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Decision 11-07-057 July 28, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Application of the Golden State Water Company (U133W) for an order authorizing it to increase rates for water service by $20,327,339 or 20.12% in 2010; by $2,646,748 or 2.18% in 2011; and by $4,189,596 or 3.37% in 2012 in its Region II Service Area and to increase rates for water service by $30,035,914 or 32.67% in 2010; by $1,714,524 or 1.39% in 2011; and by $3,664,223 or 2.92% in 2012 in its Region III Service Area.	Application 08-07-010 (Filed on July 1, 2008)
And Related Matters.	Application 07-01-014 (Filed January 5, 2007)

ORDER GRANTING APPLICATION OF DIVISION OF RATEPAYER ADVOCATES, MODIFYING DECISION 10-11-035, AND DENYING APPLICATION OF GOLDEN STATE WATER COMPANY FOR REHEARING OF DECISION, AS MODIFIED

I. INTRODUCTION

This order addresses the disposition of two separate timely filed applications for rehearing of Decision (D.) 10-11-035, one by the Golden State Water Company (Golden State), the other by our Division of Ratepayer Advocates (DRA).

We have reviewed each and every allegation raised by Golden State and DRA and are of the opinion that there is merit to the arguments presented by DRA; we find no merit to the arguments presented by Golden State. Accordingly, for the reasons discussed below, we deny Golden State's application for rehearing but shall grant a rehearing of D.10-11-035 on the issues raised by DRA; we also find good cause to modify D.10-11-035 as set forth herein.

II. BACKGROUND

Golden State (or GSWC) is a Class A water utility subject to the jurisdiction of the Commission, and a subsidiary of American States Water Company, serving over 240,000 customers within California. D.10-11-035 concerns Golden State's Test Year (TY) 2010 general rate case (GRC). It adopted the 2010, 2011 and 2012 revenue requirement for Golden State's Regions II and III. D.10-11-035 also addressed the rehearing ordered by D.08-08-031 of the La Serena project costs for Region I. Although the rehearing on that issue granted by D.08-08-031 involved Region I, the rehearing proceeding was instead consolidated with the GRC for Regions II and III.

Public participation hearings on the TY 2010 GRC for Golden State's Regions II and III service areas began in January 2009, and an evidentiary hearing was held in May 2009. On November 17, 2009, the assigned administrative law judge (ALJ) issued a proposed decision (PD) in the consolidated proceeding that, among other things, found that the costs associated with the La Serena project were unjustified and unreasonable. In its December 7, 2009 comments on the November 2009 PD, Golden State opposed the PD's outcome regarding the La Serena project costs.

In response to new information regarding a contract between Golden State and the City of Torrance for provision of non-regulated services, the Commission withdrew the PD on December 15, 2009. On January 29, 2010, the Assigned Commissioner and ALJ issued a ruling that expanded the scope of the proceeding, reopened the record to include, among other things, additional evidence by Golden State concerning the La Serena project, and extended the statutory deadline for the proceeding until October 31, 2010.[1]

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[1] In previous decisions, the Commission has warned Golden State that it is required to justify its rate requests during its direct testimony and in D.08-01-020, issued an Order to Show Cause why Golden State should not be fined $50,000 for its continued failure. (D.08-01-020 at p. 4 Ordering Paragraph No. 1; and see, D.07-11-037 at p. 111, and D.04-03-039 at pp.84-85.) Golden State did not contest the findings and paid the $50,000 penalty; the matter was dismissed by D.08-04-035.

Because the Commission is not currently publishing its decisions in an official reporter, citations to Commission decisions in this memorandum follow the form for non-published decisions and will,

(footnote continued on next page)

Following the completion of the supplemental phase, the ALJ issued a PD on October 20, 2010. Assigned Commissioner Bohn issued an alternate proposed decision (APD) on that same date. Both the PD and APD approved the settlement agreements between Golden State and DRA. Unlike the alternate, which was adopted by the Commission as D.10-11-035, the PD, among other things, found that the evidence did not support Golden State's argument that without a one percent equity adjustment it would be unable to attract and retain highly skilled employees or that customer service would suffer. Further, the PD denied Golden State's request for a pension balancing account as unreasonable. The PD and the APD also differed on the La Serena costs, with the PD finding they were unreasonable. In addition, the PD and APD differed regarding the costs incurred by Golden State for its consultant CH2MHill for consultation concerning Regions II and III, and also differed regarding the methodology for determining the number of service connections at military bases.[2]

Golden State's affiliate American States Utility Service (ASUS) supplies water and wastewater services to six military bases. In that capacity, it has 17,788 connections at the six bases. The PD determined that the total number of connections at each military base served by ASUS should be counted as customers in the general office cost allocation methodology that the Commission had adopted in the previous Golden State GRC. It also found that the total value of all distribution assets at the military bases served by ASUS should be included in the plant factor of the four factor cost allocation methodology. However, under the methodology adopted in D.10-11-035, the Commission recognized only six service connections for ASUS.

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hereinafter, informally refer to the Commission's decision numbers as found in the pdf version on the Commission's website at: http://docs.cpuc.ca.gov/cyberdocs/Libraries/WEBPUB/Common/decSearchDsp.asp.

[2] CH2MHill was also involved in the La Serena project.

The PD found that the activities engaged in by Golden State's consultant CH2MHill concerning a long-term pipeline replacement and main replacement program, prioritization of capital improvement projects and the Asset Management program were outside the normal rate case preparation. However, because the Water Action Plan specifically encouraged companies to include infrastructure improvement and replacement plans as part of their long-term planning, it found the activities of CH2MHill were reasonable for purposes of forecasting for the test year and granted Golden State's request for a total of $450,000 in regulatory commission expenses for Regions II and III in 2010. D.10-11-035 determined that the Commission's Uniform System of Accounts (USOA) Account 146 is like a memorandum account and accordingly, although not forecasted or approved for memorandum account treatment, Golden State should be able to collect the already incurred consultant fees for Regions II and III from its ratepayers.

With respect to the La Serena costs, the PD found that they were not reasonable because: (1) they had been poorly estimated, (2) Golden State had failed to revise the special facilities fees based on updated cost estimates, (3) the utility had failed to collect special facilities fees from all of the developers, (4) the costs were incorrectly included in rate base without authorization and after Golden State's last GRC, and (5) the La Serena plant project was undertaken for the sole benefit of the new developments. The PD required Golden State to provide a one-time credit of $1,112,275 to customers in Region 1 as an offset to the La Serena plant project costs included in rate base. D.10-11-035, however, allocated the costs among the ratepayers and the developers, assigning 29.4% of the cost of the La Serena facility to Golden State's existing customers.

By its application for rehearing of D.10-11-035, Golden State challenges the order to remove $1,843,956 in costs relating to the La Serena project from rate base. Golden State contends that the decision's calculations leading to the $1,843,956 figure were erroneous because it disregarded the $287,000 in special facilities fees that Golden State collected from two of the four developers and applied as rate base offsets to the La Serena project.

By its application for rehearing of D.10-11-035, DRA alleges legal error by not assigning the entire costs of the La Serena project to the developers, and that the challenged decision's application of Tariff Rule 15 constituted arbitrary and capricious decision-making. It also claims that the La Serena costs have been in rate base since January 2008. (DRA application for rehearing at p. 3.) Further, DRA challenges the methodology used to arrive at the number of connections for ASUS, and contends that already incurred consultant costs for CH2MHill cannot be legally collected from ratepayers absent the Commission having already previously authorized memorandum account treatment. Both of DRA's challenges to the issues concerning the La Serena costs and the CH2MHill costs allege retroactive ratemaking. Golden State filed a response opposing DRA's application for rehearing.

III. DISCUSSION

A. Rehearing of the La Serena Project

Golden State had estimated that the La Serena plant improvement project would cost $400,000. The final costs for the La Serena project totaled $3,700,000. DRA argued that $3,519,000 of the costs should be excluded from rate base because those expenditures were undertaken solely for the benefit of new developments. $181,000 in La Serena costs had been authorized for the La Serena project by an earlier Commission decision in 2000. Golden State argues it should be credited $287,000 collected from two of the four developers (based on its $400,000 estimate for the project) and have the amount of La Serena costs it must remove from rate base reduced to $1,556,956. DRA argues, among other things, that the entire unauthorized cost of the La Serena project should have been charged to the developers, and that the portion allocated to Golden State's customers is unlawful, unreasonable, arbitrary and capricious.

