

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of VALENCIA WATER COMPANY (U-342-W), a Corporation, for an Order Authorizing It to Increase Rates Charged for Water Service in Order to Realize Increased Annual Revenues of \$4,751,000 or 18.78% in a Test Year Beginning January 2011, \$1,957,000 or 6.40% in a Test Year Beginning January 2012, \$701,000 or 2.16% in an Escalation Year Beginning January 1, 2013, and to Make Further Changes and Additions to Its Tariff for Water Service.

Application No. 10-01-006
(Filed January 4, 2010)

ORDER DENYING REHEARING OF DECISION (D.) 10-12-029

I. INTRODUCTION

In Decision (D.) 10-12-029 (or “Decision”), the Commission approved two settlement agreements between the Division of Ratepayer Advocates (“DRA”) and Valencia Water Company (“Valencia”). The Decision also provided, inter alia, for the disposition of approximately \$3.6 million in total gross contamination proceeds from Valencia’s settlement of perchlorate contamination claims. The Decision adopted a 50/50 split of the net proceeds between ratepayers and shareholders. (D.10-12-029, p. 16.)

DRA timely filed an application for rehearing of D.10-12-029, challenging the Decision’s evaluation of the cost of a replacement well. Specifically, DRA alleges: (1) the Decision erred by deviating from the Contamination Proceeds Rules (or “Rules”) adopted in D.10-10-018 by improperly applying the Rule regarding calculation of net

proceeds in using *estimated* plant costs rather than *actual* costs; and by bypassing the analysis required by the Rules to determine the appropriate level of sharing between ratepayers and shareholders; and (2) the Commission violated Public Utilities Code section 1708 by modifying D.10-10-018 without notice and an opportunity to be heard.¹

Valencia filed a timely response to the application for rehearing. In its response, Valencia opposes the rehearing application. (Response to Rehr. App., p. 2.)

We have reviewed each and every issue raised in DRA's application for rehearing of D.10-12-029. For the reasons discussed below, we are of the opinion that good cause does not exist for the granting of a rehearing. Therefore, we hereby deny the application.

II. DISCUSSION

A. **The Commission correctly applied the Contamination Proceeds Rules in D.10-10-018 in calculating the net proceeds.**

DRA asserts that the Decision's use of "estimated" costs rather than "actual" costs for the replacement of the contaminated Well V-157 with the new Well V-206 does not comport with the Contamination Proceeds Rules in D.10-10-018.² (Rehr. App., p. 6.) It further argues that the determination to use the "estimated costs" is not supported by the record. (Rehr. App., p. 6.) These assertions have no merit.

¹ All subsequent section references are to the Public Utilities Code, unless otherwise specified.

² *Order Instituting Rulemaking on the Commission's Own Motion to Develop Rules and Procedures to Ensure that Investor-Owned Water Utilities Will Not Recover Unreasonable Return on Investments Financed by Contamination Proceeds, Including Damage Awards, and Public Loans Received Due to Water Supply Contamination -- Decision Adopting Rules for Accounting Treatment of Contamination Proceeds Arising from Government Grants and Proposing Counterpart Rules for Government Loans and Damage Awards ("Contamination Proceeds Rules Decision")* [D.10-10-018] (2010) ___ Cal.P.U.C.3d _____. We adopted the Rules in two separate Decisions in the Contamination Proceeds Rulemaking, R.09-03-014: D.10-10-018 and D.10-12-058. The latter Decision revised the Rules and was adopted the same day as the Decision under review. (*Modifying and Adopting Various Rules for the Accounting of the Treatment of Contamination Proceeds* [D.10-12-058] (2010) ___ Cal.P.U.C.3d ____.)

1. DRA's interpretation of the Rules is flawed.

DRA argues that the Rules require the use of “actual” costs for a new Well V-206 that replaced the contaminated Well V-157. (Rehrg. App., p. 6.) DRA relies on the definition of “net proceeds” in D.10-10-018. Specifically, DRA claims that the type of remediation costs to be deducted from gross proceeds are the “costs of remedying plants, facilities, and resources to bring the water supply to a safe and reliable condition in accordance with General Order 103-A standards.” (Rehrg. App., pp. 5-6.) DRA reasons that these costs constitute “all costs associated with contamination,” and that the actual cost of the new well for determining net proceeds was \$2.4 million, not the \$1 million we assigned to the cost of this well. (Rehrg. App., p. 6.) DRA's argument has no merit.

As we stated in the Decision: “In adopting \$1 million as the remediation cost of Well V-157, we note that although replacement Well V-206 and associated pipeline cost \$2.4 million, Well V-206 has significantly more capacity and provides ratepayers with new plant with a longer service life.” (D.10-12-058, at p.15, fn. 21.) DRA disregards the fact that the sum of \$2.4 million was spent to do much more than just “replace contaminated Well V-157,” arguing instead that every dollar spent on new plant that replaces contaminated plant is necessarily “remediation cost,” even where, as in the present case, the replacement plant has substantially more capacity, a significantly longer useful life than the plant lost to contamination, as well as an additional pipeline. DRA provides no authority to support this interpretation, however. Other than the fact that the new well and pipeline cost \$2.4 million, DRA does not provide a reasonable explanation for why \$2.4 million, rather than \$1 million, is the correct calculation of costs necessary to remedy the plants, facilities and resources to bring the water supply to a safe and reliable condition in accordance with General Order 103-A standards. DRA's charge that the Decision ignores the Rules is incorrect. The Decision applied them correctly.

