascertained that if it had to curtail pumping from its wells when the flows in the North Fork Gualala River are less than specified in Term 9, it would have to develop a water supply project. In an April 27, 2000 letter to the SWRCB, North

Gualala's consultants provided cost estimates for developing some alternate water supply projects, with costs ranging from \$1 - \$10 million. These alternatives included additional groundwater wells, an off stream water reservoir, and desalination. Additional alternatives identified in this letter, but with no cost information, included co-mingling water from North Gualala's Well No. 3¹¹ with water pumped from Wells Nos. 4 and 5, and the use of other appropriative water rights held by North Gualala.¹² The cost and details of these additional alternatives were not sufficiently developed for the Division to review their feasibility.

The SWRCB has also suggested¹³ that North Gualala apply for a new permit or amend the limiting conditions under Term 9 of Permit 14853. It appears that a permit amendment or a new permit, if granted, could allow North Gualala to pump sufficient water to meet its customers' demand without developing a new water source, and could therefore be considerably less costly than developing a new water source. In 2002, prior to the onset of the court challenge, North Gualala's consultants put together a strategic work plan delineating a procedure to petition lowering the bypass flow requirements included in Term 9. Although there is no guarantee that Term 9 could be successfully amended, North Gualala did express at the time that DFG "considers the winter bypass flows presently required by Permit 14853 to be excessive"¹⁴. This knowledge and the fact that Term 9 was included as a consequence of DFG's protests suggest North Gualala's potential success in amending Term 9 and resolving its problem. North Gualala has also acknowledged that if its bypass requirements were

¹¹ This well, not currently in use, is affected by iron and manganese, therefore co-mingling was identified by North Gualala's consultants as a means to reach secondary drinking water standards.

¹² North Gualala holds three other water right permits, Permits 5431, 5432 and 11535 that allow a combined year round diversion of up to 2.16 cfs. The first two of these permits allow a total diversion of 2 cfs from Robinson Gulch or Big Gulch, where North Gualala owns existing diversion facilities and a treatment plant with storage tanks, all of which are not presently utilized by North Gualala.

¹³In 1992, the SWRCB recommended that North Gualala obtain a water right permit for Wells No. 4 and 5. In the 2001 Order, the SWRCB invited North Gualala to petition to change the bypass flow requirements in Term 9. More recently, the SWRCB issued Order WR 2009-0036 approving a settlement agreement where North Gualala agreed to file either 1) a petition for change in Term 9, or 2) a new application to appropriate water.

¹⁴ December 14, 2001 letter to BKS (North Gualala's Attorneys) by Wagner and Bonsignore Consulting Civil Engineers (Consultants to North Gualala).

lowered, it would “virtually solve” its problems of meeting Term 9’s bypass flow requirements. North Gualala is currently pursuing a new water permit as a solution to its lack of supply, which was also suggested by the agency prior to the onset of litigation. North Gualala failed to identify or provide a cost estimates for obtaining a new water permit.

To date, North Gualala has expended hundreds of thousands of dollars¹⁵ in an unsuccessful attempt to defend its water rights and to challenge the SWRCB’s jurisdiction. North Gualala has failed to provide satisfactory evidence that there were no other reasonable, cost effective or realistic options in lieu of litigation.

Reasonableness of litigation

There exist significant risks when challenging a state agency’s decision, especially where the decision relies on the highly specialized expertise of that agency. North Gualala does not possess this level of expertise, and thus relied on its attorneys and consultants for legal and technical advice, costing \$132,107.10. Both the trial and appellate courts sided with and upheld the SWRCB’s determination, and the Supreme Court denied North Gualala’s request for review.

The outcome of this particular litigation is indicative of its reasonableness. North Gualala has failed to meet its burden of proof that its “legal uncertainties” possessed enough weight to justify challenging the SWRCB’s jurisdiction in court. The high risk associated with this type of litigation, combined with the fact that the challenge was denied by three different courts is substantial evidence that litigation was not the most reasonable option for North Gualala. Moreover, it is evident that, at a high cost, its actions unnecessarily delayed implementation of any real solutions. Thus the ratepayers should not be held responsible for the costs of risky and unsuccessful litigation that did not result in any ratepayer benefit.