1. Rehearing of the La Serena issue was consolidated with the GRC for Regions II and III and consequently delayed, underemphasized and misunderstood.

To date, the $3.7 million in La Serena costs have *not* been authorized for rate base treatment. D.08-08-031 granted rehearing of D.08-01-043, concerning Golden State's GRC for its Region I, on the question of whether it was reasonable of Golden State to include $3.7 million in charges to ratepayers for its La Serena plant. (D.08-08-031 at pp. 11-13.) Instead of going forward with the rehearing, the Commission consolidated the La Serena rehearing with the GRC for Golden State's Regions II and III for Test Year 2010. (See AC/ALJ October 22, 2008 ruling in A.07-01-009.) Golden State objected to consolidating the La Serena rehearing with the GRC for Regions II and III. The Assigned Commissioner at the time ordered consolidation based on the mistaken belief that the costs were already in rate base. (October 21, 2008 AC/ALJ ruling at page 4.)

The primary focus of D.10-11-035, however, was not Region I but the GRC for Golden State's Regions II and III. Notwithstanding the rehearing order, the challenged decision, like the ruling consolidating the rehearing with the GRC, assumed that the $3.7 million was already in the rate base. Nothing in the record explains why this mistaken belief was not discovered, or why Golden State did not address it. As a consequence, because of apparent confusion, the focus of D.10-11-035 for purposes of the La Serena issue was on allocating the costs among customers and developers. The actual issue of whether the costs were just and reasonable has never been resolved; that is, there was never a decision issued by the Commission which found the $3.7 million in La Serena costs to be justified and reasonable, and authorized Golden State to place them into its rate base.

2. Evidence shows that the Commission did not authorize any capital projects for the La Serena project prior to October 2008.

By D.00-12-063 the Commission had authorized $181,000 in capital projects for the La Serena Plant Improvement project; specifically, $42,000 for Reservoir Seismic Improvements Project, $104,000 for Plant Complete Electric Upgrades, and $35,000 for Automation and Telemetry. (D.08-08-031 at p.11.) However,

> Since D.00-12-063, we have not approved any specific capital projects for the La Serena Improvement Project. ... [Nevertheless, without Commission authorization] … the La Serena Plant Improvement Project has developed a total budget of $3,794,741. [Footnote omitted.] Of this total, $3,701,215 [Footnote omitted] is already closed to the GSWC plant account. … [However], we have authorized only $181,000 of these costs in D.00-12-063.

(D.08-08-031 at p. 12.)

The $3.7 million in La Serena costs were at issue in the underlying proceedings leading to D.08-01-043; but Golden State failed to submit evidence on those costs, apart from support for the $181,000 for landscaping and paving costs associated with the La Serena Improvement Project. (D.08-08-031 at p. 13; D.08-01-043 at p. 58.) Because the $3.7 million had never been authorized, rehearing was granted by D.08-08-031.

3. Golden State has provided conflicting evidence of whether the La Serena costs were in rate base.

Whether the La Serena costs were/are in rate base is an unresolved issue. In its application for rehearing Golden State infers the costs are in rate base, and in comments on the November 2009 PD in the underlying consolidated proceeding it claimed that the $3.7 million was in rate base. (Golden State 12/7/09 comments on 11/21/09 PD at p. 21.) In its application for rehearing of D.08-01-043 (the Region I GRC decision), DRA alleged that Golden State had improperly withheld the capital costs of the

La Serena project from rate review. (D.08-08-031 at p. 11.) In response, however, Golden State denied that the $3.7 million was in rate base. According to D.08-08-031:

> … [W]ith respect to the La Serena Plant site work budget item, DRA alleges that GSWC has included $3.7 million in project costs in rate base without prior Commission review ("unauthorized rate burden"). GSWC presented evidence to rebut that false allegation by DRA, and GSWC's witness was cross-examined by DRA. GSWC's reply trial brief detailed GSWC's testimony on this issue … There is no merit to DRA's claim [that the $3.7 million is in rate base absent authorization]….
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> *We did not rule on the reasonableness of the $3.7 million of La Serena Plant Improvement Project costs in any prior decision, nor do we authorize rate base treatment*, either directly or by inference, of the $3.7 million in this decision. *GSWC's Reply Brief indicated, and we accept, that the $3.7 million of costs are not yet included in rate base*.

(D.08-08-031 at p. 13, emphasis added.)

However, although D.08-08-031 determined that the Commission *had not yet authorized, and would not authorize*, the $3.7 million into Golden State's rate base, it appears that amount may indeed have been in Golden State's rate base. Upon reconsideration, we are no longer certain that DRA's allegation in 2008 was necessarily inaccurate, and we cannot help but wonder whether it may have been correct.

4. There has been no formal determination by the Commission regarding the reasonableness of the La Serena costs; and placing unauthorized costs into rate base is a violation of law and Commission rules, orders and directives.

The Commission granted rehearing on "whether it is reasonable to include the $3.7 million of La Serena Plant Improvement Project costs in GSWC's rate base." (D.08-08-013 at p. 13, and p. 15 Ordering Paragraph No. 2.) Yet, D.10-11-035 never considered that issue. The point of the rehearing ordered by D.08-08-031 was to provide Golden State with an opportunity to provide evidence regarding the La Serena costs in order for the Commission to have a record upon which to make a determination as to whether the $3.7 million was just and reasonable and should be placed into rate base. There have been no decisions between 2008 and 2010 that determined the La Serena costs were just and reasonable and authorized rate base treatment of them. Based on the record, the PD in this underlying proceeding found them to be unreasonable. It is absolutely clear that prior to D.10-11-035 Golden State was not authorized to place $3.7 million in costs for the La Serena project into its rate base, and had been directed that the money was *not* to be in rate base.

A utility may not raise its rates to account for previously incurred expenses and doing so, absent Commission authorization, results in retroactive ratemaking. (See e.g., *Re Southern California Water Co. Headquarters* (1992) 43 Cal.P.U.C.3d 596 (D.92-03-094).) The Commission articulated this rule in that case:

> It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for *previously* incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking. This impacts not only rate recovery for operational expenses, but also rate recovery for ownership costs, such as depreciation expense and return on investment.

(*Id*. at p. 600, emphasis retained.)

No memorandum or balancing account treatment for the La Serena costs was ever authorized.[3] Public Utilities Code sections 451 and 728 require the Commission to

[3] "A memorandum account is not a guarantee of eventual recovery of expenses, nor is it carried as a regular account under the uniform system of accounts for water utilities. It is carried 'off the books', as a memo account." (Resolution W-4089, 1998 Cal.PUC LEXIS 1121*8.)

authorize only just and reasonable rates supported by an evidentiary record.[4] Only just and reasonable costs shall be included in the rate base. Section 454 requires public utilities to charge only just and reasonable rates. Section 453 prohibits a public utility from prejudicing or causing disadvantage to its ratepayers. Section 532 permits public utilities to charge for service in accordance with its filed tariffs. Section 702 requires public utilities to obey and comply with every order, decision, directive, or rule made by the Commission. Commission Rules of Practice and Procedure rule 1.1 requires, among other things, compliance with state laws.[5]

Section 2101 requires the Commission to enforce, and ensure compliance with all provisions of the State Constitution and statutes which affect public utilities.[6] The Commission may do that sua sponte, and/or may request the aide of the State Attorney General or a local district attorney "in prosecuting actions or proceedings for the enforcement of the provisions of the Constitution and statutes … affecting public utilities and for the punishment of all violations thereof." (§ 2101.)

In D.09-11-008, the Commission rejected a provision of a settlement agreement concerning California Water Service Company, that would have, among other things, imposed charges on ratepayers that the Commission had not yet determined were just and reasonable, and that the Commission also found would impose a fee upon property owners without justification, and thus would be prejudicial or disadvantageous and therefore, a violation of section 453.[7] (D.09-11-008 at pp. 9-12.) "Cal Water may

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[4] All statutory references are to the Public Utilities Code unless otherwise indicated.

[5] Rule 1.1 provides: "Any person who signs a pleading or brief, enters an appearance, offers testimony at a hearing, or transacts business with the Commission, by such act represents that he or she is authorized to do so and agrees to comply with the laws of this State; to maintain the respect due to the Commission, members of the Commission and its Administrative Law Judges; and never to mislead the Commission or its staff by an artifice or false statement of fact or law."

[6] In addition, pursuant to section 2110, violations and/or failures to comply with relevant constitutional or statutory provisions, as well as any part of any order, decision, rule, direction, demand or requirement of the Commission, are misdemeanor offenses.