DRA's interpretation of the Contamination Proceeds Rules reads into them an extreme degree of rigidity and misses the point of the Decision's analysis. The issue we addressed was not, as DRA posits, a choice between “estimated” and “actual” costs.

The issue was to determine a fair and appropriate valuation of the remediation or replacement cost *element* that was included in the total \$2.4 million cost of the new Well V-206 and the connecting 18-inch pipeline that Valencia placed into service in 2005.

As the Decision finds, Well V-206 was partially funded by contamination proceeds and partially funded by the utility. (D.10-12-029, p.15) The Rules provide a mechanism to deal with this situation, and permit alternative accounting treatment other than that proposed by DRA based on the specific facts of each case. (*See, e.g., Contamination Proceeds Rules Decision* [D.10-10-018], *supra*, at p. 32 (slip op.)) Several elements of the Rules adopted in D.10-12-058, which DRA ignores, confirm the point demonstrated above – that a cost of remediating or replacing contaminated plant may be an element of a larger investment amount, just as the Decision rightly determined the cost of replacing the contaminated well was less than the total investment in Well V-206 and the associated pipeline. (*See Modifying and Adopting Various Rules for the Accounting of the Treatment of Contamination Proceeds* [D.10-12-058], *supra*, at Appendix C: Rules 1, 2 and 11 (slip op.)) For example, Rule 2 (previously Rule 1) has been modified to add the qualifiers, “remediation and replacement,” for “plant” and to make it clear that the ban on return only applies to the extent that the remediation and replacement plant is funded by contamination proceeds. (*See id.* at p. 11 (slip op.)) In light of this, DRA’s claim that the Decision errs in applying the Rules to the facts lacks merit and we reject it.

2. The record supports the Commission determination to use \$1 million, rather than \$2.4 million, as the valuation of the costs for the replacement of the contaminated well.

DRA argues that the determination to use the “estimated costs” is not supported by the record. (Rehrg. App., p. 6.) The record, however, supports the determination of \$1 million as the value of the replacement.

The evidence in the record demonstrates the following: Before the settlement, Valencia invested \$1.4 million to construct new Well V-206 with a production capacity of 2,500 gallons per minute (“gpm”), and invested an additional \$1.0 million in a connecting pipeline. (Exhibit 10 (Milleman/VWC), at p. 6.) This new well

and pipeline did more than replace the contaminated Well V-157, which was constructed in 1962 with a capacity of 1,500 gpm. Well V-157 was 35 years old when it was taken out of service in 1997 due to perchlorate contamination. The additional capacity of the new well “provides customers additional water supply reliability, especially during droughts.” (Exhibit 10 (Milleman/VWC), at p. 14.) The new well was equipped with a more efficient pump and motor, resulting in lower operating costs, and with its extended life expectancy will need less maintenance. (*Ibid.*) The mile-long 18 inch pipeline brought substantial additional value to Valencia’s system, since this pipeline was “upsized to accommodate the flows from future additional wells planned for the area.” (Exhibit 10 (Milleman/VWC), at p. 6.) This pipeline now also connects a more recently constructed Well V-207 to Valencia’s distribution system. (Exhibit 2, (Report on Capital Additions), Tab 400 (DiPrimio/VWC).)

Additional evidence in the record shows that the settlement agreement that resolved the perchlorate litigation earmarked \$1.0 million of the gross proceeds to resolve Valencia’s claims for construction and installation of Well V-206 and associated pipelines and permanent closure of Well V-157. (*See* Exhibit 10 (DiPrimio/VWC), p. 4 and Appendix A, § 1.48, p. 11 (hand-numbered page 10-37) and § 3.3, pp. 26-27 (hand-numbered pages 10-52 to 10-53).) Valencia proposed that \$1.0 million amount as an alternative evaluation for the loss of Well V-157. (*See*, Valencia Opening Brief, at 15, citing Exhibit 10 (DiPrimio/VWC), App. A. (Castaic Lake Water Agency Settlement Agreement), at pp. 26-27.) In the Decision, we expressly adopted the figure of \$1.0 million as the replacement value of Well V-157, not as an “estimate” of the cost of the new Well V-206. (D.10-12-029, pp. 14-15.)

Thus, the evidence supports our \$1 million evaluation of the remediation costs. Moreover, DRA’s interpretation of “remediation costs” within the definition of “net proceeds” in Ordering Paragraph 6 of D.10-10-018 gives an unrealistic degree of rigidity into the Rules and oversimplifies the task of applying the new Rules to the facts of this case. Here, where there was no exact replacement of the contaminated well, we exercised our judgment to determine an appropriate portion of that \$2.4 million

investment that comprised, in the words of D.10-10-018, “costs of remedying plants, facilities and resources.” In our opinion, the best available evidence in the record to support that figure was the one identified in the settlement agreement. Therefore, we reject DRA’s allegation that the use of the “estimated costs” is not supported by the record.

B. There is no error in the Commission’s determination regarding the sharing of net proceeds.

DRA criticizes the Decision for allegedly “bypassing” the analysis that the Rules require in determining the appropriate level of sharing of net proceeds.” (Rehrg. App., p. 4.) Specifically, DRA asserts that D.10-10-018 provided a “list of factors” that the Commission must consider “in determining any allocation of net proceeds to shareholders.” (Rehrg. App., p. 11.) DRA argues that because the Decision only discusses “two related factors from the list” in making its finding that Valencia’s shareholders were entitled to 50% of the net proceeds remaining in the Water Quality Litigation Memorandum Account, the Commission erred by not using all the factors set forth in D.10-10-018. According to DRA, we should have balanced company and customer risks, should have considered Valencia’s duty to pursue litigation, and should have recognized that Valencia bore no more than a *de minimis* risk for its litigation costs. (Rehrg. App., pp. 11-12.)

Although DRA claims that all of the listed factors set forth in Appendix D to D.10-10-018 “must be considered” (Rehrg. App., p.11), it provides no authority to support that assertion. In D.10-10-018, we provide for sharing of net proceeds between ratepayers and shareholders “upon Commission approval where circumstances warrant and on the basis of factors relevant to the individual case, including factors set out in Appendix D.” (See *Contamination Proceeds Rules Decision* [D.10-10-018], at p. 64 [Ordering Paragraph 5] (slip op.)) Moreover, it is clear from D.10-10-018 that we have not mandated that all factors must be considered. (See D.10-10-018, *supra*, at p. 48 (slip op.)) We noted that “it is not feasible, due to the wide-ranging factual variations between individual cases, to adopt a fixed formula for making allocation decisions,” but

did cite “an array of non-exclusive factors of risk, benefit, and burden that should have selective value as a checklist for such decision making in individual cases.” (*Id.*) Further, we stated that the Commission has “the discretion to consider and weigh the above factors and any others appropriate to the case before it, in a selective fashion relative to the particular circumstances of the individual case before it.” (*Id.* at p. 49 (slip op.)) Obviously, we need not consider Appendix D factors that are not relevant to the circumstances of the case. For example, factors such as “threat to and diminution of reputation,” or “obtaining replacement supply” are not relevant to the instant case for purposes of calculating the sharing of net proceeds. Consequently, DRA’s claim that there was legal error because all the listed factors in Appendix D to D.10-10-018 were not considered has no basis in law or fact and we reject it.

Furthermore, we did consider the factors of risks and burdens to ratepayers and shareholders regarding the litigation. As we explained in D.10-12-029, we disagreed with both Valencia’s and DRA’s calculations, and included a critical evaluation of Valencia’s exposure to litigation costs and burdens and the ratepayers’ burden of paying for plant in rate base. (D.10-12-029, pp. 15-16; *see* also VWC Opening Brief, pp. 8-10, citing to Exhibit 10, Appendix G (VWC/Milleman).) Consequently, our adoption of a 50/50 sharing of net proceeds is based in the evidentiary record and is consistent with the guidance of D.10-10-018. DRA’s allegations to the contrary are without merit, and we reject them.

C. D.10-12-029 does not unlawfully modify the Rules contained in D.10-10-018.

DRA’s final contention is that the Decision “deviated dramatically” from the Rules by using “estimated remediation costs” to calculate net proceeds and then allocating net proceeds without considering all the factors provided in the Appendix to D.10-10-018. According to DRA, these actions amount to a *de facto* modification of the Rules set forth in D.10-10-018, which, it claims, violates section 1708 of the Public Utilities Code since the parties were not given notice and an opportunity to be heard. (Rehrg. App., pp.12-13.) This contention lacks merit.

We did not violate section 1708 because the Decision did not modify the Rules adopted in D.10-10-018. In fact, we followed them as described above. Our adopted definition of net proceeds, which the Decision thoughtfully applies, necessarily requires interpretation and certainly does not exclude the possibility that, in a particular case, “costs of remedying plants, facilities, and resources” may be less than a utility’s total investment in a particular plant or facility. Likewise, the Decision heeds the guidance of D.10-10-018 regarding factors that may be considered in addressing the sharing of net proceeds, and reaches a conclusion that is not inconsistent with the broad guidelines stated in D.10-10-18. (See D.10-12-029, pp. 46-49.) Therefore, instead of modifying the Rules, as DRA alleges, we have acted consistent with them. Accordingly, we will reject DRA’s argument.

III. CONCLUSION

Based on the discussion above, DRA has failed to demonstrate that the Commission committed any legal or factual error in adopting D.10-12-029. Since good cause for granting rehearing has not been shown, DRA’s application for rehearing of D.10-12-029 is hereby denied.

THEREFORE, IT IS ORDERED that:

1. Rehearing of D.10-12-029 is hereby denied.
2. This proceeding, Application (A.).10-01-006, is hereby closed.

This order is effective today.

Dated January 12, 2012, at San Francisco, California.

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