Accounting Method

It is evident that by not seeking Commission pre-approval to recover the costs of this litigation North Gualala accepted the risk involved. We note that rather than booking these expenses to Account 180, for which it could have sought pre-approval in order to

¹⁵ This includes the \$323,274.67 for the “Source of Supply Study” addressed in D. 02-11-004 and the additional amounts requested in AL 75.

avoid any risk that these costs were not properly recorded, North Gualala could have alternatively requested a litigation memorandum account like those granted to other water utilities. By bringing this matter to the Commission's attention in advance by either of these methods, North Gualala could have obtained the Commission's views on the reasonableness of a court challenge to the SWRCB's order.

d) Alternate Water Supply Studies/Plan

Concurrently with participating in the groundwater classification proceeding, North Gualala retained engineers, experts, and attorneys to develop studies of alternate water supply projects. North Gualala incurred \$80,044.49 in expenses associated with these studies which consisted of: 1) a preliminary report that provided sizes for an off stream reservoir under different conditions along with associated hydrological studies; 2) a report that identified additional groundwater well sites for future exploration; and 3) a work plan report and associated actions to amend Term 9.

The projects mentioned above plan for a new water supply or intend to expand North Gualala's current supply capacity, and thus are considered capital expenditures. Capital expenditures may not be booked to account 180 or recovered as such, but at some point may become eligible for ratebase treatment. North Gualala is still exploring its alternate water supply options through a planning loan received from the California Department of Public Health (DPH). Review of the scope of work approved by DPH and the water supply contingency plan submitted to the SWRCB, dated March 2, 2010, indicate that the options discussed above are still considered as possible water supply projects which may ultimately be developed to meet current and future customer demands. As a supply solution has not yet been implemented, it is not possible to assess at this time whether North Gualala should be authorized to include these expenses in ratebase. However, once a supply solution is implemented, North Gualala may request Commission authorization to recover as part of ratebase those expenses discussed above that are found reasonable and eligible for inclusion in ratebase. This request should consider these expenditures' contribution to the implemented solution.

It is worth noting that Res. W-4678 and Res. W-4778 authorized North Gualala to recover from its customers an additional \$500,000 to cover repayment of the DPH loan mentioned above and awarded for the purpose of exploring and planning its water supply options. The loan does not include any implementation or construction costs. This now brings the costs relating to North Gualala's unsuccessful water rights defense

and lack of supply mitigation to over \$1.2¹⁶ million without any real solution implemented yet.

e) Legal representation before the Commission for A.01-10-02

Through AL-68, North Gualala also seeks to recover \$43,104.67 for legal counsel to represent North Gualala before the Commission in a formal proceeding. That proceeding was initiated by North Gualala through A.01-10-020, and resulted in D.02-11-004 where accounting issues for the "Source of Supply Study" were addressed and recovery of the latter costs also authorized. The Uniform System of Accounts for Class B, C, and D water utilities adopted by the Commission describes the operating expense account 688 "Regulatory Commission Expense" as follows:

"A. This account shall include all expenses (except salaries of regular utility employees) incurred by the utility in connection with formal cases before regulatory commissions.

B. This account shall also include fees assessed against a utility for salaries and expenses of regulatory commissions.

C. Amounts of regulatory commission expense which, by direction of the commission are to be spread over future periods shall be charged to account 180, Deferred Charges and amortized by charges to account 688, Regulatory Commission Expense."

The legal counsel costs claimed by North Gualala were incurred in connection with a formal proceeding before the Commission. The Commission has not previously reviewed or directed North Gualala to amortize these expenses, so those costs should be recorded under Account 698 as prescribed by this expense account's definition. Instead, North Gualala has recorded the above expenses under Account 180 as "items in

¹⁶ This figure includes \$323,274.67 for the "Source of Supply Study, \$420,533.24 requested in AL 68, and \$500,000 for the DPH loan. Since North Gualala has not requested recovery of its "Water Supply Memorandum Account" (WSMA), established by North Gualala in 2006 to track expenses for complying with the SWRCB's 2001 Order, this figure may be even higher as it excludes any expenses that North Gualala may have recorded under its WSMA.

suspense”; however, only “unique” costs that do not “clearly belong in any standard capital or expense account” may be booked to Account 180. Since these expenses belong under an expense account, their recovery through account 180 as *items in suspense* should not be authorized.

a) Miscellaneous

North Gualala submitted invoices for \$3,695 in legal expenses associated with other activities unrelated to the water rights defense and challenge, such as legal counsel for company restructuring. It is unclear why North Gualala has included these costs in AL 68, as they were not identified in its request. These costs are unrelated to the scope of this resolution and their recovery should be excluded from AL 68.