[7] Rehearing of D.09-11-008 was granted by D.11-01-029 and is pending. However, the rehearing will *not* consider the rejection of the proposed settlement. (D.11-01-029 at p. 4 Ordering Paragraph No. 2.)

only impose charges determined by the Commission to be just and reasonable as required by … [section] 451.” (D.09-11-008 at p. 11.) Furthermore,

> … [P]ursuant to Pub. Util. Code § 532, Cal Water must charge for water service in accord with its filed tariffs. No filed tariff requires a payment from the [prospective purchasers of property] for the benefit of … [the property developer] as a condition of service. There can be no such tariff because Cal Water may only impose charges determined by the Commission to be just and reasonable, as required by Pub. Util. Code § 451, and the Commission has not determined that a fee for payment for the benefit of … [the developer] is just and reasonable for service in any portion of Cal Water's …district.

(D.09-11-008 at p. 12.)

In *Southern California Water Company*, *supra*, 43 Cal.P.U.C.2d at pages 600-601, the Commission determined that permitting the water utility to recover ownership costs for new plant additions that had never been authorized would be unlawful retroactive ratemaking:

> …[T]here are several established regulatory procedures available for a utility to recover its ownership costs for new plant additions. These costs can be estimated in a rate case before the new plant goes into service, and rates authorized prospectively based on those estimates. Alternatively, the Commission can grant advance authorization for the utility to book these ownership costs into a memorandum or balancing account for later recovery after any necessary review of the reasonableness of the plant's costs. In this way concerns over retroactive ratemaking are eliminated. If the costs of owning the new plant are not included in authorized test or attrition year rates, and the utility has not obtained a Commission order authorizing the booking of those costs into a memorandum or balancing account, the utility cannot recover those ownership costs incurred from the date the new plant is put in service until the Commission either authorizes an increase in rates or authorizes the creation of such an account.

Because Southern California Water Company had not availed itself of those regulatory procedures, the Commission, citing the San Onofre Nuclear Power Plant Decision (D.84-12-060),[8] ruled that the costs were non-recoverable. (*Southern California Water Company, supra*, 43 Cal.P.U.C.2d at p. 601.) "To do otherwise would be unacceptable given the concerns over retroactive ratemaking." (*Id*.)

Golden State had informed the Commission in 2008 that it had *not* included the La Serena costs in its rate base.[9] Golden State had not received authorization to include the $3.7 million in its rate base. There is no record as to when and how the costs were actually placed in rate base. Yet, absent authorization by this Commission (and seemingly in contravention of explicit Commission directives), the costs appear to have been included in Golden State's rate base. D.10-11-035 never addressed these material issues, and they must be resolved. Further, because the La Serena costs appear to have been charged to ratepayers absent authorization, and because they were not adequately collected from the developers, Golden State's charges are not consistent with statute, Commission orders or Golden State's tariff. Its proposed collection, or actual collection, of the costs from its ratepayers or others does not appear to be consistent with law. (Accord *Southern California Water Company*, *supra*, 43 Cal.P.U.C.2d at p. 601.) Accordingly, we find that a rehearing should be granted.

Further, Golden State is ordered to provide evidence regarding the inconsistencies and discrepancies discussed herein. We also order an audit of the La Serena costs at issue and direct our Division of Water and Audits to prepare, in conjunction with our investigatory staff, a confidential report for the Commission's General Counsel and Executive Director based on that audit with a recommendation as to whether an investigation should be instituted to determine whether laws were broken, if

[8] *Re Southern California Edison* (1984)16 Cal.P.U.C.2d 495, 505-507.

[9] "As explained by Golden State, these projects are not yet in rate base for ratemaking purposes and Golden State seeks to obtain authorization for rate base treatment here." (D.08-01-043 at p. 53; see also, D.08-08-031 at p. 13.)

Golden State's conduct regarding the La Serena costs at issue constituted contempt, and whether penalties and/or misdemeanor sanctions may be appropriate.

5. D.10-11-035 contains irresolvable conflicts regarding the basis for the La Serena costs.

During the supplemental phase of the underlying consolidated proceeding, Golden State argued that "the La Serena Improvement Projects were necessary due to long-standing supply and storage deficiency identified in the 1998/1999 Master Plans for the Nipomo System." (D.10-11-035 at p. 77.) Golden State argued that: "… the construction of the storage tank was to address the needs of the system as a whole and therefore the $3.7 million *is correctly included in rate base.*" (D.10-11-035 at p. 77, emphasis added.)

However, D.10-11-035 and previous decisions concerning the La Serena project costs undermine the credibility of Golden State's arguments. As noted in the two 2008 decisions discussed above, the $3.7 million costs were not previously identified to, or authorized by, the Commission. Further, as D.10-11-035 mentioned, Golden State failed to address any need for an improvement project that would lead to the La Serena costs in any GRC filed after the 1998/1999 master plan. Moreover, contrary to Golden State's supplemental argument, rather than being part of an earlier master plan, D.10-11-035 specifically determined that "Golden State's testimony … demonstrates that the well size was increased to meet demand associated [with] new development." (D.10-11-035 at p. 79.) That the La Serena site improvement project was based on new development and not part of the 1998-1999 Master Plans for the Nipomo System was further corroborated by D.08-08-031 at page 12 which found the new development costs for the La Serena project occurred between 2003 - 2006.

Evidence submitted by Golden State showed that it had undertaken the La Serena construction project to supply the 41-lot development, two 12-unit developments and 650-student elementary school with water. According to D.10-11-035:

> Golden State estimated the cost of the 500,000 gallon tank at $400,000 and special facilities fees were based on the supply requirements of the new developments and the school.

> Golden State calculated the school's special facility fee as $130,000 and the 41-lot development's fee as $157,000, for a total of $287,000. Golden State did not collect special facilities fees from the 12-unit developments because [according to Golden State's witness]'… the demand of a 12-unit subdivision would be about 12 gallons a minute which is equivalent to the amount of water you could get out of a hose bib.'

(D.10-11-035 at p. 77.)

D.10-11-035 is inconsistent regarding the reasons for the La Serena costs. In discussing the evidence, the decision revealed that the costs were associated with new development, but the contrary determination that the improvements were undertaken to address deficiencies in the Nipomo System, was internally inconsistent. We believe that it is at odds with the determination in D.08-08-031 and the reasoning in D.10-11-035 concluding that the utility acted unreasonably, and also failed to collect the costs from the developers:

> Golden State's initial estimate for the cost of the La Serena 500,000 gallon storage tank was grossly underestimated. The original estimate was $400,000 and based on construction at a site in which there were no constraints or problems....
>
> The estimate included no contingencies for the possibility that the site would not be perfect, even though the site was owned by Golden State at the time of the estimate. The site required significant modifications and the final tank cost of $1,102, 256 was more than double the initial estimate. An additional $2,603,971 was spent on site construction and other improvements.…
>
> Not only did Golden State never contact the developers and revise the special facilities fees based on the updated cost estimates, Golden State did not collect from all the developers in the first place. Golden State collected fees for only the 41-unit development and the school, but not the two 12-unit developments.
>
> Additional facility improvements increased the cost to $3.7 million.

> In its supplemental testimony Golden State contends that it was not necessary to collect the special facilities fees from the two 12-unit developments because the amounts it had already collected from developers resulted in an over-collection of fees. We find it impossible to follow the logic that results in an over-collection of fees when two 12-unit developments paid nothing toward the improvements, yet millions of dollars in construction costs remain that existing ratepayers are expected to absorb. Even if we were to accept Golden State's assertions, any over-collection should benefit existing ratepayers, not provide an excuse for collecting nothing at all from the developers.
>
> It is undisputed that Golden State grossly under-estimated the cost of the La Serena project, and grossly under-collected fees from developers. We find it patently unfair to require ratepayers to shoulder cost overruns due to decisions made by Golden State's field office on an "ad hoc basis prior to the implementation of the La Serena plant improvements and without full knowledge of all the events and circumstances associated with the new developments and the La Serena project." Golden State's management failed in their duty to ensure that cost estimates were properly prepared and to require developers to pay their fair share of the La Serena project.

(D.10-11-035 at p. 79-81.)

