

Decision 08-09-004 September 4, 2008

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

Application of Pacific Gas and Electric Company (U39M) for authority to increase the annual charge for water supplied to California Water Service Company from the Miocene Canal.

Application 07-04-022  
(Filed April 27, 2007)

**INTERIM DECISION GRANTING JOINT MOTION TO APPROVE FIRST AMENDMENT TO CONTRACT AND SUPPLEMENTAL AGREEMENT CONCERNING WATER SUPPLIED FROM THE MIOCENE CANAL****Summary**

In this decision, we approve a contract amendment recently entered into between Pacific Gas and Electric Company (PG&E) and the California Water Service Company (Cal Water). Under the contract to be amended, PG&E supplies water from its Miocene Canal in Butte County to Cal Water, which Cal Water then uses to provide water service to its customers in the City of Oroville.

As explained below, PG&E has been supplying water from the Miocene Canal to Cal Water for this purpose since 1927, although the price for the water has not changed since 1954, when the Commission approved a Supplemental Agreement the parties agreed to in 1953. The proposed contract amendment would increase, for a period of one year, the price of the water supplied from \$32,400 (the price set forth in the Supplemental Agreement) to \$152,400. In the meantime, the parties agree that PG&E will bear the cost of a study to determine whether sales of surplus water from the Powers Canal (the Cal Water facility into which the water from the Miocene Canal is delivered) will be sufficient to

finance repairs to PG&E's Coal Canyon Penstock, which had been the point of delivery for the water but which has been out of service since a rupture in 2002. In addition, the study will help determine whether sales of surplus water can contribute to the maintenance costs associated with the Miocene Canal.

As set forth below, we find the proposed contract amendment -- which the parties are treating as an interim settlement -- to be reasonable in light of the existing record, consistent with law, and in the public interest. Accordingly, we will approve the proposed amendment, which is attached to this decision as Appendix A.

### **Procedural Background**

In this application, PG&E argued that its customers were suffering serious inequities as a result of the fixed price being paid by Cal Water for water supplied from the Miocene Canal. PG&E noted that while the \$32,400 annual charge for the water that the Commission approved in 1954 "has not changed in over fifty years, PG&E's costs of owning and operating the Miocene Canal System have increased significantly over this period." (Application, p. 2.) As a result, PG&E's application sought the following relief:

- \* An increase in the annual commodity charge for the water delivered by PG&E from \$24,000 to \$212,000, allegedly to reflect not only increases in the cost of water, but also in Administrative and General (A&G) and Operations and Maintenance (O&M) expense;
- \* An increase in the percentage of Miocene Canal capital costs borne by Cal Water from the 10% approved in 1954 to 50% for 2007 (for a total of \$458,000);
- \* An order directing Cal Water to pay an advance in aid of construction of \$914,000, 50% of the estimated costs of repairing the Coal Canyon penstock; and

- \* Commission approval of a formula for updating the water charge annually, without the need for subsequent applications.

On May 31, 2007, Cal Water filed a protest to PG&E's application. In its protest, Cal Water made the following arguments:

- \* If the Commission adopted PG&E's proposals, they would result in an unjustified shift of costs from PG&E's five million ratepayers to the ratepayers in Cal Water's Oroville district, who number only about 3,600;
- \* It would be unreasonable to require the Oroville district ratepayers to pay 50% of the A&G, O&M, and tax and depreciation expense for the Miocene Canal system, since these ratepayers benefit only from a portion of the O&M costs incurred to operate this system;
- \* The relief requested should be denied because PG&E was in breach of its contractual obligation to deliver water at the Coal Canyon penstock,<sup>1</sup> and had refused to negotiate in good faith on this issue; and
- \* Cal Water should not be required to pay half of the capital costs of repairing the Coal Canyon penstock, because this facility "is uniquely required to produce power, not to deliver water."

A prehearing conference (PHC) was held on October 5, 2007. At the PHC, the assigned Administrative Law Judge (ALJ) noted that Cal Water had suggested in its protest that the parties might benefit from mediation of their dispute, and he urged PG&E to consider mediation as an alternative to litigation. On October 9, 2007, PG&E informed the ALJ and Cal Water that it was willing to

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<sup>1</sup> The protest noted that after the Coal Canyon penstock ruptured in 2002, "Cal Water, at its own expense, installed a temporary diversion that has enabled it to continue to take water downstream of the delivery point." (Protest, p. 3.)

engage in a mediation if the process could begin promptly, whereupon ALJ John Thorson was assigned to the proceeding as a mediator.

The Joint Motion notes that ALJ Thorson held mediated discussions with the parties on December 5, 2007 and January 16 and February 20, 2008, and that “through these mediations the parties formulated the First Amendment.” (Joint Motion, p. 3.) The First Amendment and the Joint Motion seeking its approval were filed electronically on April 23, 2008.