Summary

In view of the Division’s investigation discussed above, North Gualala should only be allowed to recover \$147,306.10 of the amount recorded in its Account 180, sub account 184, as *items in suspense*, and expended for participating in the SWRCB’s groundwater classification proceeding.

North Gualala’s current average bill for a 5/8 x 3/4 – inch metered customer has increased \$55.91 to \$82.20, or 47% in the last two years alone, with possible future increases in response to its water supply issues. In order to avoid “rate shock”, and given that further increases may occur¹⁷, the Division agrees with North Gualala’s proposal to amortize the amount recommended for recovery over a period of five years, resulting in a \$2.36 surcharge per customer per month.

¹⁷ North Gualala should record the amounts in expenses it incurs under the appropriate accounts instead of relying on Account 180. If needed, North Gualala should request memorandum account treatment when necessary and appropriate. Memorandum accounts should be established prior to expenses being incurred.

“Authorization of a memorandum account does not mean that the Commission has decided that the types of costs to be recorded in the account should be recoverable in addition to rates that have been otherwise authorized, e.g., in a general rate case. Instead, the utility shall bear the burden when it requests recovery of the recorded costs, to show that additional recovery of the types of costs recorded in the account is appropriate, that the utility acted prudently when it incurred these costs and that the level of costs is reasonable.” (Resolution W-4824.)

The current monthly bill for a 5/8 x 3/4 – inch metered customer using approximately 620 cubic feet of water would increase from \$82.20 to \$84.26, or 2.87% for five years. The current monthly bill includes a monthly service charge of \$28.50, a quantity rate of \$4.25 per 100 cu.ft. for the first 300 cu.ft. and \$5.40 per 100 cu.ft. over 300 cu.ft. of water in addition to SDWBA and DPH loan surcharges for a 5/8 x 3/4-inch meter of \$14.70 and \$8.97, respectively.

NOTICE AND PROTESTS

In accordance with Section 4.3 of General Order (G.O.) 96-B, North Gualala served AL 68 on its G.O. 96-B service list attached as Appendix D to AL 68. Pursuant to Section 4.2 of G.O. 96-B North Gualala mailed a notice of the proposed surcharge to all of its customers on August 26, 2009. The Division received letters from four customers, and North Gualala replied to three of the four customers. An anonymous customer sent the fourth letter. These customers opposed ratepayer responsibility for North Gualala's unsuccessful legal battles. The Division has considered these letters in its recommendation.

COMMENTS

PU Code Section 311(g) (1) provides that resolutions generally 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, this draft Resolution was mailed to the utility and to the three customers who submitted signed letters and made available for public comment on May 25, 2010. Comments were received_____.

FINDINGS

1. Through AL 68, filed on June 4, 2009, North Gualala requests Commission authority to recover from its customers, via a five-year surcharge, \$420,553.24 for legal fees and consultant costs incurred during a six year period - from January 2000 through August 2006 - that North Gualala claims "necessary to defend, under challenge by another state agency, their right to pump water from its wells and to maintain the Standards of Service required by General Order 103"
2. At the center of North Gualala's request lies a dispute over the nature and source of the water pumped from its production Wells Nos. 4 and 5, with North Gualala contending that the water in question is percolating groundwater for which no

water rights permit is needed and disagreeing with the SWRCB's determination that it flows in a subterranean stream subject to the agency's permitting authority.