In reviewing the merits of DRA's rehearing application, and based on the aforementioned reasoning, there is no rational basis supporting the finding "Golden State's claims that the La Serena plant improvements were undertaken to address deficiencies in the Nipomo System are persuasive." (D.10-11-035 at p. 79.) That conclusion simply does not follow from the evidence. Moreover, it fails to address how or when Golden State placed the costs into its rate base. Accordingly, a rehearing on the issues raised by DRA is warranted. However, with respect to Golden State's application for rehearing, we are not persuaded that there is evidentiary support for its arguments. We find that Golden State's application for rehearing has no merit and shall be denied.

6. Notwithstanding the absence of a determination that the costs were properly in rate base and reasonable, the allocation of the costs in D.10-11-035 was not based on the record.

The challenged decision accepted without question Golden State's representation after the issuance of D.08-08-031 that the $3.7 million La Serena costs were already in rate base. Without making a finding whether the costs were just and reasonable, D.10-11-035 concluded "the costs associated with the La Serena plant improvements should be allocated between existing customers and new developments," and authorized a one-time refund to existing customers. (D.10-11-035 at p. 11, p.79, and p. 99 Ordering Paragraph No. 10.)

In part of its discussion, D.10-11-035 determined that the La Serena costs should be apportioned between existing ratepayers and new customers. However, D.10-11-035 also determined that the charges should be apportioned between the existing ratepayers and the developers. The challenged decision was unclear on what it actually meant. For example, D.10-11-035 declared:

> In its supplemental testimony DRA states that the objective of Special Facilities Fees is to obtain the fair share of the costs of the new developments that ought to be paid by the developers… We agree. Consequently, Golden State should seek to recover from the new development their proportionate share of the cost overruns. More importantly, Golden State should seek to collect Special Facilities Fees from those new developers who had not paid any fees. Should these efforts prove to be unsuccessful, Golden State's shareholders shall be responsible for these costs.

(D.10-11-035 at pp. 81-82.)

Yet, the challenged decision also provided: "Because we find that the La Serena project was undertaken for the benefit of both existing customers and new development, the cost overruns should be borne by both categories of customers as well." (D.10-11-035 at p. 82.) There was no determination of the amount of the cost overruns. Further, allocating costs among existing and new customers was the same as assigning all the costs to the customers. It does not matter whether they are existing or new—they are all customers, and not developers, or shareholders. Even if we assumed that the confusing language on this point was a clerical error, and that the decision really meant to say that the costs should be allocated among the customers, both existing and new, and the developers, DRA argues, is nonetheless, erroneous in light of Tariff Rule 15.

a) Tariff Rule 15

DRA contends that the failure to allocate all costs to the developers violated Tariff Rule 15. DRA argues that pursuant to Golden State's Tariff Rule 15, the entire cost should be borne by the developers if 50% or more of the new facilities' design capacity is required to supply the main extension. (DRA application for rehearing at p. 2.) D.10-11-035 determined that 52.4% of the new reservoir's total storage capacity of 500,000 gallons is used to serve new developments. (D.10-11-035 at p. 83.) Golden State admits DRA is correct with respect to the actual language in Tariff Rule 15, but argues that the language in subdivision C.1.c is discretionary, not mandatory. DRA sites numerous Commission decisions and practices over the past four decades in support of its argument, contending that "given this history, if the Commission decides to modify a long-standing practice, the change needs to be based on a solid evidentiary basis and/or changes in circumstances that justify the adoption of a new policy direction." (DRA application for rehearing at p. 3.) It argues that there is no record evidence of any change in circumstances that justified the change in the interpretation of Tariff Rule 15. (DRA application for rehearing at p. 3.) DRA is correct that there was no explicit evidentiary basis for the interpretation made in D.10-11-035; rather, it was based on an assumption made by D.10-11-035. Further, as explained below, DRA is also correct that the outcome departs from precedent.

Tariff Rule 15 concerns main extensions, and is applicable to "[a]ll extensions of distribution mains, from the utility's basic production and transmission system or existing distribution system, to serve new customers…." (Tariff Rule 15.A.1.) Pursuant to subsection A.1.a: "A main extension contract shall be executed by the utility and the applicant or applicants for the main extension before the utility commences construction work on said extensions or, if constructed by applicant or applicants, before the facilities comprising the main extension are transferred to the utility."

In weighing the evidence, D.10-11-035 determined that Golden State's management was responsible for the cost overruns. (D.10-11-035 at p. 81.)[10] Finding of Fact Number 98 provided, "La Serena project costs were poorly estimated.'' There was no specific determination of the exact cost overruns, apart from Golden State's testimony that it had estimated the special facilities fees would be $400,000. The findings on the La Serena project costs were limited and did not resolve the issue. Assuming the $400,000 estimate could be considered to be reasonable (and the decision itself disputes that even that estimate was reasonable), would mean the cost overruns may be at least $3.3 million. Finding of Fact Number 99 provided: "Golden State did not revise the special facilities fees based on the updated cost estimates." Finding of Fact Number 100 provided: "Golden State did not collect special facilities fees from all the developments." (Although D.10-11-035 rejected Golden State's reasons for its failure to collect the fees from all of the developers, it never resolved the issue of Golden State's failure.) Despite the reasoning discussed above in D.10-11-035, Finding of Fact Number 101 provided: "The La Serena plant improvements were undertaken for the benefit of existing customers and new developments." There is only one Conclusion of Law pertaining to the La Serena costs and it did not conclude the $3.7 million in costs were just and reasonable; rather, it assumed the costs were already in rate base and provided a one-time credit offset of $582,832 to customers for the La Serena plant improvements. (D.10-11-035 at p. 99 Conclusion of Law No. 10.) Finally, the challenged decision ordered Golden State to remove $1,843,956, which it determined was 52.4% of the La Serena costs, from rate base. There was no determination that the remaining amount constituted just and reasonable costs and the figure of $1,843,956 was based on an unsupported estimate regarding storage capacity.

[10] "Golden State's management failed in their duty to ensure that cost estimates were properly prepared and to require developers to pay their fair share of the La Serena project." (D.10-11-035 at p. 81.)

D.10-11-035 failed to clarify the precise cost overrun amount and it failed to clarify what amount of the costs should have been borne by the developers, apart from the $400,000 that the decision stated was unreasonably low. Instead, it reasoned that because the project was undertaken for the benefit of both existing customers and new development, "the cost overruns should be borne by both categories of customers." (D.10-11-035 at p. 82.) The evidence suggested the cost overruns were likely well in excess of the $582,832 one-time credit. Because of the outcome, ratepayers may be charged with cost overruns that the decision stated should have been assessed to the developers and were due to management failure. This issue pertains to the question of whether the La Serena costs were just and reasonable, and therefore, we find that rehearing is warranted on the Tariff 15 Rule issue raised by DRA.

b) The outcome is at odds with Commission history regarding Tariff Rule 15.

Because we know the costs had never received rate base authorization, and there was no determination of the amount of costs that were due to management failure, the question of whether the allocation of costs violated Tariff Rule 15 cannot adequately be answered. Pursuant to section 1708, "[t]he [C]ommission may at any time, upon notice to the parties, and with opportunity to be heard … rescind, alter, or amend any order or decision made by it…." D.10-11-035 did not change any of the language in Tariff Rule 15. Rather, the issue is its application of the rule, and without knowing what the cost overruns actually were, or whether any of the costs were just and reasonable, the Commission was not able to allocate costs, assuming cost allocation was appropriate. DRA argues correctly that historically the Commission has interpreted Tariff Rule 15 so that in cases such as the one now before the Commission, all of the costs would be allocated to the new developments. DRA has shown that there are absolute differences between the Commission's history regarding Tariff Rule 15 and the outcome of D.10-11-035. Nevertheless, as discussed above and as required by D.08-08-031, the ultimate question regarding the $3.7 million is whether the costs were reasonable and justified, as required by sections 451, 454, and 728. D.10-11-035 failed to make that requisite determination.

Because the record does not support the decision's assumption, the rehearing should also address the allocation of costs issue.

c) Calculation question

DRA asserts that the one time credit of $582,832 is based on a computational error "because it assumes that the La Serena Plant was only in ratebase from January 2008 through January 2009, when in fact almost three years have elapsed since it first entered ratebase." (DRA application for rehearing at p. 4.) Again—there is no record upon which the Commission can determine when or how the costs were placed in rate base. Golden State also sought rehearing on this issue, arguing at pages 3-4 of its application for rehearing that D.10-11-035:

> … is erroneous because it requires GSWC to remove $287,000 in La Serena plant improvement costs from rate base that have already been offset with special facilities fees. Specifically … in requiring GSWC to remove $1,843,956 from rate base, [D.10-11-035] failed to acknowledge that GSWC had already collected $287,000 in special facilities fees from [two of] the new development[s] and had already applied these fees as offsets to the La Serena plant improvement costs included in rate base.