In addition to seeking approval of the First Amendment to the 1927 contract and 1953 Supplemental Agreement between Cal Water and PG&E, the joint motion requests several other specific forms of relief. First, the parties request Commission approval of the following rate treatment for their interim settlement:

[T]he Commission [should] determine that amounts paid under the First Amendment are appropriately passed to Cal Water’s Oroville Purchased Water Balancing Account, and appropriately reflected in PG&E ratepayer rates, net of the incremental cost of the study required by the First Amendment and amounts assumed in PG&E’s 2007 General Rate Case (‘GRC’), through its Utility Generation Balancing Account. (Joint Motion, p. 1.)

Second, the parties have made the unusual request that this docket should remain open while the feasibility study is conducted, and that their negotiations should be facilitated by a Commission mediator:

[T]he Commission [should] authorize the continued suspension of this Application pending further negotiations, consistent with the First Amendment, under the supervision of the previously appointed mediator or such other mediator as the Commission may

direct.[<sup>2</sup>] Specifically, the parties request that a scoping memo not issue while further negotiations remain active. Alternatively, if a scoping memo is issued, the parties request that the Commission specify a date for resolution of this proceeding beyond the normal 18-month period for the resolution of ratesetting applications so that the contemplated feasibility studies and negotiations may be completed. The Commission's authority to extend the resolution date is set forth in Public Utilities Code section 1701.5(b)."  
(*Id.* at 1-2.)

## Discussion

In view of the unusual posture of this case, we have decided to grant Cal Water and PG&E all of the relief they have requested, because we agree with them that the First Amendment satisfies the criteria for approving settlements, and because approving this interim solution to the dispute between the two companies appears to be the most promising way of bringing about a permanent resolution of the pricing issues that surround water from the Miocene Canal.

In their joint motion, PG&E and Cal Water have argued that the First Amendment is reasonable and should be approved because it conforms to our rules concerning settlements. The Commission's basic standard for evaluating settlements is set forth in Rule 12.1(d), which provides in full:

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

We have no difficulty in concluding that the First Amendment satisfies the first part of this test; *i.e.*, that it is reasonable in light of the whole record.

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<sup>2</sup> This language has been included because the original mediator for this proceeding, ALJ Thorson, retired from the Commission in May 2008.

Although the nature of the parties' discussions in their mediation sessions is confidential, we note that the \$152,400 price Cal Water has agreed to pay for deliveries from the Miocene Canal during the period the First Amendment will be in effect is very close to the amount Cal Water acknowledged would be due if the factors used in the parties' 1953 Supplemental Agreement were updated.<sup>3</sup> While PG&E and Cal Water have made it clear that the First Amendment is not to be treated as any sort of admission or precedent for the ultimate resolution of this dispute,<sup>4</sup> the fact that the price under the First Amendment is close to the price that would result from updating the 1953 factors suggests that this new, interim price is reasonable. Similarly, the idea of investigating through a study

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<sup>3</sup> In its May 31, 2007 protest to the application, Cal Water stated:

While no capital cost charge is justified, if the Commission were to apply the formula used in 1953, and accepting arguendo the numbers supplied by PG&E in its application at Table 3-4, the 'demand charge' would be limited to 10% of the 'depreciation expense' in Table 3-4, or \$26,300 annually. No taxes, franchise fees, or return were included in the 1953 calculation. The annual commodity charge would be 50% of the actual O&M for the project, excluding A&G expense. That would be \$125,000. So the total annual fee would be no more than \$150,000 under the 1953 formula. (Protest, p. 5.)

<sup>4</sup> As noted in the text, the Joint Motion states that the terms of the First Amendment are not to be construed as any sort of admission or precedent applicable to either party:

PG&E and Cal Water have entered into this First Amendment on the basis that it shall not be construed as an admission or concession by either party regarding any fact or matter of law in dispute in this proceeding. Furthermore, as contemplated by Rule 12.5, PG&E and Cal Water do not intend that the Commission's adoption of this First Amendment be construed as any statement of precedent or policy of any kind for or against either of them, in the current or in any future proceeding. (Joint Motion, pp. 6-7.)

whether sales of surplus water can pay for the repairs needed to the Coal Canyon Penstock makes considerable sense.<sup>5</sup>

We also believe the second prong of the test for approving settlements is met here. As the Joint Motion states, “[t]he parties are aware of no statutory provision or prior Commission decision that would be contravened or compromised by the First Amendment. The issues resolved in the First Amendment are within the scope of the proceeding.” (Joint Motion, p. 5.) We agree with these assertions.

Finally, we think that PG&E and Cal Water have adequately demonstrated that approval of the First Amendment to their 1927 and 1953 agreements would serve the public interest. As stated in the Joint Motion, the provisions of the First Amendment reflect a careful balancing of the interests between Cal Water’s ratepayers, PG&E’s ratepayers, and the general public:

The principal public interest affected by this proceeding is delivery of safe, reliable water and power at reasonable rates. This interim contract price adjustment will be passed to Cal Water’s Oroville customers through the Oroville Purchased

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<sup>5</sup> On this issue, the Joint Motion states:

The terms of this First Amendment provide that PG&E and Cal Water will work together to determine the amount of water available through the Miocene canal and whether the sale of any surplus water can help finance the penstock repair and canal-associated maintenance costs. The parties anticipate that the engineering study and any subsequent negotiations carried out under the First Amendment will lead to a final agreement between the parties . . . At the end of one year, or earlier if the First Amendment terminates, the contract price reverts to the original price approved in the 1954 Agreement absent some further action by the Commission or the parties. (Joint Motion, pp. 4-5.)

Water Balancing Account, and will be reflected in PG&E ratepayer rates, net of the incremental cost of the study required by the First Amendment and amounts assumed in PG&E's 2007 GRC, through its Utility Generation Balancing Account. The First Amendment advances the public interest because it may make possible arrangements to save an otherwise uneconomic hydroelectric plant that is an important renewable energy source.

Commission approval of the First Amendment will provide speedy resolution of the contested issues, will save unnecessary litigation expense, and will conserve Commission resources. (*Id.* at 6.)

Finally, we address the parties' request that in order to facilitate their negotiations, we should either forebear altogether from issuing a scoping memo in this proceeding, or should set the date for resolution sufficiently far in the future so that the parties can receive the results of the water supply study PG&E is paying for and continue their negotiations. (Joint Motion, pp. 1-2.)

While PG&E and Cal Water are correct that under Pub. Util. Code § 1701.5(b), the Commission has discretion in a ratesetting case to designate a resolution date beyond the usual 18-month period, that discretion is not unlimited. Section 1701.5(b) provides that before the Commission may set a later resolution date, the scoping memo for the proceeding must include "specific reasons for the necessity of a later date," and the Commissioner assigned to the proceeding must approve.

A scoping memo has not yet issued in this proceeding because the parties agreed to mediation immediately after the October 5, 2007 PHC. However, now that the parties have agreed upon a framework for attempting to resolve their differences, we feel it is appropriate to address some of the issues that would normally be considered in a scoping memo. First, we will set October 23, 2009 as

the resolution date for this proceeding. This date, which is 18 months after the filing date of the First Amendment and Joint Motion for approval thereof, should allow the parties adequate time to receive the results of the engineering study of water flows, decide how they want to proceed, and then conduct any additional mediation sessions that may prove necessary. Second, in the event the mediation process proves unsuccessful and this matter must be litigated, the assigned ALJ for this proceeding shall serve as the presiding officer.

Third, although a scoping memo usually sets forth a list of issues to be resolved in a proceeding, we think it is unwise to set forth such a list at this time. The reason for our reluctance to delineate the issues any more than they have been by the discussion above is that, based on the history of mediation in this proceeding, we think new issues may arise between the parties during the course of the additional mediation sessions the Joint Motion contemplates.<sup>6</sup> In view of this possibility, the best course of action is to make a commitment to appoint a new mediator within 60 days after issuance of this decision, and then see how the mediation progresses. We note, however, that the Joint Motion clearly states (at page 4) that “the parties anticipate that the engineering study and any subsequent negotiations carried out under the First Amendment will lead to a final agreement between the parties.”

The assigned Commissioner for this proceeding, Timothy Alan Simon, agrees that under the unusual circumstances of this case, the approach to scoping

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<sup>6</sup> For example, neither the application nor the protest raised the possibility of conducting an engineering study of water flows, a step the parties are now obviously looking to as a way of bridging their differences about whether Cal Water should have to make a capital contribution to rebuilding the Coal Canyon penstock, as well as pay more of the O&M costs for the Miocene Canal.

memo issues set forth above is appropriate.

### **Waiver of Comments**

Because the parties are treating the First Amendment as an interim settlement, we treat this case as an uncontested matter that grants the relief requested. Accordingly, we are waiving the otherwise-applicable comment period for this proposed decision pursuant to Rule 14.6(c)(2) of the Rules of Practice and Procedure.

### **Assignment of Proceeding**

Timothy Alan Simon is the assigned Commissioner for this proceeding, and A. Kirk McKenzie is the assigned ALJ. In the event that additional mediation does not lead to a final settlement in this proceeding, ALJ McKenzie shall also serve as the presiding officer.

### **Findings of Fact**

1. Under the contract that PG&E entered into with Cal Water in 1927, PG&E agreed to deliver water without charge to Cal Water via the Miocene Canal for 25 years, in consideration of Cal Water's assumption of PG&E's obligation to serve the residents and other water customers in the City of Oroville.

2. Under Paragraph 7 of the 1927 contract between PG&E and Cal Water, the deliveries of water by PG&E to Cal Water after May 1952 are to be made at such price "as may from time to time be established therefore" by the Commission.

3. Under the Supplemental Agreement that PG&E and Cal Water entered into in 1953, the price for the water delivered by PG&E to Cal Water via the Miocene Canal was set at \$32,400 per year.

4. The Commission approved the 1953 Supplemental Agreement in 1954 in D.50839.

5. PG&E contends in its application that the costs of delivering water to Cal Water via the Miocene Canal have increased to such an extent since 1954 that an annual price for the water of \$670,000 is now justified.

6. In its protest, Cal Water contends that the new water price sought by PG&E would inequitably shift costs from PG&E's approximately five million ratepayers to the customers of Cal Water's Oroville district, who number approximately 3,600.

7. Pursuant to a mediation process that the parties agreed to at the October 5, 2007 PHC, ALJ John Thorson was appointed as mediator by the Commission, and mediation sessions were held on December 5, 2007, January 16 and February 20, 2008.

8. On April 23, 2008, PG&E and Cal Water submitted a proposed First Amendment to the 1927 contract and 1953 Supplemental Agreement thereto, which First Amendment is attached to this decision as Appendix A.

9. Under the terms of the First Amendment, Cal Water will pay PG&E \$152,400 per year for deliveries of water from the Miocene Canal for a period of one year, from April 1, 2008 to March 31, 2009.

10. Under the terms of the First Amendment, the parties agree that this \$152,400 price may not be used as evidence of the fair and reasonable price for water that PG&E delivers to Cal Water via the Miocene Canal under the 1927 contract and the 1953 Supplemental Agreement thereto.

11. Once the terms of the First Amendment go into effect, PG&E agrees to pay for an engineering study of water flows through Cal Water's Powers Canal, the object of the study being to determine whether sales of surplus water could help finance repair of the Coal Canyon penstock and contribute to the maintenance costs associated with the Miocene Canal.

12. Under the terms of the First Amendment, after receipt and evaluation of the aforesaid engineering study, either party may choose at any time to terminate the First Amendment and cease further negotiations, in which case the price for water delivered by PG&E to Cal Water shall revert to the \$32,400 annual price set forth in the 1953 Supplemental Agreement.

13. Under the terms of the First Amendment, the new \$152,400 annual price for water goes into effect of April 1, 2008, subject to refund in the event the Commission disapproves this new price.

14. The parties request that the new, \$152,400 annual price for water be passed on to Cal Water's Oroville customers through the Oroville Purchased Water Balancing Account approved in D.04-04-041, and that said price also be appropriately reflected in PG&E's ratepayer rates, net of the incremental cost of the study described in Finding of Fact (FOF) 11, and the amounts assumed in PG&E's 2007 General Rate Case through its Utility Generation Balancing Account.

15. The parties request that either a scoping memo not be issued in this proceeding, or that if a scoping memo is issued, the resolution date for this proceeding be set sufficiently in the future so that the contemplated engineering studies and negotiations can be completed.

### **Conclusions of Law**

1. The proposed interim settlement set forth in the First Amendment is reasonable in light of the whole record.

2. The proposed interim settlement set forth in the First Amendment is consistent with law.

3. The proposed interim settlement set forth in the First Amendment is not inconsistent with the public interest.

4. The proposed interim settlement set forth in the First Amendment, which is attached to this decision as Appendix A, should be approved.

5. The ratemaking treatment for the \$152,400 price and cost of the engineering studies provided for in the First Amendment, as described in FOF 14, is reasonable and should be approved.

6. A resolution date of October 23, 2009 is appropriate for this proceeding, but it is not otherwise appropriate to issue a scoping memo at this time.

7. The Commission should appoint a new mediator through its Alternative Dispute Resolution Process to assist the parties in their negotiations once the engineering study described in FOF 11 has been completed and evaluated.

8. This order should be made effective immediately.

### **INTERIM ORDER**

**IT IS ORDERED** that:

1. The First Amendment to Contract and Supplemental Agreement For Water Supplied From the Miocene Canal, which is set forth in Appendix A to this decision, is hereby approved.

2. The ratemaking treatment set forth in Finding of Fact 14 of this decision is hereby approved.

3. The resolution date for this proceeding is October 23, 2009.

This order is effective today.

Dated September 4, 2008, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
TIMOTHY ALAN SIMON  
Commissioners