3. D.02-11-004 authorized North Gualala to recover from its ratepayers \$323,274.67 for a "Source of Supply Study" that North Gualala undertook between 1998 and 1999 to establish before the SWRCB the nature and source of the water pumped from its wells.
4. North Gualala's dispute spanned a period of over ten years, and in addition to the "Source of Supply Study" addressed in D.02-11-004, it claims it was required to participate in SWRCB proceedings, in which it did not prevail, and then to engage in unsuccessful Court challenges to the SWRCB's jurisdiction in order to "defend" its right to pump water from its Wells Nos. 4 and 5.
5. Both the Trial and Appellate Courts denied North Gualala's challenge to the SWRCB's order, which found that the SWRCB has jurisdiction over Wells Nos. 4 and 5, while the California Supreme Court denied North Gualala's request that it review the litigation.
6. North Gualala recorded the expenses requested for recovery in AL 68 under Account 180 as *items in suspense* in a sub-account entitled "Contingency Memorandum Account 184".
7. D.02-11-004 defined Account 180 as a standard ratemaking account – not a memorandum account – that provides some flexibility, which avoids the prohibition on retroactive ratemaking. Only expenses that are "unique costs that do not meet the definitional criteria of any established memorandum account but which do not clearly belong in any standard capital or expense account" may be booked to Account as *items in suspense*. "Upon a reasonableness review, the amounts listed as *items in suspense* may be recovered from ratepayers by a Commission-approved means, such as a surcharge".
8. D.02-11-004 also cautioned that because Account 180 "is not an identified, special purpose memorandum account, a utility which chooses to list unique cost items as items in suspense under Account 180 may wish to seek, in advance by advice letter, Commission authority to do so. Such "pre-approval" will remove the risk of the Commission subsequently determining that the broad category or class of costs should have been accounted for differently."
9. Contrary to the Commission's warning, North Gualala failed to seek "pre-approval" to record the expenses requested in AL 68 as *items in suspense* under Account 180.
10. The expenses submitted for recovery by North Gualala represent a broad class of costs that, for reasonableness review, were further classified as follows:
 - a) *Compliance with the SWRCB's 1999 Orders* -\$14,275.88

- b) *Participation in the SWRCB's groundwater classification proceeding - \$147,306.10*
 - c) *Legal challenge to the SWRCB's jurisdiction - \$132,107.10*
 - d) *Alternate waters supply project studies - \$80,044.49*
 - e) *Legal representation before the Commission in A.01-10-02 - \$43,104.67*
 - f) *Miscellaneous costs - \$3,695*
11. \$14,275.88 of the expenses requested by North Gualala in AL 68, were incurred in connection with inadequately complying with the SWRCB's 1999 Orders.
 12. The SWRCB's 1999 Orders granted North Gualala's own petition to add Wells No. 4 and 5 as the diversion points of Permit 14853, one of the four water right permits held by North Gualala.
 13. The SWRCB's 1999 orders also required North Gualala to submit a flow measurement plan and a water supply contingency plan to ensure compliance with the bypass flow requirements set forth by Term 9 of the permit, which preclude North Gualala from pumping when the river flow falls below certain prescribed limits.
 14. North Gualala failed to demonstrate that its actions of selectively and ineffectively complying with the SWRCB's 1999 Orders helped preserve its right to pump water from its wells, or that these actions contained any ratepayer benefit. Moreover, these actions only unnecessarily delayed resolving the fundamental issue of the SWRCB's jurisdiction over North Gualala's wells.
 15. Recovery of \$14,275.88 for costs related to North Gualala's compliance with the SWRCB's 1999 Orders should be denied.
 16. \$147,306.10 of the expenses requested by North Gualala in AL 68 were incurred in relation to North Gualala's participation in a SWRCB groundwater classification hearing intended to determine if the groundwater pumped from North Gualala's wells was percolating groundwater, as North Gualala contended, or a subterranean stream subject to the SWRCB's jurisdiction.
 17. The groundwater hearing is the legal mechanism by which North Gualala could formally present the technical findings made in its "Source of Supply Study" – found to be reasonably undertaken by D.02-011-004 - and to present the SWRCB with its arguments supporting its belief that the SWRCB did not have jurisdiction over its wells.
 18. North Gualala's costs for participating in the groundwater classification hearing are "unique" costs properly booked to Account to 180.
 19. North Gualala's participation in the groundwater classification hearing was reasonable and recovery of \$147,306.10 for related expenses should be allowed.