For the reasons set forth above regarding La Serena project costs, we shall include the one-time credit discussed in Conclusion of Law Number 10 as an issue to be considered on rehearing, in light of questions regarding what was included in the rate base regarding La Serena costs and when the $3.7 million was placed in the rate base. Golden State's application for rehearing has no merit and shall be denied.

B. Methodology used for counting water service to military bases served by Golden State's affiliate, ASUS.

DRA alleges that D.10-11-035 arbitrarily and capriciously departed from relevant Commission policy and past decisions, concerning the four-factor methodology in reaching the determination that each military base served by Golden State's affiliate, ASUS, should be counted as a single customer. In Golden State's last GRC for Region II, the Commission, by D.07-11-037, identified the four factors, initially set forth in an intra-agency memorandum in the mid-1950s as follows:

> The four factors that have traditionally been used to allocate indirect costs not capable of direct assignment are set forth in the 1956 Commission memo that was admitted as Exhibit 41 [in A.06-02-023]. As noted in the memo, the four factors to be used in allocating indirect costs are (1) direct operating expenses, (2) gross plant, (3) number of employees, and (4) number of customers. These factors have been used with a high degree of consistency over the years, and when the Commission has approved allocation formulas based on factors other than these four, it has clearly stated its reasons for doing so.

(D.07-11-037 at pp. 23-24.)

In that same decision, the Commission established an "equivalent number of customer" factor for use in determining the number of customers factor for customers served under military contracts, because those customers do not receive full utility services from ASUS but do receive water service. "For contracts where ASUS is providing services to a military base, it is appropriate to assume that each of the base's connections is equivalent to a full retail customer." (D.07-11-037 at p. 166, Finding of Fact No. 19.)[11] Nevertheless, D.10-11-035 did not follow the equivalent number of customer factor, but instead accepted Golden State's argument that a military contract constitutes a single customer, and applied that to the four-factor methodology.

[11] With respect to those military bases where ASUS provided water and wastewater services, which D.07-11-037 characterized as "full utility service," it determined that "it is appropriate to use 100% of the connections at these bases to determine the appropriate weighted percentage customer count." (D.07-11-037 at pp. 36-37.) However, with respect to those contracts where ASUS was providing less than the full utility service, D.07-11-037 used the same formula but acknowledged, the weighted number of customers formula "is more complex," and went on to arrive at the number of customers for purposes of those contracts as well. (D.07-11-037 at p. 38.)

Citing D.03-05-078, as well as D.07-11-037, DRA argues that the Commission had previously rejected the idea of treating a military base as one customer, because to do so unfairly shifts the costs away from its unregulated affiliate and toward Golden State's customers. DRA alleges that by D.10-11-035, the Commission essentially disregarded the "number of customers" factor from its determination, and in so doing disregarded the principal for using the allocation methodology, which the Commission declared in D.07-11-037 and D.01-06-077, "is to 'guard against cross-subsidy of nonregulated ventures by regulated ventures.'" (D.07-11-037 at p. 32, quoting from D.01-06-077 at p.50, fn 5.) DRA's argument that the Commission accepted the very same argument it rejected in Golden State's last GRC for Region II is correct and not consistent with Commission past practices, in which the number of connections at the military bases are taken into consideration in determining the number of customers served by ASUS.

In D.07-11-037, the Commission rejected Golden State's argument that each military contract should be treated as one customer, stating:

> Contrary to GSWC's position, Commission decisions in recent years have either approved the use of the traditional four-factor methodology, or the use of less than four factors if it can be demonstrated that one or more of the traditional factors are irrelevant or would skew the allocation study results in unreasonable ways.
>
> In D.03-05-078, for example, … [Suburban] argued the Commission should use the traditional four-factor analysis, whereas ORA argued that only three factors should be used. In accepting ORA's position, the Commission explained that using four factors in the manner advocated by Suburban would shift costs [from an unregulated affiliate] on to ratepayers.[[12]]

(D.07-11-037 at p. 29.)

[12] For a short period of time, the name of the Division of Ratepayer Advocates was statutorily changed from DRA to Office of Ratepayer Advocates (ORA).

The Commission also stated:

> An additional reason we are rejecting GSWC's proposed approach is that, like Suburban in D.03-05-078, GSWC has skewed the operation of the traditional four-factor methodology … by assuming that ASUS had only 11 customers, one for each of the [military] contracts that ASUS held on September 30, 2005 …
>
> This single assumption makes a significant difference in the outcome of the four-factor methodology. Even though – according to Exhibit 46 – 91,115 customers received service through the 11 entities with which ASUS held contracts at the end of 1995, the practical effect of assuming ASUS had only 11 customers is to assign one of the four traditional allocation factors – the number of an entity's customers – a value of zero. It is clear from the discussion in D.03-05-078 that we have disapproved of this practice because it results in a serious distortion of the four-factor methodology.

(D.07-11-037 at p. 33.)

The challenged decision acknowledged that DRA's proposed method of using the weighted average number of customers, based upon the number of ultimate connections served and the nature of services provided by the affiliate "is the method we adopted in D.07-11-037…." (D.10-11-035 at p. 23.) D.10-11-035 also acknowledged that in all of its recent decisions, the Commission rejected the use of less than four factors except upon a showing that one or more of the factors is inappropriate or would result in an unreasonable allocation of costs:

> …[R]ecent Commission decisions have either approved the use of the traditional four-factor methodology, or fewer than four factors if it can be shown that one or more of the established four factors are inappropriate or would result in distorting the allocation results unreasonable.

(D.10-11-035 at p. 23.)

D.10-11-035 reasoned, however, that unlike the circumstances present in D.07-11-037 where ASUS provided varying levels of services pursuant to its contracts with the military and cities, here ASUS was under contract with the military and only one city (Torrance). The basis of D.10-11-035's determination that ASUS has only six customers is that under its contracts with the military, ASUS does not provide direct service to military base residents, and further, by including "both the total dollar amount of plant involved in the military contracts and the number of ASUS employees (as opposed to payroll expenses)[13] provide a better means to ensure that the costs for general office expenses are properly allocated between Golden State and its affiliates." (D.10-11-035 at p. 23-24.) DRA is correct that this rationale is at odds with D.07-11-037. Further, D.10-11-035 fails to provide the effect on Golden State's captive ratepayers—which was a primary reason the Commission rejected Golden State's argument in D.07-11-037.

Pursuant to section 1708, the Commission may at any time, provided it has given adequate notice and an opportunity to be heard, rescind, alter, or amend any of its orders or decisions. However, a change or refinement of existing Commission precedent is an issue of major significance. (Rule 16.3.)[14] Commission precedent is persuasive, if not binding. (*Postal Telegraph-Cable Co.* v. *Railroad Commission* (1925) 197 Cal.426, 536-437; *Folsom Estates Unit No. 2B and 3 Homeowners Association* v. *Citizens Utilities Company of California* (1993) 52 Cal.P.U.C.2d 677, 679; *Re Toward Utility Rate Normalization (TURN)* (1993) 52 Cal.P.U.C.2d 673, 675; *Re Pacific Gas and Electric Company (Diablo Canyon)* (1988) 30 Cal.P.U.C.2d 189, 223-225 (as amended June 16, 1989 by D.89-06-032.) Relying on *Postal Telegraph-Cable Co., supra*, the Commission in *TURN*, stated that:

> The Commission may legally depart from its 'own precedent' or may fail to 'observe a rule ordinarily respected by it,' so long as '[c]ircumstances peculiar to a given situation may justify such a departure.' [Citation omitted.] Thus, when the

[13] Unlike the situation in D.07-11-037, ASUS's number of employees has tripled since December 2007. (D.10-11-035 at p. 24.)

[14] Oral arguments are not a standard procedure in an application for rehearing, and are provided in cases where "the application raises issues of major significance…." Pursuant to rule 16.3(a)(2), one ground for oral argument is whether a decision "changes or refines existing Commission precedent."

> circumstances warrant it, the Commission may adopt an exception to the general rule.

(*TURN*, *supra*, 52 Cal.P.U.C.2d at p. 675.)

In alleging that the challenged decision's divergence from past precedent is arbitrary, capricious, and unreasonable, DRA argues that determining that only six customers were served when there are over 17,000 connections impermissibly skewed the allocation in an entirely unreasonable way and contrary to the Commission's rationale for rejecting the number of bases served approach and using the four-factor approach as articulated in D.07-11-037.

D.10-11-035 agrees that the approach advocated by DRA for military bases was in compliance with the formula adopted by D.07-11-037, however, it departed from the adopted formula with its determination that "ASUS has only six customers," on the rationale that "the total dollar amount of plant in the Golden State military contracts and the number of ASUS employees…provide a better means to ensure that the costs for general office expense are properly allocated between Golden State and its affiliates. " (D.10-11-035 at pp. 23-24.) D.10-11-035 did not explain how. D.10-11-035 acknowledged that the Commission has not adopted the single factor methodology and should "use of the traditional four-factor methodology, or fewer than four factors if it can be shown that one or more of the established four factors are inappropriate or would result in distorting the allocation results unreasonably." (D.10-11-035 at p. 23.) D.10-11-035 stated "the cost methodology adopted today considers four factors …." However, it failed to clarify what, if any differences existed from the contracts to serve military bases at issue in D.07-11-037 that justified six connections being a reasonable outcome when over 17,000 connections would have been the outcome of the formula adopted by D.07-11-037. Although D.10-11-035 acknowledged that Golden State has a contract with one city instead of several as it did in D.07-11-037, D.10-11-035 did not explain how that could justify a departure from Commission practice regarding connections at military bases served by ASUS. (D.10-11-035 at p. 23.) We find that DRA's allegation has merit and rehearing is granted on this issue.

C. Authorization of memorandum account treatment for regulatory Commission expenses.

"[T]he regulatory expenses at issue for Regions 2 and 3 were the CH2MHill consulting fees." (Golden State's July 14, 2009 Reply Brief at p 65.)[15] Golden State argued that they should be included in the rates for 2010. Golden State requested a total of $450,000 for consulting fees associated with developing the underlying three-year GRC capital budget for Regions II and III.[16] Without prior authorization, Golden State booked those costs into its capital budget, arguing that doing so "correspond[ed] with the Commission's USOA Account 146" (Other Deferred Debits). (Golden State's July 14, 2009 Reply Brief at p 65.) Golden State argued that it had booked the expenses into Account 797 (Regulatory Commission Expenses) and, upon approval, intended to move them into Account 146 to be charged to ratepayers. (See Golden State's Exhibit 88, Rebuttal Testimony of Hilda B. Wahhab at p. 4.) DRA contended that, contrary to Golden State's assertion, those expenses were already in Account 146, and that Golden State had failed to obtain prior Commission authorization to have placed them into Account 146. (DRA July 6, 2009 Opening Brief at p. 49.)[17] In its reply brief, Golden State argued: "[u]pon Commission approval, these expenses will be amortized over the three-year rate case cycle and moved to USOA account 797 ('Regulatory Expense Account') one year at a time." (Golden State's July 14, 2009 Reply Brief at p 66.)

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[15] CH2MHill is a consulting firm specializing in construction. (Golden State's Exhibit 88, Rebuttal Testimony of Hilda B. Wahhab at p. 4.)

[16] Initially, Golden State had also sought to recover consultant fees for Regions II and III in the amounts of $15,100 and $14,900, respectively, for the development of the Distribution System Improvement Charges (DSIC). However, Golden State removed those charges because the DSIC issue was removed from the GRC. In addition, Golden State also requested, and later removed, $35,500 and $34,800 for Regions II and III, respectively, form mailing costs to Region I.

[17] "Without prior Commission authority or direction the expense cannot be booked in Account 146 and transferred later to Account 797 to avoid retroactive ratemaking. GSWC needed to book this expense directly into Account 797 for the year incurred." (DRA July 6, 2009 Opening Brief at pp. 49-50.)

On top of not being a properly booked expense, DRA also contended that the fees were due to the development of long-term pipeline and main replacement programs, prioritization of capital improvement projects, preparation of a rate case risk based asset management program (none of which would be regularly occurring regulatory expenses every three-years), and to provide GRC testimony. (DRA July 6, 2009 Opening Brief at pp 50-51.) DRA had argued that the consultant fees should have been disallowed because they were a one-time, non-recurring fee, and that the level of work performed by CH2MHill was extraordinary. (DRA July 6, 2009 Opening Brief at p. 50.) Further, DRA argued that because the fees were a past cost, Golden State should have, but did not, obtain either memorandum or balancing account treatment authorization in order to avoid retroactive ratemaking. (DRA July 6, 2009 Opening Brief at p. 50; DRA July 14, 2009 Reply Brief at p. 19.) Nevertheless, DRA argued that notwithstanding that the consulting fees were not a properly booked regulatory expense and lacked sufficient justification in the underlying GRC, DRA, believed that the costs may be allowed "if GSWC could show that it had prior authorization from the Commission to allow retroactive recovery of this expense." (DRA July 6, 2009 Opening Brief at p. 51.)

The PD found that the consultant's activities, or similar future activities, complied with the Water Action Plan. Accordingly, the PD reasoned that the amount of the fees ($450,000) were a reasonable forecast of future expenses—but did not find that the prior, unauthorized expenditure of $200,000 for Region II and $250,000 for Region III had been reasonable or that recovery of the past costs should be authorized. D.10-11-035 made similar findings (at page 89); however, unlike the PD, D.10-11-035 contained dicta that provided that "[a]lthough regulatory expenses may appear [from Commission decisions] to be a forecast of future expenses, that is not always the case." (D.10-11-035 at p. 48.) D.10-11-035 adopted Golden State's argument that the USOA "provides for current regulatory expenses found reasonable by the Commission to be charged to Account 146 and amortized … to Account 797… over a future time period. (D.10-11-035 at p. 48.)

USOA Account 797 concerns administrative and general expenses, and permits a utility to charge all approved regulatory commission expenses which are authorized to be spread over future periods to Account 146 and amortized by charges to that account. Account 146 pertains to a balance sheet account that must include "all debits, not elsewhere provided for, the proper final disposition of which is uncertain, and unusual or extraordinary expenses, not included in other accounts, which are in process of amortization." In its July 14, 2009 brief, Golden State did not provide an argument as to why USOA Account 146 should be applicable in this instance. In fact, its argument that the expenses are unusual or extraordinary, but will be incurred in the future seemingly would undermine its allegation that use of Account 146 for the consultant fees was permissible. Further, the consultant fees at issue here did not constitute debits whose final disposition was uncertain and in the process of amortization because the Commission never previously found them to be reasonable, thus, there was no order in place authorizing their recovery through amortization.[18]

There does not appear to be any precedent for finding that non-forecasted, unauthorized routine consultant fees may be booked into Account 146 by a utility. In fact, the Commission's long standing practice is to set rates based on forecasted expenses. (See e.g., D.09-07-021 at p. 73; D.03-06-036 at p. 4.) "… [A]bsent a memorandum account, the Commission may not grant a 'three-year amortization period for regulatory expenses used in this proceeding' as requested by Cal-Am… The Commission's task instead is to forecast regulatory expense for the upcoming three-year rate period." (D.09-07-021 at pp. 73-74.)

[18] Historically, Account 146 has been used for costs associated with unanticipated expenses, such as administrative fees taken out of government contamination loan proceeds (*Rulemaking to Ensure That Investor-Owned Water Utilities Will not Recover Unreasonable Return on Investments Financed by Contamination Proceeds* R.09-03-014, Appendix B, footnote 2) and condemnation costs and proceeds (*Investigation into Monterey Peninsula District of California-American Water Company* (1977) 82 Cal.P.U.C.2d 406 (D.87710), but were inappropriate as part of severance damages (*Application of East Yolo Community Services District* (1979) 1 Cal.P.U.C.2d 474 (D.90360).

Pursuant to D.02-08-054,[19] memorandum accounts are appropriate when the following four conditions exist: (1) the expense is caused by an event of an exceptional nature that is not under the utility's control; (2) the expense cannot have been reasonably foreseen in the utility's last GRC and will occur before the utility's next scheduled rate case; (3) the expense is of a substantial nature in the amount of money involved; and (4) the ratepayers will benefit by the memorandum account treatment. (D.02-08-054 at p. 3; accord D.04-06-018 at p. 27.) "Determining whether to create a memorandum account under these standards may well require complex factual findings and legal conclusions." (D.04-06-018 at p. 27.)