20. After conclusion of the groundwater classification hearing, the SWRCB determined that North Gualala's wells indeed met the criteria for groundwater that falls under its jurisdiction and subject to all of the permit conditions.
21. \$132,107.10 of the expenses requested by North Gualala in AL 68 was incurred in relation to North Gualala's court challenge to the SWRCB's jurisdiction.
22. Both the trial and appellate courts sided with and upheld the SWRCB's jurisdiction determination, and the Supreme Court denied North Gualala's request for review.
23. North Gualala failed to provide satisfactory evidence that there were no other reasonable, cost effective or realistic alternatives to litigation.
24. North Gualala's actions of engaging in a risky, costly and unsuccessful court challenge were unreasonable.
25. North Gualala should not be allowed to recover \$132,107.10 of costs related to the unsuccessful court challenge to the SWRCB's jurisdiction.
26. North Gualala ascertained that if it had to curtail pumping from its wells when the flows in the North Fork Gualala River are less than specified in Term 9, it would have to develop a water supply project.
27. \$80,044.49 of the expenses requested by North Gualala in AL 68 was incurred for preliminary studies that planned for alternate water supply projects.
28. The preliminary studies plan for a new water supply or intend to expand North Gualala's current supply capacity, and these are considered capital expenditures, and may not be recovered through Account 180.
29. North Gualala has yet to implement a water supply project or solution to its supply issue.
30. Once a supply solution is implemented, North Gualala may request Commission authorization to include eligible capital expenses in ratebase for recovery through rates.
31. \$43,104.67 of the expenses requested by North Gualala in AL 68 and booked to account 180 as *items in suspense* were incurred for legal counsel to represent North Gualala before the Commission in a formal proceeding it initiated through A.01-10-020.
32. The costs discussed in the preceding finding should have been booked to the appropriate operating expense account, Account 688 "Regulatory Commission Expense", and thus do not meet the criteria that only "unique" costs which do not "clearly belong in any standard capital or expense account" may be booked to Account 180.
33. \$43,104.67 in legal counsel costs for CPUC related matters were incorrectly recorded under Account 180 and recovery should not be authorized.

34. \$3,695 of the expenses requested by North Gualala in AL 68 were not identified in its filing and correspond to legal counsel activities unrelated to its water rights defense, including company restructuring.
35. Recovery of the costs discussed in the preceding finding should be excluded from AL 68.
36. North Gualala should be authorized to recover a total of \$147,306.10 of the amount requested in AL 68 and recorded in Account 180, sub account "184 Contingency Memorandum Account" for expenses found to be reasonable and prudent.

THEREFORE IT IS ORDERED THAT:

1. North Gualala is permitted to transfer the amount of \$147,306.10 of items in suspense in Account 180, subaccount 184, to a balancing account for recovery over a period of 5 years.
2. In all other respects, the relief requested in AL 68 is denied.
3. North Gualala should remove from Account 180, subaccount 184, all amounts requested in Advice Letter 68 and not transferred pursuant to Ordering Paragraph No. 1.
4. North Gualala Water Company is permitted to recover the amounts in the balancing account by imposing a surcharge of \$2.36 per customer per month for twelve months.
5. North Gualala shall track revenue received from this surcharge in the balancing account.
6. Within 5 days of the date of this resolution, North Gualala Water Company shall file a revised rate schedule to incorporate the surcharge described in Ordering Paragraph No. 3, and concurrently cancel its presently effective Schedule 1, General Metered Service. The effective date of the revised tariff sheets shall be five days after the date of their filing, subject to staff's review for compliance.

7. 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 24, 2010; the following Commissioners voting favorably thereon:

PAUL CLANON
Executive Director

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of Draft Resolution W-4832 on all parties in this filing or their attorneys as shown on the attached list:

Dated May 25, 2010, at San Francisco, California.

_____/s/JOSIE L. JONES

Josie L. Jones

NOTICE

Parties should notify the Division of Water and Audits, Third Floor, California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, CA 94102, of any change of address to ensure that they continue to receive documents. You must indicate the Resolution number on which your name appears.

**SERVICE LIST
DRAFT RESOLUTION W-4832**

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