Golden State failed to demonstrate that it had obtained prior authorization to book those fees into a memorandum or balancing account, because it had not obtained authorization to book those fees into such accounts. Golden State, citing *Re Application of Suburban Water Systems for Test Year 2003*, D.03-05-078, argued that "the Commission has been aware of GSWC's treatment of regulatory expenses for GRCs as deferred costs, and the Commission has approved this treatment." (Golden State's July 14, 2009 Reply Brief at p. 66.) It also argued that the consulting fees were for GRC preparation and were not a one-time only expense; that it had incurred consulting fees in the past and planned to do so in the future. It contended that regardless of the fact that the nature of the consulting activities may change, normally consulting fees are associated with GRC preparation and thus, should be permitted. Although Golden State argued that its future consulting fees would likely change, Finding of Fact Number 52 stated that Golden State's request for $200,000 for Region II and $250,000 for Region III regulatory expenses were "a reasonable forecast of future expenses." (D.10-11-035 at p. 89.)

Contrary to Golden State's argument, D.03-05-078 does not support its inference that the Commission had been aware that it had treated the consultant fees as

[19] Interim order authorizing California Water Service Company to establish a memorandum account for costs associated with treating four well sites for contamination in the Salinas District.

deferred costs. In D.03-05-078, Suburban's recorded expenses for its 2003 rate case were $55,000 at the beginning of the previous year, but it expected costs to increase to more than $100,000 due to unanticipated regulatory expenses because of issues that were added to the 2003 GRC. (D.03-05-078 at p. 17.) The Commission found that the two issues added to the proceeding were uncontested and further, an additional issue could have been dealt with earlier by Suburban. The Commission discounted Suburban's request by $80,000.

Golden State did not provide support for its proposition that the Commission had been aware of its treatment of regulatory expenses as deferred costs. Indeed, Golden State essentially admitted that it had misinformed the Commission that the fees were booked into a different account (Account 797), when in fact they had been booked into Account 146. Further, its argument that the Commission had approved this treatment in Suburban's case, discussed above, is not accurate.

D.10-11-035 did not discuss the fact that Golden State had already booked the fees into Account 146. Instead D.10-11-035 stated:

> For all practical purposes, Account 146 is treated as a memorandum account to accumulate regulatory [C]ommission costs for which recovery has yet to occur. This has been a long-standing practice of the Commission. Since the rate case cycle covers a three-year time period, the amount of current regulatory [C]ommission expense deemed reasonable and placed in Account 146 should be amortized and recovered over the three year rate case cycle.

(D.10-11-035 at pp. 48-49.)

The reference of a similarity between Account 146 and a memorandum account that D.10-11-035 makes may be that both pertain to unanticipated, extraordinary expenses. Golden State, however, argued that the consulting fees were neither. When asked whether the utility considered seeking memorandum or balancing account authorization for the CH2MHill consulting fees, Golden State's witness Wahhab testified that the fees did not meet the criteria established for memorandum account treatment. (Golden State's Exhibit 88, Rebuttal Testimony of Hilda B. Wahhab at pp.4:19-5:8.) She further testified that “the GRC is the proper place to request this type of expense.” (Golden State’s Exhibit 88, Rebuttal Testimony of Hilda B. Wahhab at p.5:7.) Indeed, such expenses are typically forecasted, because they are foreseeable.

By authorizing Golden State to amortize historical regulatory expenses that the Commission had never previously authorized for memorandum account treatment, DRA argues, the outcome reversed long-standing Commission practice and overturned the rate case plan (RCP). Further, DRA correctly asserts that memorandum accounts cannot be established absent Commission authorization; therefore, because Golden State never obtained Commission authorization before it began booking regulatory Commission expenses into Account 146, any recovery of amounts booked into that account may constitute retroactive ratemaking.

In its argument opposing DRA’s application for rehearing, Golden State relies on D.10-04-031, arguing that the Commission declared that it does not rely on “a fixed set of factors in determining whether to establish a memorandum account.” (Golden State opposition to DRA application for rehearing at p. 15 fn. 51.) Yet, D.10-04-031 also provided: “Regardless of the specific factors considered, the question presented to the Commission in all instances is whether a utility should be permitted to seek recovery of these costs at a later date without encountering retroactive ratemaking issues.” (D.10-04-031 at p. 44.) Further, D.10-04-031 described the traditional four criteria used for memorandum account treatment and denied Golden State’s request for a memorandum account for attorneys fees and other out-of-pocket costs, specifically because Golden State’s request was not consistent with the four criteria. (D.10-04-031 at p. 44.) D.10-04-031 provided:

> A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility’s last GRC. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive ratemaking issues. However, when the Commission authorizes a memorandum account, it has not yet determined whether recovery of booked costs is appropriate, unless so specified.

(D.10-04-031 at pp. 43-44.)

By D.07-05-062, the Commission superseded its former RCP, adopted by D.04-06-018 (which required a three-year RCP for Class A water utilities pursuant to section 455.2) with its new RCP.[20] With respect to waivers of requirements set forth in section 455.2, specifically regarding waivers to the requirement to file a GRC application every three years, authorization must first be obtained from the Executive Director. (D.07-05-062 at p. 32 Ordering Paragraph No. 6.) D.07-05-062 does not otherwise concern requests for waivers from any other requirement of the adopted RCP. Section F of the new RCP, clarifies that "[n]ew or additional items or forecasted costs are not updates to recorded data and will not be accepted, except that the water utility is permitted to file a motion for permission to file updates of" specified items. (D.07-05-062, Appendix A at p. A-9.) Nevertheless, "[u]nder extraordinary circumstances, a water utility may seek discretionary post-application modifications." (*Id*.) However, any such request must, among other things, show that the addition was not foreseeable. (*Id*.) Further, such request must be made by written motion. (*Id*.) DRA is correct that Golden State failed to forecast and failed to follow the procedure for seeking a waiver for the type of expenses at issue. Further as noted in D.09-07-021, "… absent a memorandum account, the Commission may not grant a 'three-year amortization period for regulatory expenses used in this proceeding' ... The Commission's task instead is to forecast regulatory expense for the upcoming three-year rate period." (D.09-07-021 at pp. 73-74.) Accordingly, we find DRA's allegation has merit and rehearing shall be granted on this issue.

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[20] As set forth in D.04-06-018, a test year is described as a "12-month period over which projected costs and revenue are evaluated to determine if a rate change is required. This evaluation includes a specific review of all projected costs and forecasts of consumer use…." (D.04-06-018 at p. 5.) In the *Final Decision on the Rate Case Plan*, D.06-02-010 as modified by D.06-06-037, the Commission required water utilities desiring to obtain a waiver from any requirement of the adopted RCP "file a petition to modify the RCP Decision for Class A water companies." (*Id.* at p. 5.)

D. Allegation that 10-11-035 may permit a double-recovery.

DRA argues that Golden State's response to a DRA data request established that the amount Golden State reported to the Commission in its 2008 annual report for Regions II and III for rate case charges of $2,550,276 included $1,316,018.97 of regulatory expenses that are properly attributable to Golden State's Bear Valley Electric Company and have nothing to do with Golden State's customers. (DRA application for rehearing at p. 9.) Further, DRA provides that Golden State informed it through its response to a data request (which was not moved into the evidentiary record) that the utility was not requesting to recover Bear Valley Electric regulatory expenses in A.08-07-010. (DRA application for rehearing at p. 9.) Nevertheless, the error in Golden State's 2008 annual report has never been corrected. Consequently, permitting the Bear Valley Electric expenses to remain in Golden State's Account 146, created a situation that allows the utility to charge its captive water ratepayers for regulatory commission expenses it already recovered from its Bear Valley electric customers. (DRA application for rehearing at p. 9.) DRA argues that D.10-11-035 must be modified to ensure that Golden State is not authorized to recover from its water ratepayers, regulatory commission expenses that properly belong to and were already recovered from its Bear Valley electric customers.

In its response, Golden State contends that DRA's argument is new, and thus, not permitted under section 1732.[21] However, Golden State has failed to establish that section 1732 prohibits DRA's allegation. Golden State also argues that DRA's allegation is based on evidence that is not in the record. Golden State has not denied the allegation in its opposition; rather, it argues that Bear Valley Electric is a division of Golden State and that Golden State "uses only one Account 146 for all of its Regions and Divisions." (Golden State response to DRA application for rehearing at p. 17.)

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[21] Section 1732 requires applicants for rehearing to specifically set forth the grounds upon which the challenged decision is alleged to be unlawful. No petition for appellate review of a Commission decision may assert an allegation not first argued in an application for rehearing.

However, Golden State claims that "the amounts tracked in the account are separated by sub-legers relating to the respective general rate case for each Region and Division." (Golden State response to DRA application for rehearing at p. 17.) Golden State further argues that there are separate sub-legers for Regions I, II and III, respectively, and also for Bear Valley Electric; and thus, Golden State "will not recover regulatory costs associated with any Region or Division from ratepayers in a Region or Division tracked in a distinct sub-ledger…." (Golden State response to DRA application for rehearing at p. 17.) Golden State further contends that due to its segregation of costs, it will not recover the same regulatory costs in multiple proceedings.

Golden State's response fails to address DRA's allegation that the utility's 2008 annual report for Regions II and III for rate case charges of $2,550,276 included $1,316,018.97 of regulatory expenses that are properly attributable to Golden State's Bear Valley Electric Company. Golden State is required to file a verified annual report. (§ 584; General Order (G.O.) 104-A.) If the utility tracked its regulatory costs in distinct sub-ledgers then this alleged discrepancy should not have occurred. The audit ordered herein shall also undertake a review of Golden State's 2008 annual report to determine whether the regulatory expenses attributable to Golden State's Bear Valley Electric Company have been included in charges attributable to Golden State's water ratepayers.

E. D.10-11-035 shall be modified.

On pages 16-17, D.10-11-035 provided:

> While Golden State's interpretation of "extraordinary circumstances" as the basis for including vacant positions in its labor expense is not persuasive, there is no evidence of bad faith on Golden State's part. Although bad faith is not an element of Pub. Util. Code § 2107 [footnote omitted], it is the basis upon which we determine if Golden State's failed claim of "extraordinary circumstances" for including vacant positions in its labor expense rises to the level of non-compliance with a Commission order….

Section 2107 empowers the Commission to assess monetary penalties against any public utility which violates or fails to comply with the State Constitution, the

Public Utilities Act and/or, among other things, Commission orders, rules and directives. It is true that "bad faith" is not a prerequisite or an element of section 2107; however, the decision errs in suggesting that bad faith is the basis upon which the Commission would determine if Golden State's claim for extraordinary circumstances rises to the level of non-compliance. Accordingly, the decision is modified as set forth in the ordering paragraphs below to remove that unnecessary and inaccurate language.

IV. CONCLUSION

For the reasons set forth above, upon review, we find merit in the allegations raised by the DRA in its application of D.10-11-035. Therefore, we grant a rehearing of D.10-11-035 with respect to the issues discussed above, as set forth below in Ordering Paragraph Numbers 1, 2 and 3. Because, for the reasons discussed above, we do not find merit in Golden State's application for rehearing of D.10-11-035, it is denied. Furthermore, we shall modify D.10-11-035 as set forth in Ordering Paragraph Number 4 below.

THEREFORE, **IT IS ORDRED** that,

1. Rehearing of D.10-11-035 in response to the application for rehearing filed by the Division of Ratepayer Advocates is granted.

2. Within 30 days of the issuance of this order, Golden State shall provide the Director of the Commission's Division of Water and Audits with copies of all information it has regarding the La Serena project costs at issue, including information detailing whether, when, how and by whom, the costs at issue were placed into rate base. To the extent such information is already in records retained by the Commission, Golden State shall forthwith identify with specificity and in writing all such records. No later than 30 days from the issuance of this order, Golden State shall provide the presiding Administrative Law Judge, and also the staff attorneys representing the Commission's Division of Ratepayer Advocates in the underlying proceedings with copies of all information provided to the Director of the Division of Water and Audits in compliance with this Ordering Paragraph, or if less burdensome, with a written log listing all of the documentation provided to the Director of Water and Audits in response to this order.

3. Rehearing of D.10-11-035 ordered in Paragraph Number 1 above shall include the following issues:

a. If the $3.7 million in La Serena costs are already in Golden State's rate base, when were they placed in rate base and for how long have they been in it?

b. If the answers to Ordering Paragraph Number 3.a. above are positive, under what authorization were the $3.7 million costs at issue placed into Golden State's rate base?

c. Did Golden State seek authorization from the Commission for the La Serena project prior to undertaking it? If so, when? If not, why not?

d. Did Golden State inform the Commission during the La Serena project that the project was being constructed, and whether there were any cost overruns? If so, when? If not, why not?

e. What, if any, amount of cost overruns resulted from the La Serena project?

f. What was the cause of the cost overruns for the La Serena project?

g. Did Golden State seek facilities fees from each of the developers concerning the La Serena project? If so, why and for how much? If not, why not?

h. What are the names and business addresses of the persons employed at each of the construction project development companies that Golden State management and/or its consultants, agents or employees informed of the facilities fees with respect to the La Serena project costs?

i. Did Golden State provide each of the four construction project developers with updated information concerning the actual costs of the La Serena project?

j. If the answer to Ordering Paragraph Number 3.i. above is negative, who was involved in deciding that Golden State would not provide each of the four construction project developers with updated information concerning the actual costs of the La Serena project? Provide all names and addresses in response to Ordering Paragraph Number 3.j.

k. Why did Golden State not collect updated facilities costs from each of the four construction project developers with respect to the La Serena project?

l. Are the La Serena costs just and reasonable; if so, based on what evidence?

m. What amount of credit may be due Golden State's Region I ratepayers concerning the La Serena project at issue, and what is the basis for any such credit?

n. What is the evidentiary basis, if any, that supports the Commission permitting any deviation for purposes of Application 08-07-010, from application of an equivalent number of customer factor for use in determining the number of customers (for purposes of the four-factor methodology) served under military contracts by Golden State and/or its affiliate American States Utility Service?

o. If Golden State did not receive authorization to book the CH2MHill consultant costs totaling $450,000 for Regions II and III into a memorandum account or any other account, how, when, where and by whom were these costs booked into USOA Account 146 and/or 797?

p. Under what legal authorities, if any, may the Commission authorize a three-year amortization period for already incurred regulatory commission expenses in the form of consultant costs for CH2MHill concerning Regions II and III and not engage in retroactive ratemaking?

q. Did Golden State's 2008 annual report for Regions II and III concerning rate charges to its water customers, include regulatory expenses that are attributable to Golden State's Bear Valley Electric Company?

4. D.10-11-035 is modified as follows: The three sentences in the last paragraph beginning on page 16 and continuing to page 17 are deleted and the following added in their place:

> Golden State's interpretation of "extraordinary circumstances" as the basis for including vacant positions in its labor expense is not persuasive and there is no evidence of bad faith on Golden State's part. Under these particular circumstances, we do not find that including vacant positions in its labor expense rose to a level of non-compliance with a Commission order.

5. The application for rehearing of D.10-11-035 filed by the Golden State Water Company is denied.

6. Ex parte communications related to any Staff investigation related to the rehearing ordered herein are prohibited.

7. No later than thirty days after the issuance of this order, the Director of the Commission's Division of Water and Audits shall inform the Executive Director and the Commission's General Counsel whether Golden State has fully complied with Ordering Paragraph Number 2 above. In the case of non-compliance, the Executive Director and General Counsel shall immediately inform the Assigned Commissioner and Administrative Law Judge, who shall issue an order to show cause why Golden State should not be found in contempt of the Commission.

8. The Commission's Director of Water and Audits shall forthwith undertake an audit of Golden State Water Company concerning the La Serena project costs discussed above. The Commission's Director of Water and Audits shall also undertake an audit concerning Golden State's 2008 annual report for Regions II and III on the limited question of whether rate charges to its water customers included regulatory expenses that were or should have been attributable to Golden State's Bear Valley Electric Company, and shall provide the Assigned Commissioner, Presiding ALJ and parties to the rehearing proceeding with a report of this audit. The Director of the Division of Water and Audits shall prepare and provide the General Counsel and Executive Director, on an expedited basis and in conjunction with our investigatory staff, a confidential report based on the audit of the La Serena project costs with recommendations whether an adjudicatory investigation should be instituted by this Commission to determine whether laws were broken, and if so, to determine the appropriate remedies, including any monetary penalties and/or misdemeanor sanctions that may be appropriate.

9. Upon issuance of this order, the Executive Director shall provide all parties to these proceedings with a copy of this order.

10. Pursuant to Public Utilities Code section 1734, the Administrative Law Judge Division shall forthwith convene a rehearing of D.10-11-035 as set forth herein.

11. The suspension of Advice Letter 1430-W is continued until further notice; otherwise, D.10-11-035 is not stayed pending the rehearing.

12. Application 08-07-010 and Application 07-01-014 remain open.

This order is effective today.

Dated July 28, 2011, at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners