

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service by \$55,771,300 or 18.71% in the year 2024, by \$19,565,300 or 5.50% in the year 2025, and by \$19,892,400 or 5.30% in the year 2026.

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OPENING BRIEF OF CALIFORNIA-AMERICAN WATER COMPANY ON DECOUPLING ISSUES

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SUMMARY OF REQUESTS

California's water supply is increasingly at risk as it confronts more frequent and extreme droughts and floods, rising temperatures, aging infrastructure and other challenges made more acute by climate change. This is not a time for half-measures. The Commission must ensure that the water utilities it regulates have the best tools available to implement strong conservation measures.

To that end, California American Water ("CAW") developed the Water Resources Sustainability Plan ("WRSP"), which consists of several components, including the decoupling Essential Services Balancing Account ("ESBA"), a modified Annual Consumption Adjustment Mechanism ("ACAM"), enhanced amortization options, and rate design modifications. CAW developed these components to allow it to maximize its conservation efforts, while addressing concerns regarding previous decoupling mechanisms. The WRSP components work in conjunction with each other to provide the best outcome for CAW's customers while furthering the conservation policy goals.

As compared to the non-decoupling M-WRAM supported by the Public Advocates Office, the WRSP is the far superior conservation tool. It removes conservation disincentives, addresses the substantial variability of water sales, and will allow CAW to maximize its conservation efforts. The WRSP also includes customer protections and will result in long-term savings for customers.

Approving the WRSP is consistent with the Legislature's intent in the recently enacted SB 1469 to ensure that water corporations are authorized to establish revenue adjustment mechanisms that provide for a full decoupling of sales and revenue in order to further incentivize water conservation efforts, and will allow the Commission to fulfill its duty to encourage water utilities and their customers to practice water conservation.

TABLE OF CONTENTS

					<u>Page</u>	
I.	INTRO	DUCTI	ON	1		
II.	BACK	GROUN	id and f	PROCEDURAL HISTORY1		
	A.	Conservation as a California Way of Life				
	В.	Decoupling is a Best Practice				
	C.	The Failure of the M-WRAM				
	D.	The Adoption and Success of Water Decoupling				
	E.	Procedural History of Decoupling-Related Requests				
	F.	Stand	ard of Pr	oof	7	
III.	DISCL	JSSION				
	Α.	A. Special Request No. 1: Authorization of a Water Resources Sustainability Plan (WR Monterey-Style Water Revenue Adjustment Mechanism (M-WRAM)				
		1.	Water	Resources Sustainability Plan (WRSP)	8	
			a.	Essential Services Balancing Account (ESBA)	8	
			b.	Annual Consumption Adjustment Mechanism (ACAM) (Updated Special Request 3)	9	
				(1) Modifications to the ACAM in the Initial Application	9	
				(2) WRSP Modifications to the ACAM	10	
			C.	Amortization (Updated Special Request No. 14)	10	
111.			d.	Rate Design	11	
		2.	Monte	rey-Style Water Revenue Adjustment Mechanism (M-WRAM)	12	
			a.	Full Cost Balancing Account (FCBA) / Incremental Cost Balancing Account (ICBA) (Special Request 2)	13	
				(1) Incremental Cost Balancing Accounts (ICBAs)	14	
				(2) Full Cost Balancing Account (FCBA)	14	
			b.	Annual Consumption Adjustment Mechanism (ACAM) (Special Request 3)	16	

		C.	Amor	tization (Special Request 14)	17
		d.	Rate Design		17
Β.	Comp	arison c	f Impact	s of WRSP and M-WRAM	17
	1.	The V	The WRSP is the Far Superior Conservation Tool		
		a.	The WRSP Removes Conservation Disincentives		18
		b.	The WRSP Addresses the Substantial Variability of Water Sales		
		C.	The WRSP Will Allow CAW to Maximize Conservation		
			(1)	Water Utilities with Decoupling Mechanisms Have More Conservation-Oriented Rate Designs	22
			(2)	Water Utilities with Decoupling Mechanisms Have Higher Authorized Conservation Expenditures Per Customer	22
			(3)	Water Utilities with Decoupling Mechanisms Achieved Substantially Higher Levels of Water Use Reductions	22
		d.	The V	VRSP Is Most Consistent with State Conservation Policy	24
	2.	The WRSP Benefits CAW Customers			24
		a.	The V	VRSP Protects Customers	25
		b.	The V Later	VRSP Simply Allows CAW to Recover CPUC-Approved Costs at a Time	25
		a.	The V	VRSP Will Provide Long-Term Savings for Customers	26
		b.	The A	CAM Will Mitigate Future Large WRSP Balances	26
		C.	The V Exces	VRSP Amortization Component Will Further Protect Against ssive Balances	28
		d.	The V	VRSP Benefits Low-Income Customers	29
		e.	The F	Record Evidence Does Not Support PAO's Claims of Customer Harm	29
			(1)	The WRSP Will Not Have Significant Impact on Customer Bills	29
			(2)	The WRSP Will Not Allow CAW to Generate "Extraordinary Profit"	30
			(3)	The WRSP Eliminates Risks for both CAW and its Customers	31
		f.	The V	VRSP Provides Better Outcomes for Customers than the M-WRAM	31
	3.	3. The CPUC Should Adopt CAW's Proposed Rate Design			32

		a.	CAW's Rate Designs are Consistent with CPUC Guidance	
		b.	PAO Failed to Address Price Elasticity	
	4.	The Pre	eponderance of the Evidence Supports the Adoption of the WRSP	
IV.	CONCLUSION.			34

TABLE OF AUTHORITIES

CPUC Decisions

D.93887	2
D.96-12-005	4
D.04-07-034	
D.06-08-030	7
D.08-02-036	4
D.08-08-030	5
D.08-09-026	5
D.08-11-023	5
D.09-07-021	5
D.10-04-031	
D.16-12-026	12, 20, 32
D.18-05-027	9
D.18-07-025	
D.18-12-021	
D.19-12-063	7
D.20-08-047	5, 31, 33
D.21-11-018	
D.22-10-005	
D.82-12-055	
Statutes	
Pub. Util. Code §451	8
Pub. Util. Code §727.5	

Pub. Util. Code §§727.5(d)(2)(B)-(C)	
SB 1469	

Other Authorities

Executive Order N-10-19, April 29, 20191	1
California's Water Supply Strategy: Adapting to a Hotter, Drier Future, California for All, California Natural Resources Agency, Department of Water Resources, State Water Resources Control Boards, California Environmental Protection Agency, California Department of Agriculture, August 2022	
California Water Resilience Portfolio, July 2020, California Department of Food & Agriculture, California Environmental Protection Agency, California Natural Resources Agency, California Department of Finance, California Department of Fish & Wildlife, California Department of Water Resources, California State Water Resources Control Board, Delta Stewardship Council	<u>></u>

I. INTRODUCTION

Pursuant to Rule 13.12 of the Rules of Practice and Procedure of the California Public Utilities Commission ("CPUC") and the October 31, 2023 Administrative Law Judge's Ruling Updating the Proceeding Schedule and Providing Direction Regarding Briefing, California-American Water Company ("CAW" or "the Company") hereby submits this opening brief on issues related to decoupling. As discussed in more detail below, decoupling, which has a long history at the CPUC, is recognized as a best practice across utility industries and across the country, and is considered a key conservation tool for both public and private water service providers.

California could lose ten percent of its water over the next 20 years.¹ This is not a time for half-measures. The CPUC must ensure that the water utilities it regulates have the best tools available to implement strong conservation measures. The CPUC should therefore adopt CAW's proposed Water Resources Sustainability Plan ("WRSP"), which consists of several components, including the decoupling Essential Services Balancing Account ("ESBA"), a modified Annual Consumption Adjustment Mechanism ("ACAM"), enhanced amortization options, and rate design modifications that send strong conservation signals while mitigating potential under-recovery. The WRSP components work in conjunction with each other to provide the best outcome for CAW's customers while furthering the State policy goal of making conservation a way of life.

II. BACKGROUND AND PROCEDURAL HISTORY

A. Conservation as a California Way of Life

The California commitment to conservation has been made clear by the Legislature, Governor, and state agencies. The California Legislature enacted SB 606 and AB 1668 in 2018 to make conservation a California way of life and create a new foundation for long-term improvements in water conservation and drought planning.² The purpose of these two bills is to strengthen the state's water resiliency in the face of future droughts with provisions that include establishing water use objectives and long-term standards for efficient water.³ In 2019, Governor Newsom issued Executive Order N-10-19, which recognized that "the future prosperity of our communities and the health of our environment depend on tackling pressing current water challenges while positioning California to meet broad water needs through the 21st century."⁴ In response to this executive order, the California Water Resilience Portfolio, which establishes the goal of achieving greater efficiency of water use in all sectors, was issued in 2020.

¹ NAWC-NJK-001, p. 12, citing *California's Water Supply Strategy: Adapting to a Hotter, Drier Future*, California for All, California Natural Resources Agency, Department of Water Resources, State Water Resources Control Boards, California Environmental Protection Agency, California Department of Agriculture, August 2022.

² CALAM-PP-001A, p. 21

³ CALAM-PP-001A, p. 21.

⁴ Executive Order N-10-19, April 29, 2019.

The Portfolio recognized that water efficiency and conservation must be prioritized to "stretch existing water supplies to meet future demands."⁵

The CPUC also has a role to play. On September 30, 2022, Governor Newsom signed into law Senate Bill ("SB") 1469, which amended Section 727.5 of the Public Utilities Code to require the CPUC to consider, and authorized the CPUC to authorize, the implementation of a mechanism that separates the water corporation's revenues and its water sales, commonly referred to as a "decoupling mechanism." In SB 1469, the Legislature noted the "importance of encouraging both water suppliers and their customers to practice water conservation as the most cost-effective means of ensuring that there are adequate water supplies for the environment and people in the state." Importantly for this proceeding, SB 1469 stated, "It is the intent of the Legislature to ensure that water corporations are authorized to establish revenue adjustment mechanisms that provide for a full decoupling of sales and revenue in order to further incentivize water conservation efforts."⁶ Approving the WRSP is consistent with this Legislative intent, and will allow the CPUC to fulfill its duty to encourage water utilities and their customers to practice water conservation.

B. Decoupling is a Best Practice

Decoupling is a regulatory mechanism designed to eliminate or reduce the dependence of a utility's revenues on the level of sales. The use of decoupling mechanisms to encourage conservation and further policy goals has a long history at the CPUC. More than two decades ago, in 1981, the CPUC adopted the Electric Revenue Adjustment Mechanism ("ERAM") for Pacific Gas and Electric Company ("PG&E"), noting that the mechanism was "fair to ratepayers"⁷ and "especially important to eliminate any disincentives for a utility to promote conservation."⁸ The purpose of the ERAM was to decouple revenue from sales by addressing fluctuations in consumption. The CPUC subsequently adopted ERAMs for San Diego Gas & Electric Company ("SDG&E") and Southern California Edison ("SCE").⁹ In adopting the ERAM for SCE, the CPUC stated, "the adoption of a revenue adjustment mechanism is effective in eliminating disincentives for the utility to promote the conservation."¹⁰ The CPUC particularly noted the challenge of forecasting consumption:

It is unrealistic to expect that all of the key assumptions reflected in a revenue forecast will be borne out during the two-year period for which base rates are being set. Unforeseen and unpredictable factors which

⁵ *California Water Resilience Portfolio*, July 2020, California Department of Food & Agriculture, California Environmental Protection Agency, California Natural Resources Agency, California Department of Finance, California Department of Fish & Wildlife, California Department of Water Resources, California State Water Resources Control Board, Delta Stewardship Council, p. 15, cited in CALAM-JTL-002, p. 5.

⁶ SB 1469, Section 1(b).

⁷ D.93887, p. 55.

⁸ D.93887, p. 53.

⁹ D.82-12-055, p. 12.

¹⁰ *Id.*, p. 13.

are beyond the control of the utility usually cause recorded base rate revenue to be larger or smaller than the adopted test-period level of base rate revenue.¹¹

There is nothing about water utilities that make them less suited for decoupling than the energy utilities that the CPUC regulates, all of which are currently decoupled.¹² The National Association of Regulatory Utility Commissioners ("NARUC") endorsed decoupling for water utilities¹³ and decoupling mechanisms for water utilities have also been adopted in multiple other states.¹⁴ Decoupling is not limited to the private sector. The Los Angeles Department of Water and Power, also has a decoupling mechanism, which has allowed it to achieve continued and significant conservation savings.¹⁵

Moreover, there are factors specific to the water industry that heighten the need for a decoupling mechanism. Water utilities experience significantly more sales variability than energy utilities¹⁶ and water utility sales variations are less predictable than those of energy utilities.¹⁷ These differences in usage variability and issues related to forecasting make a decoupling mechanism more necessary for water utilities. Additionally, as is also discussed below, water utilities have a high proportion of fixed costs, which are not affected by sales volume,¹⁸ making recovery of water utility fixed costs more challenging when rates are designed to discourage sales.

Decoupling is one of the best ratemaking methods of encouraging conservation, and this tool should be available to water utilities in California, just as it is for the state's energy utilities.¹⁹ David Mitchell²⁰ frankly characterized the issue before the CPUC:

Unless the Commission on principle simply believes that water utilities deserve less consideration as a separate class of utilities — a rationale that to my knowledge it has never previously expressed — then the Commission should provide at least similar revenue stability mechanisms to water utilities as to those supplying energy.²¹

¹¹ Id.

- ¹⁴ *Id.*, pp. 17-18.
- ¹⁵ CWEP-MAD-001, p. 7.

²¹ CALAM-DM-002, p. 21.

¹² CALAM-DM-002, p. 2.

¹³ NAWC-NJK-001, p. 17.

¹⁶ *Id.*, p. 17.

¹⁷ *Id.*, p. 20.

¹⁸ *Id.*, p. 16.

¹⁹ NAWC-NJK-001, p. 12.

²⁰ Mr. Mitchell is the founder and principal of the economic consulting firm, M. Cubed, was Director of Research for the California Urban Water Conservation Council, and is an Adjunct Fellow at the California Public Policy Institute. Mr. Mitchell has three decades of experience developing integrated water management plans for public and private water supplies in California, and pioneered the methods and analytical models now widely used to evaluate urban water conservation programs. CALAM-DM-001, Attachment 1.

C. The Failure of the M-WRAM

In 1996, the CPUC approved a settlement allowing CAW to implement an experimental three-tier conservation rate design in its Monterey District²² to address requirements for CAW to drastically reduce diversions from the Carmel River.²³ The CPUC noted that the tiered conservation rate design "would increase the variability of Cal-Am's revenues."²⁴ As part of the settlement, the CPUC also approved the Monterey Water Revenue Adjustment Mechanism ("M-WRAM"). Unlike the ERAM, however, the M-WRAM was <u>not</u> a decoupling mechanism. Instead, it tracked "the variation in projected revenue between the experimental conservation rate design and the standard (single tier) CPUC rate design at the actual consumption level of customers."²⁵

However, as David Stephenson,²⁶ who developed the experimental conservation rate design and the M-WRAM, explained, "The fact that the M-WRAM did not address changes in consumption due to conservation rates soon became problematic," mainly because of the inherent volatility of tiered rate designs, which only increased as CAW implemented rate designs with steeper tiers to encourage greater conservation in its Monterey District.²⁷ To address this revenue instability, CAW implemented a new allotment based rate design that would collect above the authorized levels if the consumption in the third and fourth tiers was not less than estimated.²⁸ This overcollection provided some protection against fluctuations in consumption due to conservation and was returned to customers as a bill surcedit.²⁹ As time passed, CAW faced increasing challenges with respect to its Monterey District water supply, including the threat of multi-million-dollar fines and severe rationing.³⁰ To avoid fines and rationing, which would have been economically devastating for CAW's customers, CAW implemented increasingly aggressive tiered rate designs. As always, however, more steeply tiered rates meant greater revenue volatility, making it impossible for CAW to recover its revenue requirement.³¹

D. The Adoption and Success of Water Decoupling

In 2008, as part of a proceeding to consider policies to achieve the CPUC's conservation objectives for Class A water utilities, the CPUC approved two contested settlement agreements that provided for a decoupling

³⁰ *Id.*, p. 5.

²² The new rate design also reduced the revenues collected through the monthly fixed service charge and waived the service charge for low-income customers. D.96-12-005, pp. 8-9.

²³ CALAM-DPS-001, pp. 2-3.

²⁴ D.96-12-005, p. 13.

²⁵ CALAM-DPS-001, p. 3.

²⁶ Mr. Stephenson spent thirty-seven years at CAW, most of that as the director of all rate activities for the Company. Mr. Stephenson was also an instructor at the National Association of Regulatory Commissioners ("NARUC") Rate School and served for eight years on the Commission's Low-Income Oversight Board. CALAM-DPS-001, pp. 1-2.
²⁷ CAL-DPS-001, p. 3

²⁸ *Id.*, p. 4.

²⁹ Id.

³¹ *Id.*, p. 5

water revenue adjustment mechanism ("WRAM"), along with a modified cost balancing account ("MCBA"), for California Water Service Company and Park Water Company.³² By making water utilities largely financially indifferent to the amount of water sold, the decoupling WRAM/MCBA allows these water utilities to take strong measures to encourage conservation. The CPUC observed, "WRAMs and MCBAs will balance utility and ratepayer interests and will ensure that neither is harmed nor benefits from the adoption of conservation rates."³³

The CPUC subsequently approved WRAM/MCBAs for CAW.³⁴ This was particularly important for CAW's Monterey District, because "[c]ertain rate designs are only financially viable with a decoupling mechanism."³⁵ It was only once the CPUC adopted the WRAM for the Monterey District that CAW was able to implement its current steeply tiered rate design that specifically targets high levels of use in upper tiers.³⁶

Not all Class A water utilities implemented WRAM/MCBAs. Although all eight Class A utilities have achieved significant reductions in water usage since 2008, the water utilities that implemented WRAM/MCBAs achieved greater conservation savings than the Class A water utilities that did not.³⁷ In particular, CAW achieved the greatest decline in per capita usage – 34% since 2008.³⁸ The difference between the reductions in water use by the companies with the WRAM/MCBA and those without is enough to meet the needs of **84,000 households**.³⁹

E. Procedural History of Decoupling-Related Requests

Despite the success of decoupling in encouraging water conservation, in 2020, in D.20-08-047 the CPUC prohibited water utilities with WRAM/MCBAs, including CAW, from including WRAM/MCBAs in their next GRCs and provided the option to transition to M-WRAMs in those proceedings. In a proceeding without testimony or evidentiary hearings, and in what the CPUC characterized "as a policy decision not determined by law,"⁴⁰ the CPUC claimed that the WRAM/MCBA is not necessary for achieving conservation.⁴¹

⁴⁰ D.20-08-047, p. 104, Conclusion of Law 3.

³² D.08-02-036, p. 28. This proceeding included testimony and evidentiary hearings. D.08-02-026, p. 3. ³³ *Id.*, p. 26.

³⁴ *Id.*, pp. 14-17, p. 26; D.08-11-023, pp. 12-15, 21; D.09-07-021, p. 56, 157. The CPUC also approved WRAM/MCBAs for Golden State Water Company and Apple Valley Water Company (with Park Water, now Liberty) D.08-08-030, pp. 16-17, 41-42; D.08-09-026, p. 12, Ordering Paragraph 1.

³⁵ CALAM-DPS-001, p. 6.

³⁶ Id.

³⁷ CWA-001, p. 7, Table 1.

³⁸ CWA-001, p. 7, Table 1.

³⁹ CALAM-DM-002, p. 12. This figure only reflects conservation achieved through 2018.

⁴¹ *Id.*, p. 69. CAW and others filed applications for rehearing of D.20-08-047, but the CPUC denied rehearing in D.21-09-047. CAW, along with other companies with WRAM/MCBAs and CWA, filed a petition for writ of review of D.20-08-047 with the California Supreme Court. On May 18, 2022 the California Supreme Court issued the writ of review and consolidated the petitions into Case No. S269099. This matter remains pending.

CAW filed its general rate case application on July 1, 2022, and included several special requests related to decoupling. Because it was at that time prohibited from proposing to continue its existing decoupling WRAM/MCBA, CAW sought authorization in Special Request 1 to implement M-WRAMs in all of its ratemaking districts.⁴² In Special Request 2, CAW sought to replace existing MCBAs with incremental cost balancing accounts ("ICBAs") for its San Diego and Ventura County Districts and full cost balancing accounts ("FCBAs") for its Monterey, Los Angeles, Sacramento, and Larkfield districts.⁴³ In Special Request 3, CAW requested the retention of the ACAM pilot program for all of its districts and the permanent ACAM program in the Monterey District, as well as certain modifications.⁴⁴ In Special Request 14, CAW requested that the current 15% cap on the annual amortization of the WRAM/MCBA should remain in place as long as CAW has WRAM/MCBA balances to recover.⁴⁵ CAW also proposed modifications to its rate design to address the impact of the loss of the decoupling WRAM/MCBA.⁴⁶ CAW provided direct testimony in support of these requests.⁴⁷ The Public Advocates Office ("PAO") filed a protest to the application on August 5, 2022 and CAW filed a reply to this protest on August 15, 2022. The Monterey Peninsula Water Management District and the City of Thousand Oaks sought and were granted party status. A prehearing conference was held on September 12, 2022.

As noted above, Governor Newsom signed SB 1469 into law on September 30, 2022. On October 10, 2022, CAW filed a motion requesting that the CPUC adopt a schedule for this proceeding to allow for consideration of a decoupling mechanism pursuant to the newly enacted legislation. PAO filed a response objecting to CAW's motion on October 25, 2022 and CAW filed a reply to PAO's response on November 4, 2022. On November 15, 2022, the assigned Administrative Law Judge issued a ruling granting CAW permission to update its application to propose a decoupling mechanism as an alternative to the M-WRAM. As directed by that Ruling, on December 5, 2022 the parties to this proceeding submitted a joint statement proposing a procedural schedule for consideration of implementation of a decoupling mechanism.

On January 27, 2023, CAW filed its updated application, in which it requested that the CPUC authorize it to implement the WRSP. As CAW explained, the WRSP consists of several components, including the decoupling ESBA, a modified ACAM, enhanced amortization of balances, and rate design modifications.⁴⁸ CAW also updated

⁴² Application, p. 8.

⁴³ Id.; In its Application, CAW referenced SB 1469, which was then pending before the Legislature, and raised the possibility that it would file an amended application requesting implementation of a decoupling mechanism if it was enacted.
⁴⁴ Id.

⁴⁵ *Id.*, pp. 12-13.

⁴⁶ *Id.*, p. 15.

⁴⁷ See CALAM-DM-001, CALAM-JTL-001, CALAM-JM-001.

⁴⁸ Updated Application, p. 2.

Special Requests 1, 3 and 14 and indicated that it was only seeking approval of Special Request 2 if the CPUC did not adopt the WRSP.⁴⁹ CAW also provided supplemental testimony in support of the WRSP.⁵⁰

On February 6, 2023, PAO filed a protest to the updated application. National Association of Water Companies ("NAWC") filed a response to the updated application and motion for party status, which was granted on February 9, 2023. California Water Association ("CWA") and Public Water Now also subsequently sought and were granted party status. CAW filed a reply to PAO's protest on February 10, 2023. The Assigned Commissioner's Scoping Memo and Ruling ("Scoping Memo") was issued on March 21, 2023. PAO served its testimony on April 13, 2023. The other parties to this proceeding served testimony on April 20, 2023. CAW served rebuttal testimony on May 25, 2023. Evidentiary hearings were held via WebEx from October 5-9, 2023. Cross examination of witnesses on decoupling-related issues was conducted on October 5 and 6, 2023.

F. Standard of Proof

CAW has the burden of proof in this proceeding, and the standard that CAW must meet is the preponderance of the evidence.⁵¹ According to the CPUC, "Preponderance of the evidence is defined in terms of probability of truth, *e.g.*, such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth."⁵² In this proceeding, the evidence provided by multiple parties in support of adoption of the WRSP has far more convincing force and the greater probability of truth than evidence provided against it.

CAW has provided extensive evidence proving that its proposed WRSP is the superior method for encouraging conservation, and that it provides important customer protections and benefits, as well as stability for the Company. Multiple parties have also provided evidence demonstrating the need for and benefits of decoupling as a crucial tool to encourage water conservation. In determining whether the standard of proof has been met, the CPUC must weigh the preponderance of conflicting evidence in the record and consider the credibility of the testimony provided. In evaluating the credibility of witnesses, the CPUC has the discretion to decide how much weight to apportion to a witness. The CPUC does this based on the logic of the written testimony and, to the extent applicable, the impressions of witness credibility derived as part of the hearing process.⁵³ CAW will address the expertise of witnesses, logic of written testimony, and witness credibility below.

⁴⁹ *Id.*, pp. 12-14, 17-18.

⁵⁰ See CALAM-TWC-001, CALAM-JTL-002, CALAM-DM-002, CALAM-DP-002, CALAM-DPS-001.

⁵¹ D.18-12-021, p. 10.

⁵² Id.

⁵³ D.19-12-063, citing D.06-08-030. In CPUC practice, which includes both written testimony and the possibility of oral testimony, waiving cross-examination of a particular witness is not in any way a concession as to validity of the written testimony of the witness.

III. DISCUSSION

As California deals with the effects of climate change, including more frequent and longer lasting droughts, extreme temperatures and increasingly unpredictable weather, water utilities must have access to the best tools to maximize efficiency and conservation. In this proceeding, the CPUC is faced with a choice between two regulatory mechanisms: (1) CAW's proposed Water Resources Sustainability Plan ("WRSP"), which includes a decoupling element, a best practice as described above, as well as proposals to address customer impact based on CAW's previous experience with the WRAM, and (2) the M-WRAM, a non-decoupling regulatory mechanism that addresses changes in revenue related to conservation rates, but does not address changes in consumption due to conservation and does not protect customers against differences between adopted and actual water consumption. CAW discusses the specifics of each mechanism below.

A. Special Request No. 1: Authorization of a Water Resources Sustainability Plan (WRSP) or Monterey-Style Water Revenue Adjustment Mechanism (M-WRAM)

1. Water Resources Sustainability Plan (WRSP)

As noted above, the Legislature enacted SB 1469 to ensure that water corporations are authorized to establish revenue adjustment mechanisms that provide for a full decoupling of sales and revenue in order to further incentivize water conservation efforts.⁵⁴ To that end, the Legislature amended Section 727.5 to require the CPUC to consider, and authorized the CPUC to authorize, decoupling mechanisms for Class A water utilities. It is in the context of the directive from the Legislature to ensure that water corporations be authorized to establish decoupling mechanisms in order to further incentivize water conservation efforts, as well as the CPUC's previous history regarding decoupling mechanisms, that CAW proposes the WRSP. Taken as a whole, the WRSP benefits customers by providing greater conservation incentives while addressing some of the concerns that the CPUC has previously expressed regarding the WRAM.

a. Essential Services Balancing Account (ESBA)

The ESBA is the decoupling mechanism of the WRSP. The purpose of the ESBA is to track the difference between <u>CPUC-authorized</u> revenues and recorded revenues, as well as the difference between <u>CPUC-authorized</u> and recorded expenses for purchased water, power, and pump taxes.⁵⁵ The ESBA trues up <u>fixed</u> costs and is based on the revenues and expenses, that the CPUC, through the GRC process, had determined are just and reasonable,⁵⁶ and necessary for CAW to continue to provide safe and reliable water service to its customers. Fixed costs are water utility costs that do not fluctuate with customer usage in any given year, such as labor, benefits,

⁵⁴ SB 1469, Section 1(b).

⁵⁵ CALAM-JTL-002, p. 2.

⁵⁶ See Pub. Util. Code §451.

maintenance, depreciation, and capital investment costs. These fixed costs are critical to CAW's ability to continue to provide safe and reliable water service, and make up the vast majority of the cost of service. For example, in 2024 CAW's revenue requirement will be made up of approximately 80% fixed cost and 20% variable costs on a statewide basis.⁵⁷

The ESBA includes two subaccounts: (1) the Essential Service Revenue Balancing Account ("ESRBA"), which balances quantity revenues collected through the volumetric charge,⁵⁸ and (2) the Essential Service Cost Balancing Account ("ESCBA"), to balance the associated variable production costs.⁵⁹ The net under- or over-collection in the ESBA will be refunded or recovered via surcredit or surcharge.⁶⁰

b. Annual Consumption Adjustment Mechanism (ACAM) (Updated Special Request 3)

The ACAM annually adjusts volumetric rates based on actual sales. The CPUC first approved the ACAM as a pilot program for CAW's Monterey District in D.18-05-027⁶¹ and made the program permanent in D.21-11-018.⁶² The CPUC also authorized CAW to implement the ACAM as a pilot program for all of CAW's other service areas in D.21-11-018.⁶³ California Water Service Company has had a similar mechanism in place since 2015, and energy utilities have been able to make similar adjustments since the early 1990s.⁶⁴

Currently, CAW files a Tier 2 advice letter for the ACAM on or before November 15. The advice letter provides actual recorded monthly consumption by classification and by tier from October 1 of the prior year through September 30 of the current year. Upon approval of the Tier 2 advice letter, CAW files a Tier 1 advice letter to implement new rates January 1 of the subsequent year. The approved data replaces the adopted quantities beginning January 1 of the subsequent year and is used for future rate adjustments during that year.⁶⁵ As discussed below, the ACAM is necessary whether or not the CPUC approves the WRSP.

(1) Modifications to the ACAM in the Initial Application

In its initial application, CAW proposed three modifications to the existing ACAM: (1) a trigger mechanism to allow projected consumption to be adjusted when there is a regulatory requirement to reduce consumption, (2) a

⁵⁷ *Id.*, pp. 49-50; *see* CALAM-BP-001, Attachment 1.

⁵⁸ Metered service charges, sale for resale, private fire service, private hydrant service, irrigation service, flat rat residential service, and other unmetered miscellaneous revenue are excluded from the ESRBA. Surcharges and surcredits, unless specially included in the adopted revenue requirement, are also excluded. CALAM-JTL-002, p. 3.

⁵⁹ *Id.*, p. 2.

⁶⁰ *Id.*, Attachment 1.

⁶¹ D.18-05-027, p. 11.

⁶² D.21-11-018, pp. 156-157.

⁶³ Id.

⁶⁴ CALAM-JTL-001, p. 29.

⁶⁵ Id.

process to align changes in projected customer consumption to levels of production and production-related costs, and (3) a weather adjustment for CAW's Southern District. The first modification will allow CAW to immediately adjust projected consumption when requirements to reduce consumption are imposed, including drought restrictions, mandatory reductions, and source water limitations.⁶⁶ The second modification will address the highly different costs and availability of water sources, which affects production costs. The ACAM should allow the production levels and costs to be adjusted annually in response to changes in usage.⁶⁷ The third modification will remove the contemporaneous effect of weather on sales in CAW's Southern Division, where year-to-year variability in weather can cause sales fluctuations of plus or minus ten percent.⁶⁸

(2) WRSP Modifications to the ACAM

As a component of the WSRP, CAW recommends further modifying the ACAM to allow it to be implemented twice annually and to allow CAW to automatically adjust rate tier breakpoints to maintain the sales allocations within the rate tiers approved by the Commission.⁶⁹ As part of the WRSP, CAW will continue to file the November 15 ACAM Tier 2 advice letter and subsequent January 1 Tier 1 rate adjustment advice letter, but will also file a second Tier 2 advice letter on May 15 and a Tier 1 advice letter to adjust rates based on the ACAM filing beginning July 1.⁷⁰ The May 15 advice letter will provide recorded consumption by classification and by tier for the period from April 1 of the prior year to March 30 of the current year. Rates based on actual sales would be updated as of July 1 and would remain in place through the end of that year, when they would be adjusted to reflect the November 15 ACAM advice letter.⁷¹ The current ACAM rate changes implemented on January 1 are incorporated into changes from GRC decisions in test years or step-rate increase for non-test years. The July 1 ACAM rate changes will be made in conjunction with purchased water offsets.⁷² Aligning the ACAM rates changes with pre-existing rate changes mitigates the potential for customer confusion.

c. Amortization (Updated Special Request No. 14)

In its initial application, CAW requested that the current 15% cap on the annual amortization of the WRAM/MCBA remain in place as long as there are WRAM/MCBAs balances to be recovered.⁷³ In its updated application, as part of the WRSP, California updated Special Request 14 to also seek authorization to collect balances beyond the 15% cap in extraordinary circumstances where the balances grow large enough that they

- ⁶⁸ *Id.*, p. 34.
- ⁶⁹ *Id.*, pp. 7-13.
- ⁷⁰ *Id.*, pp. 8-9.
- ⁷¹ *Id.*, p. 9.
- ⁷² *Id.*, pp. 10-11.

⁶⁶ *Id.*, p. 33.

⁶⁷ *Id.*, pp. 34-35.

⁷³ CALAM-JM-001, p. 9. This would also apply to WRSP balances, if approved.

cannot be recovered in less than 24 months.⁷⁴ Under the settlement filed on November 17, 2023, CAW and PAO agreed to the continuation of the 15% cap of the authorized revenue requirement for recovery of the under-collected WRAM/MCBA balances.⁷⁵ The parties did not reach agreement on CAW's request to collect balances beyond the 15% cap if under-collected WRAM/MCBA or WRSP balances grow large enough that they cannot be recovered in less than 24 months.

d. Rate Design

In a GRC, the CPUC adopts the revenue requirement for a utility, which is the total amount of money that the utility needs to pay the costs of providing service and earn a reasonable return of and on its investment.⁷⁶ Once the CPUC has determined the reasonable revenue requirement, it then allocates this amount to customers through the rates that they pay. The process of determining what rates or prices the utility needs to charge each customer in order to collect its revenue requirement is rate design.⁷⁷ Rate designs must be designed to allow a utility to recover its authorized revenue requirement.⁷⁸ Consistent with guidance provided by the CPUC, CAW's rate design objectives are: (1) affordability, (2) conservation and efficient water use, (3) equity, and (4) rate clarity and simplification.⁷⁹ Extensive detail regarding CAW's original rate design proposal is provided in the direct testimony of CAW witness Bahman Pourtaherian.⁸⁰

In its initial application, CAW proposed two main changes to its existing rate design: (1) increased recovery of fixed costs in the meter charge, and (2) allocation of more fixed cost recovery to non-residential customers. CAW proposed that other aspects of rate design, such as the number of volumetric tiers, tier break points and rate differentials to the standard quantity rate remain consistent with its current rate design, with minor exceptions.⁸¹ With exception of newly acquired systems in the Southern District, CAW is not proposing to change the rate block widths that the CPUC approved in the last GRC.⁸² The rate design approved in the last GRC has only been in effect since March 2022, and changing them again so soon would likely result in customer confusion.

⁷⁴ CALAM-JTL-002, p. 13.

 ⁷⁵ Joint Motion for Adoption of a Settlement Agreement Between California-American Water Company and the Public Advocates Office in the General Rate Case, November 17, 2023 ("Settlement Agreement Motion"), Exhibit A, pp. 34-35.
 ⁷⁶ CALAM-BP-001, p. 38.

⁷⁷ Id.

⁷⁸ CALAM-BP-001, p. 41.

⁷⁹ CALAM-BP-001, p. 39, citing D.16-12-026, p. 2.

⁸⁰ CALAM-BP-001. Mr. Pourtaherian, the principal at Blue Planet Consulting and previous senior financial analyst CAW, has significant expertise with respect to regulatory and financial modeling. CALAM-BP-001, pp. 1-2. Mr. Pourtaherian demonstrated his credibility at the evidentiary hearing, where testified regarding rate design. RT 459-496 (Pourtaherian/CAW).
⁸¹ CALAM-BP-001, pp. 36-37.

⁸² D.21-11-018, pp. 15-16.

CAW proposed to increase the percent of the fixed cost recovery in the meter charge to 50% of fixed costs for all service areas except for the Monterey Central Satellite systems, where CAW proposed to set the meter charge at 35% of fixed costs.⁸³ This is consistent with the CPUC's guidance in D.16-12-026, in which it established a 40% floor for recovery through the meter charge, with the flexibility to proposed collection of up to 50%, and an "out clause" for extraordinary local circumstances.⁸⁴ CAW also proposed to set the monthly fixed charge rate for meter size for non-residential customers at a 50% percent higher monthly rate than the equivalent size meter rate for residential customers.⁸⁵ CAW made both of these proposals to improve stability of revenue requirement.

CAW engaged Mr. Mitchell to analyze various rate design scenarios, which informed CAW's rate design. Mr. Mitchell provided five technical memorandums, which he included with this direct testimony.⁸⁶ Mr. Mitchell evaluated the impact of alternative rate designs on customer bills, water use, and system revenue variability.⁸⁷ Mr. Mitchell based his models on 2021 bill tabulations, and calculated the change in customer water sales under the various rate design scenarios based on the percentage change in the volume for each customer, in accordance with demand elasticities estimated with the econometric models of water use that Mr. Mitchell developed for the GRC forecast.⁸⁸

In the updated application, as part of the WRSP, CAW modified its rate design. The WRSP rate design to provide greater incentives for water conservation, continue to support low-income customers and provides a reasonable opportunity for CAW to recover the revenue the CPUC has determined is necessary to continue to provide safe and reliable service, while still moderating the overall impact on customers.⁸⁹

2. Monterey-Style Water Revenue Adjustment Mechanism (M-WRAM)

CAW requested a M-WRAM in its original application. The M-WRAM tracks the difference between the billed quantity-rate revenues at actual sales over a calendar year period at the adopted conservation tiered rate design and the CPUC's non-tiered single block "uniform rate."⁹⁰ The M-WRAM is not a decoupling mechanism since it does not adjust revenues for sales fluctuations due to conservation-oriented tiered rates designs.

Former CAW Director of Rates David Stephenson developed the M-WRAM in conjunction with the implementation of a then-experimental three-tiered rate design in the Monterey District.⁹¹ The initial M-WRAM was

⁸⁷ *Id.*, p. 4.

- ⁸⁹ CALAM-BP-002, pp. 7-8.
- ⁹⁰ CALAM-JTL-001, p. 20.

⁸³ CALAM-BP-001, p. 42.

⁸⁴ D.16-12-026, pp. 57, 88 (Ordering Paragraph 13).

⁸⁵ CALAM-BP-001, p. 43.

⁸⁶ CALAM-DM-001, Attachment 3.

⁸⁸ See e.g., CALAM-DM-001, Attachment 3, pp. 4-5.

⁹¹ CALAM-DPS-001, p. 2.

designed to overcollect revenues to provide protection against the revenue instability created by the tiered rate design.⁹² Over time, however, the CPUC eliminated this element and CAW implemented increasingly aggressive tiered rate designs with higher upper block quantity rates aimed at the customers using the most water.⁹³ This resulted in a severe under-collection of revenues and large M-WRAM balances on a going forward basis due to water supply limitations.⁹⁴ Because the M-WRAM did not address the resulting changes in consumption due to conservation, it made it impossible for CAW to recover its CPUC authorized revenue requirement.⁹⁵ In short, the M-WRAM was a failure (albeit a well-intentioned one) for CAW that caused substantial financial harm to the Company.

CAW's current circumstances are even less favorable for reinstatement of the M-WRAM. Unlike the relatively simple three-tiered rate design adopted in conjunction with the M-WRAM, CAW's current and proposed rate design incorporates additional tiers, which are more steeply inclined to provide strong pricing signals for high-use customers.⁹⁶ As discussed in the testimony of CAW witness Patrick Pilz,⁹⁷ CAW has implemented robust conservation programs statewide to encourage efficient water use.⁹⁸ Crucially, CAW operates under more significant water supply limitations than it did when the M-WRAM was developed, both in the Monterey District⁹⁹ and statewide.¹⁰⁰ Since, as discussed below, the WRSP is the superior conservation tool and provides better outcomes for customers, there is no reason for the CPUC to revert to a mechanism that previously failed CAW.¹⁰¹

a. Full Cost Balancing Account (FCBA) / Incremental Cost Balancing Account (ICBA) (Special Request 2)

In its original application, CAW sought authorization to implement incremental cost balancing accounts ("ICBAs") for its San Diego and Ventura County Districts, and establish full cost balancing accounts ("FCBAs") for its Monterey, Los Angeles, Sacramento and Larkfield Districts.¹⁰² If the CPUC adopts the WRSP, including the decoupling ESBA, these accounts will not be necessary. If the CPUC rejects the WRSP, it should adopt the

⁹² *Id.*, p. 4.

⁹³ CALAM-JTL-001, p. 21.

⁹⁴ *Id.*, p. 21, fn. 9.

⁹⁵ *Id.*, p. 21, fn. 10.

⁹⁶ *Id.*, p. 20.

⁹⁷ Mr. Pilz is the Senior Manager for Field Operations for CAW, as oversees all conservation programs and activities for the Company. He has been with CAW for nearly twenty years, and serves on the Board of Directors for CalWEP. CALAM-PP-001, pp. 1-2.

⁹⁸ CALAM-PP-001, p. 21.

⁹⁹ CALAM-JTL-001, p. 21.

¹⁰⁰ CALAM-PP-001, pp. 21-22.

¹⁰¹ If the M-WRAM is approved CAW will likely need to propose conservation-oriented rate designs with substantially muted conservation signals in future GRCs.

¹⁰² Application, p. 9.

proposed ICBAs and FCBAs to protect customers from changes to water supplies that are beyond the control of CAW.

(1) Incremental Cost Balancing Accounts (ICBAs)

An ICBA tracks the difference between the CPUC-adopted prices of water production components and the actual water production price components and adjusts rates to account for changes in the prices of water production components due to supplier price changes that are outside CAW's control.¹⁰³ The ICBA is appropriate for CAW's San Diego and Ventura County Districts because it purchases all of the water that it uses to supply those districts.¹⁰⁴ There is no material variability in the supply mix for these two districts. CAW purchases water from the City of San Diego to serve the San Diego District and from the Calleguas Municipal Water District to serve the Ventura County District.¹⁰⁵ Both of these entities have the authority to make changes to the per-unit cost of the water that they sell to CAW, and these changes are not easily forecasted and are beyond the control of CAW.¹⁰⁶ The ICBAs ensure that neither CAW nor its customers either unreasonably benefit or are unreasonably harmed by these price changes. PAO does not oppose CAW's request for ICBAs for these districts.¹⁰⁷

(2) Full Cost Balancing Account (FCBA)

The FCBA is similar to the ICBA, but it also tracks variances in quantity from the CPUC-adopted amounts due to changes in the supply mix.¹⁰⁸ San Gabriel Valley Water Company ("San Gabriel") has had a FCBA for decades. The FCBA has allowed San Gabriel to provide multi-million dollar refunds to its customers due to savings achieved when changes in the supply mix that were not forecast in the GRC allowed San Gabriel to use lower cost water supplies.¹⁰⁹ The CPUC found that the FCBA was justified due to water variations in water production and power supply costs, and because the "the supply mix is determined by hydrogeological conditions that are beyond San Gabriel's ability to predict or control."¹¹⁰ The CPUC subsequently affirmed San Gabriel's FCBA, noting, "Drought conditions continue to highlight the supply uncertainties and variabilities."¹¹¹ Similar circumstances exist in CAW's Monterey, Los Angeles, Sacramento and Larkfield Districts that justify authorization of FCBAs for those districts.

¹⁰⁵ *Id*.

¹⁰³ CALAM-JTL-001, p. 25.

¹⁰⁴ *Id*.

¹⁰⁶ *Id.*

¹⁰⁷ CALAD-MD-001, p. 48.

¹⁰⁸ CALAM-JTL-001, p. 26.

¹⁰⁹ See e.g., D.04-07-034, pp. 62-63.

¹¹⁰ *Id*., p. 63.

¹¹¹ D.10-04-031, pp. 35-36. The Commission also recently approved a settlement agreement that provides a FCBA for San Jose Water Company. D.22-10-005, Appendix 1, Section II.D.1.

For example, the Carmel River and the Seaside Groundwater Basin, the historic major supplies for the Monterey District, have seen significant reductions in the last decade based on the SWRCB's Cease and Desist Order requiring CAW to cease all unauthorized diversions from the Camel River and the tri-annual ramp-downs required by the Seaside Groundwater Basin adjudication.¹¹² The amount of water from aquifer storage and recovery ("ASR") and the Sand City Desalination Plant has also varied over the last decade.¹¹³ The changes in water source trends have required a significant change in pumping operations and overall conveyance planning in order to stay within new source water limits.¹¹⁴ CAW does not, however, have any flexibility in terms of limiting the amount of water it produces from each supply while still meeting customer demand during times of extended drought in the Monterey District. In particular, CAW does not have the option of prioritizing the purchasing or production of water by cost in the Monterey District.¹¹⁵

In its Los Angeles District, CAW strives to provide the least-cost water to its customers by maximizing lower-cost groundwater before purchasing supplemental imported water.¹¹⁶ CAW faces contamination and mechanical issues challenges beyond its control, however, that affect the supply mix. For example, in the Baldwin Hills service area of the Los Angeles District, a plume of volatile organic compounds have impacted the groundwater production of two of the system's four wells, requiring CAW to purchase more water from the West Basin Municipal Water District.¹¹⁷ Although a treatment plant should allow CAW to increase groundwater production, the drifting contamination plume could affect the other Baldwin Hills wells.¹¹⁸ In the San Marino service area, when the reservoir is taken out service CAW is unable to pump any groundwater supplies from the Raymond Basin and must turn to higher-cost purchased water to serve customers.¹¹⁹

CAW serves its Sacramento District customers using a combination of groundwater and purchased water from the City of Sacramento, Sacramento County Water Agency, Sacramento Suburban Water District and Placer County Water Agency.¹²⁰ These agreements, however, place limitations on CAW's ability to use both groundwater and purchased water. For example, CAW uses purchased water from the City of Sacramento to allow recovery of groundwater basins as part of conjunctive use agreements. CAW also has an agreement with Sacramento Suburban Water District to manage water resources. Additionally, CAW may only use water purchased from the

- ¹¹⁴ *Id.*, p. 10.
- ¹¹⁵ *Id*., p. 11.
- ¹¹⁶ *Id*., p. 24.
- ¹¹⁷ Id. ¹¹⁸ Id.
- ¹¹⁹ Id.

¹¹² CALAM-CC-001, p. 9.

¹¹³ *Id*.

¹²⁰ *Id.*, p. 25.

Placer County Water Agency to serve its West Placer service area.¹²¹ The use of purchased water is balanced against the possibility that the groundwater basins may require additional management or fail altogether.¹²² CAW uses groundwater and purchased water from Sonoma County Water Agency to serve its Larkfield District customers.¹²³ Although CAW primarily uses purchased water to aid with the backwash demand from the Larkfield District treatment plant, it also sometimes needs to use purchased water to serve customers as groundwater wells and pumps and rehabilitated.¹²⁴

PAO did not address the merits of CAW's FCBA proposal.¹²⁵ PAO claims that the proposed FCBA is similar to the decoupling ESBA, and should be rejected by the CPUC.¹²⁶ San Gabriel Water has a M-WRAM however,¹²⁷ and its experience with the FCBA shows that it is necessary and beneficial even in the absence of decoupling. Similar to San Gabriel Water, CAW's supply mix in its Monterey, Los Angeles, Sacramento and Larkfield Districts is subject to "supply uncertainties and variabilities" beyond CAW's control. As the CPUC did for San Gabriel Water, it should authorize CAW to implement FCBAs for these districts to protect and benefit customers and CAW.

b. Annual Consumption Adjustment Mechanism (ACAM) (Special Request 3) In its initial application, CAW requested continued authorization of the existing ACAM and proposed three modifications to the existing ACAM: (1) a trigger mechanism to allow projected consumption to be adjusted when there is a requirement to reduce consumption, (2) a process to align changes in projected customer consumption to levels of production and production-related costs, and (3) a weather adjustment for CAW's Southern District.¹²⁸ CAW also proposed additional modifications of the ACAM as part of the WRSP.¹²⁹ PAO argues that if the CPUC does not adopt the WRSP, "the basic rationale for the ACAM has evaporated."¹³⁰ The ACAM, however, is an important tool that the CPUC should maintain whether or not it approves the WRSP.

As discussed in more detail below, water usage is highly variable.¹³¹ The ACAM uses updated consumption data (both overall and by tiers) to better align rates with sales thereby improving the recovery of authorized costs

¹³⁰ CALAD-MD-001, p. 49.

¹²¹ Id.

¹²² Id.

¹²³ Id.

¹²⁴ Id.

¹²⁵ CALAD-MD-001, p. 48.

¹²⁶ *Id.* It unclear whether PAO would support adoption of ICBAs for these districts if the Commission rejects both the WRSP and the proposed FCBAs.

¹²⁷ San Jose Water Company also has a M-WRAM.

¹²⁸ Application, p. 9.

¹²⁹ Updated Application, p. 14.

¹³¹ CALAM-DM-002, p. 15.

and improve revenue recovery.¹³² Additionally, as the CPUC has recognized, the ACAM provides "improved price information so that use-reduction (conservation) rate signals are more timely and consistently provided to customers."¹³³ The ACAM will continue to deliver these benefits whether or not the CPUC adopts the WRSP. Therefore, even if the CPUC does not approve the WRSP it should still approve CAW's original Special Request 3.

c. Amortization (Special Request 14)

As discussed above, CAW initially requested that the current 15% cap on the annual amortization of the WRAM/MCBA remain in place as long as there are WRAM/MCBAs balances to be recovered.¹³⁴ Under the settlement filed on November 17, 2023, CAW and PAO agreed to the continuation of the 15% cap of the authorized revenue requirement for recovery of the under-collected WRAM/MCBA balances.¹³⁵

d. Rate Design

CAW summarized its proposed rate design for the M-WRAM above. PAO, however, has also proposed a rate design to implemented in conjunction with the M-WRAM.¹³⁶ The noteworthy aspects of PAO rate design include reducing CAW's recovery of its revenue requirement through the meter charge to below 40% in all but one area,¹³⁷ establishing the usage for the first rate tier at 6 ccfs¹³⁸ for all districts,¹³⁹ and significant changes to the block rate widths in all districts.

B. Comparison of Impacts of WRSP and M-WRAM

In order to determine whether to adopt the WRSP or the M-WRAM, the CPUC must consider how each mechanism incentivizes conversation and affects customers. As discussed in more detail below, based on the preponderance of the evidence, the WRSP emerges from this comparison as the clear winner. By severing the linkage between cost of service recovery and sales, the WRSP removes conservation disincentives, allows implementation of more aggressive conservation policies, and protects customers interests. The CPUC should adopt the WRSP to provide CAW with the tools it needs to further the State policy goal of making conservation a California way of life while providing the best outcome for its customers.

¹³² CALAM-SWO-002A, p. 77.

¹³³ D.18-07-025, p. 11.

¹³⁴ Application, p. 12.

¹³⁵ Settlement Agreement Motion, Exhibit A, pp. 34-35

¹³⁶ CALAD-HM-001, pp. 20-45.

¹³⁷ *Id.*, p. 22, Table 2-1.

¹³⁸ Ccf stands for one hundred cubic feet.

¹³⁹ CALAD-HM-001, p. 27.

1. The WRSP is the Far Superior Conservation Tool

The WRSP, including the decoupling ESBA, addresses the challenges and disincentives related to incentivizing conservation, particularly through steeply tiered conservation rates, and will result in more significant conservation than the M-WRAM.

a. The WRSP Removes Conservation Disincentives

There is no question that water utilities have a financial disincentive to encourage conservation. In SB 1469 the Legislature found:

Because water suppliers have very significant fixed costs that do not fluctuate with changes in consumption patterns, they have a financial disincentive to encourage water conservation as reductions in water consumption directly translate into cost recovery challenges.¹⁴⁰

Urban water systems are capital intensive, with fixed costs comprising approximately 50-80% of total costs.¹⁴¹ These costs do not decline as usage drops. "Regardless of how much water customers use, utilities still must treat and transport drinking and wastewater, which includes maintaining the infrastructure necessary to provide safe and reliable service."¹⁴² Since more than half of fixed costs are typically recovered via volume charges, when sales decrease, the ability of a water utility to recover fixed costs is put in jeopardy.¹⁴³ Because a decline in sales can hinder a utility's ability to recover fixed costs that the CPUC has determined are reasonable and necessary to continue to provide safe and reliable water service, there is a disincentive for water utilities to promote customer efficiency. Under the WRSP, the decoupling ESBA is a "powerful solution to this problem" because it breaks "the link between how much a utility sells and the revenues it collects to recover the costs of providing service to customers" and ensures recovery of necessary fixed costs.¹⁴⁴ As CAW Senior Director of Rates, Stephen (Wes) Owens¹⁴⁵ testified, the WRSP "will allow California-American Water to continue aggressively pursuing conservation while at the same time recovering fixed costs in such a way that we can continue aggressively also pursuing our capital investment program."¹⁴⁶

Recovering sufficient revenue to cover the fixed costs of providing water service while encouraging reduced consumer demand is a problem for all water service providers. "Without financial viability, a water utility cannot

¹⁴⁰ SB 1469, Section 1(a)(5).

¹⁴¹ CALAM-DM-002, p. 16.

¹⁴² NAWC-NJK-001, p. 10.

¹⁴³ CALAM-DM-002, p. 16.

¹⁴⁴ NAWC-NJK-001, pp. 10-11.

¹⁴⁵ Mr. Owens previously worked for the Commission's Division of Ratepayer Advocates (predecessor to the current PAO) as well as for San Jose Water Company. Mr. Owens adopted the testimony of Jeffrey Linam, and provided rebuttal testimony on the WRSP. Mr. Owens demonstrated his credibility as a witness at the evidentiary hearing, where he testified as to the need for the WRSP and the substantial errors in the testimony of PAO

¹⁴⁶ RT 348:24-349:3 (Owens/CAW).

meet its mission of delivering safe and reliable water cost-effectively."¹⁴⁷ This is why publicly owned systems are also considering and implementing decoupling.¹⁴⁸ For example, the Los Angeles Department of Water and Power implemented decoupling so that it could more aggressively pursue conservation through rate design while ensuring recovery of its fixed costs.¹⁴⁹ Likewise, CalWEP witness Ms. Dickinson is currently helping to design a decoupling mechanism for public water suppliers in Connecticut.¹⁵⁰

By contrast, the M-WRAM does little to ameliorate conservation disincentives. The goal of conservation is to reduce customer usage, whether through steeply tiered conservation rates that provide strong pricing signals, or other conservation programs. Although the M-WRAM allows water utilities to recover the difference between the revenue it would have recovered under uniform single-block rates and the revenue it recovered under tiered conservation rates at the same usage level, it leaves water utilities in danger of not being able to recover the revenue requirement that the CPUC determined was just and reasonable if the conservation programs work as intended and customers do in fact reduce their consumption. Since reduced consumption does not affect water utilities' substantial fixed costs, it is only prudent for water utilities to temper their conservation efforts to ensure that they are able to recover sufficient revenue to continue to provide safe and reliable service to customers.

b. The WRSP Addresses the Substantial Variability of Water Sales

The reason that conservation-oriented rates hinder the ability to recover fixed costs is due to challenges associated with forecasting water usage. If the CPUC's adopted forecast of water usage is too high, a water utility will not be able recover the costs the CPUC determined were necessary to provide safe and reliable service. This is because the rates, which are based on the forecast, are too low to recover authorized costs when sales turn out to be lower than expected.

As compared to energy utilities, water utilities experience significantly more sales variability. For example, during the period of 2000-2020, the coefficient of variation of electricity sales for Pacific Gas & Electric Company ("PG&E") was only 3.8%.¹⁵¹ By comparison, the coefficient for CAW for divisional sales for the same period was 13-14% - three times as large.¹⁵² Additionally, for PG&E, the largest deviation from the trend sales level in any single year was 6.1%, while for CAW it was a whopping 31.3%.¹⁵³

¹⁴⁷ NAWC-NJK-001, p. 22.

¹⁴⁸ CWEP-MAD-001, pp. 4, 7.

¹⁴⁹ RT 323:7-11 (Mitchell/CAW).

¹⁵⁰ CWEP-MAD-001, p. 2.

¹⁵¹ CALAM-DM-002, p 15. The coefficient of variation is the standard deviation in annual sales divided by mean annual sales. It is a unitless measure of the typical variability in a data series.

¹⁵² Id.

¹⁵³ Id.

Not only is water usage more variable than energy usage, but the variations are harder to predict. This is because water usage variability is most strongly influenced by weather and water availability. Excessively wet years suppress sales by reducing the need for landscape irrigation.¹⁵⁴ There is not much upside for sales, however, "because years when sales would be higher than expected are precisely the years when rationing is most likely – namely, years when rainfall is sparse, and/or temperature is higher than normal."¹⁵⁵ It is more likely for sales to come in under forecast than over.

Water utilities must contend with irreducible uncertainty associated with California's climate. It is almost impossible to predict the water conditions for a coming year because there is no strong long-term trend and the deviations up or down from the average can be more than 50% downward or over 100% upward. It is certainly not possible to predict whether there will be a drought during the upcoming rate case period. Neither CAW nor the CPUC can know if the years in the rate case period will be wet, dry, or average. Inaccurate forecasts are not the fault of the utility, but rather a consequence of nature.¹⁵⁶ As Mr. Mitchell observed, "It's the hard facts of life with respect to running a water system in California which has the most variable weather in North America."¹⁵⁷

Forecasting challenges are exacerbated by aggressive conservation rate designs, which provide strong price signals regarding usage in the upper tiers. With higher rates in upper tiers, even small changes in water usage result in large changes in revenue collection.¹⁵⁸ This means that if less water is sold in the upper tiers, a utility would undercollect revenues, even if water usage was greater than forecasted in the lower tiers.¹⁵⁹ Targeting customers with extremely high consumption is consistent with the CPUC's conservation objectives,¹⁶⁰ but increases revenue volatility, which can hinder a water utility's ability to recover the costs necessary to continue to provide safe and reliable service. Under the WRSP, the decoupling ESBA addresses reductions in overall water usage, as well as reductions in usage in specific rate tiers.

As discussed above, when the CPUC adopted decoupling for energy utilities, it did so because it was "unrealistic to expect that all of the key assumptions reflected in a revenue forecast will be borne out during the...period for which base rates are being set" due to "[u]nforeseen and unpredictable factors which are beyond

¹⁵⁴ *Id.*, p. 19.

¹⁵⁵ *Id.*, p. 16.

¹⁵⁶ CALAM-DM-003, p. 59, fn. 98.

¹⁵⁷ RT 305:20-22 (Mitchell/CAW). Mr. Mitchell subsequently explained that the variability of California weather was established through the research of Professor Jay Lund, head of the Center for Watershed Science at University of California – Davis and the foremost expert on urban and agricultural water systems. RT 318:4-12, 323:22-24 (Mitchell/CAW).
¹⁵⁸ CALAM-DPS-001, p. 7.

¹⁵⁹ RT 345:4-19 (Owens/CAW).

¹⁶⁰ D.16-12-026, pp. 49-50.

the control of the utility."¹⁶¹ This is even more true for water utilities. There is no reason why decoupling, which has been in place for CPUC-regulated energy utilities for decades, should not also apply to water utilities. The decoupling ESBA proposed by CAW has the same effect as the decoupling mechanisms currently in place for energy utilities. Just as energy utility customers are not harmed – and are even helped – by those decoupling mechanisms, CAW's decoupling ESBA also helps both customers and the Company. By contrast, the M-WRAM would penalize both CAW and its customers to the extent that "unforeseen and unpredictable factors which are beyond the control of the utility" result in actual revenues that are higher or lower than the forecasted revenues.

Furthermore, the M-WRAM introduces a "moral hazard" to the forecasting process.¹⁶² Because the M-WRAM does not decouple revenue from sales, it essentially *guarantees* that there will be an over- or underrecovery of CPUC-authorized water sales revenues. Utilities with a M-WRAM have a strong incentive to propose very conservative sales forecasts to help mitigate the risk of revenue under-recovery.¹⁶³ Other entities may propose high sales forecasts to lower customer rates. Indeed, it appears that PAO succumbed to this moral hazard in this proceeding. In proposing sales forecasts in this proceeding, PAO did not rely on a consistent methodology but instead used whichever method resulted in a higher sales forecast.¹⁶⁴ Mr. Mitchell testified, "<u>In all my career</u> (which spans more than 30 years), I have never run into such a blatant manipulation of a forecast to achieve a specific result."¹⁶⁵

The WRSP removes this "moral hazard." Because it decouples sales from revenues, any over-recovery will be credited back to customers and any under-recovery will be recovered from customers via a surcharge. All parties should have the same goal – to reduce the likelihood and magnitude of over- or under-recovery of the revenue requirement that the CPUC has determined is just and reasonable.

c. The WRSP Will Allow CAW to Maximize Conservation

As discussed above, the CPUC authorized decoupling WRAM/MCBAs for CAW, California Water Service, Golden State Water, and Liberty Utilities. The remaining Class A water utilities all have M-WRAMs. Comparing the conservation rate designs, conservation expenditures and conservation achievements of the water utilities with decoupling mechanisms and the water utilities with M-WRAMs provides a helpful indication of CAW's conservation under the WRSP and the M-WRAM. Based on the comparison below, the WRSP will better allow CAW to maximize conservation than the M-WRAM.

¹⁶¹ D.82-12-055, p. 13.

¹⁶² CALAM-DM-002, Attachment 1, p. 4, fn. 6.

¹⁶³ *Id*., p. 8.

¹⁶⁴ CALAM-DM-003, p. 7.

¹⁶⁵ CALAM-DM-003, p. 7.

(1) Water Utilities with Decoupling Mechanisms Have More Conservation-Oriented Rate Designs

While regulated water utilities with M-WRAMs and water utilities with decoupling mechanisms all have increasing block commodity rates, there are systematic differences between the water conservation incentives provided by the rates of water utilities with M-WRAMs and those that are fully decoupled. Research has shown that water customers respond to the marginal rate that they face (the rate charged for the last unit of consumption) as well as the total bill.¹⁶⁶ Therefore, Mr. Mitchell and Dr. Chesnutt¹⁶⁷ considered both the rate multipliers and bill multipliers as indicators of the relative strength of a rate design's conservation incentive.¹⁶⁸ Water utilities with decoupling mechanisms had higher rate multipliers, and decidedly more conservation-oriented bill multipliers.¹⁶⁹ Water utilities with M-WRAMs also had rate designs that recovered more revenue through the service charge than water utilities with decoupling mechanisms, and recovered a substantially higher share of fixed costs through the service charge. The M-WRAM rate designs, by relying more on service charge revenue recovery, provide additional protection against revenue shortfalls, and thus to revenue volatility, but dilute the incentives to conserve water and shift more of the revenue recovery burden to customers using the least amount of water – often these are low-income customers who tend, on average, to use less water than higher income customers.

(2) Water Utilities with Decoupling Mechanisms Have Higher Authorized Conservation Expenditures Per Customer

As Mr. Mitchell and Dr. Chesnutt determined, "authorized expenditure by the utilities operating with the Monterey-Style WRAM is significantly less than authorized expenditure for the fully decoupled utilities – about 56 percent less if Cal Am Monterey is included in the comparison, and 47 percent less if it is excluded."¹⁷⁰

(3) Water Utilities with Decoupling Mechanisms Achieved Substantially Higher Levels of Water Use Reductions

In his testimony, Richard Rauschmeier, Program Manager of the Water Branch for PAO, claims that the presence of a decoupling mechanism "does not appear to have any significant impact on reducing water usage."¹⁷¹ In support of this claim, Mr. Rauschmeier included two figures: one purporting to show the annual change in

¹⁶⁶ CALAM-DM-002, Attachment 1, p. 9.

¹⁶⁷ Dr. Chesnutt is the co-author of the comparative analysis of companies with and without WRAM/MCBAs included with Mr. Mitchell's testimony. Dr. Chesnutt is President and CEO of A & N Technical Services, a water policy and analytics consulting firm that provide state-of-the-art expertise in the fields of water sector governance, water utility efficiency, water resource economics, rate design, water conservation, and water system (demand and supply) modeling. Dr. Chesnutt is also a Certified Analytics Professional and Accredited Professional Statistician. CALAM-TWC-001, pp. 1-2, Attachment 1.

¹⁶⁸ CALAM-DM-002, Attachment 1, p. 9.

¹⁶⁹ *Id.*, Attachment 1, p. 10, Figures 1-2.

¹⁷⁰ *Id.*, Attachment 1, p. 13, Table 3.

¹⁷¹ CALAD-RR-001, p. 8.

consumption per connection with and without decoupling from 2010-2021 (Figure 1) and one purporting to show the cumulative reduction in consumption per connection from 2010-2021 (Figure 2).¹⁷²

CAW witness Dr. Chesnutt, a Certified Analytics Professional and Accredited Professional Statistician, concluded that Mr. Rauschmeier's testimony "is a rhetorical exercise rather than a serious empirical pursuit, grounded in reality" due to issues related to the classification of the independent variable, independent sources of causal variation, and the fact Mr. Rauschmeier's results are not able to be reproduced.¹⁷³ Mr. Mitchell identified similar flaws.¹⁷⁴

More damning, however, is the calculation error that renders Mr. Rauschmeier's figures meaningless. The data that Mr. Rauschmeier used to create his two figures is not valid because it is based on inconsistent volumetric units.¹⁷⁵ Although water utilities report usage in different units in their annual reports,¹⁷⁶ Mr. Rauschmeier failed to convert the data to and instead simply added the reported amounts together.¹⁷⁷ Due to these computational errors affecting both figures, the evidence that Mr. Rauschmeier cites to support his claim regarding conservation is, as Mr. Mitchell observed, "**untethered from any real world physical quantity**."¹⁷⁸

In addition to these calculation errors, Mr. Rauschmeier's calculation of changes in water use per service connection included both flat and metered service connections in the denominator of the ratio, but excluded the water use from the flat service connections in the numerator. Flat rate services do not have their water use metered and are not included in reported water usage. As Mr. Owens explained, "Critically, and seemingly obviously, consumption for unmetered service connections cannot be measured because they do not have meters."¹⁷⁹ Mr. Rauschmeier's inclusion of flat rate services in the denominator and exclusion of their associated water use in the numerator results in a downward bias in the calculation of water use per service.¹⁸⁰ Mr. Rauschmeier also incorrectly included contract services, or sales-for-resale, in his calculation. These services typically involve serving water to a contract customer through a single point of connection, which the contract customer then uses to serve

¹⁷² *Id.*, pp. 6-7.

¹⁷³ CALAM-TC-002, pp. 4-5.

¹⁷⁴ CALAM-DM-003 pp. 45-50.

¹⁷⁵ CALAM-SWO-002A, p. 9. Mr. Rauschmeier's errors were revealed in the workspapers used to prepare Figure 1. CALAM-DM-003, Attachment 1.

¹⁷⁶ *Id.*, p. 15.

¹⁷⁷ CALAM-DM-003, p. 50. Mr. Rauschmeier also incorrectly converted San Jose Water's water deliveries, leading him to substantially underreport the company's water delivery. CALAM-SWO-002A, p. 16.

¹⁷⁸ CALAM-DM-003, p. 50.

¹⁷⁹ CALAM-SWO-002A, p. 10.

¹⁸⁰ CALAM-DM-003, p. 51.

its own customers.¹⁸¹ For these customers, the reported use per connection is extremely large, and including contract water in the calculation creates an upward bias in use per connection.¹⁸²

Also concerning is Mr. Rauschmeier's false claim that the cumulative reduction in water use by CAW was significantly less than the reductions achieved by the M-WRAM companies.¹⁸³ CAW's cumulative reduction in consumption per connection from 2009 to 2021 was 28%, while the reduction for the four utilities operating without decoupling ranged from 15% to 19%, about a third to a half as much reduction as CAW.¹⁸⁴

Indeed, when corrected, Mr. Rauschmeier's Figure 2 shows that CAW has the <u>highest</u> cumulative reduction in consumption per connection of the analysis period, and that companies with the decoupling WRAM were able to achieve greater cumulative reductions in consumption per connection during period from 2009-2011 than the companies with M-WRAM.¹⁸⁵ This is consistent with analysis of Keith Switzer¹⁸⁶ on behalf of CWA, which shows that while all Class A water companies have achieved strong water use reductions, companies with decoupling mechanisms achieved substantially higher levels of water use reductions than companies with M-WRAMs.¹⁸⁷

d. The WRSP Is Most Consistent with State Conservation Policy

The California commitment to conservation has been made clear by the Legislature, Governor, and state agencies. Because the WRSP removes conservation disincentives, addresses forecasting challenges associated with water sales variability, and will allow CAW to maximize its conservation efforts, it best furthers State conservation policy. While CAW may still be able to achieve conservation under the M-WRAM, its inherent limitations make it a halfhearted measure. Consistent with the Legislature's directive in SB 1469 to further incentivize water conservation efforts, the CPUC should adopt the WRSP.

2. The WRSP Benefits CAW Customers

As discussed in more detail below, the WRSP better protects customer interests and will provide long-term savings for CAW's customers.

¹⁸¹ CALAM-SWO-002A, p. 18.

¹⁸² CALAM-DM-003, p. 52.

¹⁸³ CALAD-RR-001, p. 8.

¹⁸⁴ CALAM-DM-003, p. 54.

¹⁸⁵ CALAM-SWO-002A, p. 26.

¹⁸⁶ Mr. Switzer recently retired as Vice President of Regulatory Affairs from Golden State Water Company, where he was the senior officer in charge of regulatory issues involving the Commission and was responsible for all regulatory filings and proceedings involving eight separate water districts and one electric district. Notably, Mr. Switzer held this role during the development, adoption, and implementation of the WRAM/MCBA for Golden State Water Company.
¹⁸⁷ CAW-001, pp. 7-8.

a. The WRSP Protects Customers

The decoupling ESBA component of the WRSP ensures that differences between actual and authorized water sales do not result in an over- or under-recovery of CPUC-authorized water sales revenues. If there are under or over-collected balances in the ESBA due to differences between actual and authorized volumetric revenues or actual and authorized variable costs CAW will either return or collect the balances from customers via surcharge or surcredit.¹⁸⁸

CAW's proposed WRSP also complies with statutorily imposed customer protections. Section 727.5 of the Public Utilities Code Section requires that a "decoupling mechanism shall be designed to ensure that the differences between actual and authorized water sales do not result in the over-recovery or under-recovery of the water corporation's authorized water sales revenue" and "shall not enable the water corporation to earn a revenue windfall by encouraging higher sales."¹⁸⁹ While CAW is committed to conservation as a way of life, and would not encourage higher sales, under the WRSP (unlike the M-WRAM) it would not "earn a revenue windfall" if sales are higher than forecasted because the difference between the authorized quantity and the actual quantity will be captured in the ESBA.

b. The WRSP Simply Allows CAW to Recover CPUC-Approved Costs at a Later Time

To the extent that CAW recovers an overcollection in the ESBA via surcharge, it is important to remember that this is not additional revenue for CAW. Rather, this is the revenue that the CPUC found to be just and reasonable as part of the GRC process, but which CAW was unable to recover due to the inherent variability of water sales and aggressive conservation rates. Moreover, as discussed above, the ESBA provides for a true up of fixed costs. These costs, which include labor, benefits, maintenance, depreciation, and capital investment costs, are critical to CAW's ability to continue to provide safe and reliable water service to its customers, which make up the vast majority of CAW's cost of service. Ultimately, the WRSP, including the decoupling ESBA, is designed to provide for cost recovery of these critical costs.¹⁹⁰

PAO misleadingly characterizes these surcharges as fees that customers would pay for water service in addition to regular rates.¹⁹¹ Actually, the surcharges represent authorized and necessary costs that the utility was unable to recover at the time they were incurred due to lower-than-expected sales.¹⁹² The fact that CAW would

¹⁸⁸ CALAM-JTL-002, p. 18.

¹⁸⁹ Pub. Util. Code §§727.5(d)(2)(B)-(C).

¹⁹⁰ CALAM-SWO-002A, pp. 49-50.

¹⁹¹ CALAD-RR-001, p. 10.

¹⁹² CALAM-DM-003, p. 59.

recover the CPUC-approved costs in part through a decoupling mechanism does not shift additional costs to customers. It is simply another way in which the CPUC-approved costs are recovered.¹⁹³

a. The WRSP Will Provide Long-Term Savings for Customers

Not only will the WRSP protect CAW's customers, it will also lead to long-term cost savings due to conservation. Over time, conservation keeps rates lower than they would have been had conservation not taken place.¹⁹⁴ In regions with high water supply and infrastructure costs, water conservation is often the least-cost way to meet future water demands and deferring or reducing the need for new water supply infrastructure through increased conservation can yield large dividends for customers.¹⁹⁵

Dr. Chesnutt conducted a technical estimation of the economic benefit of conservation efforts by using avoided marginal costs of water service to value the savings.¹⁹⁶ He evaluated the costs that have been avoided by CAW's water efficiency efforts, and the impact this has had on customer bills. Dr. Chesnutt's analysis proves that CAW's sustained drive to lower per capita water use over the last decade has financially benefitted its customers.¹⁹⁷ For example, Dr. Chesnutt's modeling indicates that lower per capita water demand over the last decade reduced operating costs by 4.3-31.4% percent in the six service areas examined.¹⁹⁸

CAW's results are consistent with a wide body of research into the long-run benefits of conservation for customers.¹⁹⁹ Indeed, a study of the Los Angeles Department of Water and Power determined that water conservation allowed the agency to avoid supply costs totaling \$11 billion.²⁰⁰ As Dr. Chesnutt explained, "Investing in water conservation directly benefits customers by helping to slow the increase in water service costs over time. Economic investments in water efficiency are critical to help ensure that water utilities can continue to provide water service that is both affordable and sustainable."²⁰¹ By allowing CAW water to maximize its conservation and water efficiency efforts, the WRSP will result in long-term cost savings to the benefit of customers.

b. The ACAM Will Mitigate Future Large WRSP Balances.

One of the key factors that helped CAW's WRAM balance reach the current historically low level is the adoption of the ACAM for the Monterey District in 2018 and the expansion of it to most service areas in 2021.²⁰² Mr.

- ¹⁹⁸ *Id.*, Attachment 2, p. 2.
- ¹⁹⁹ *Id.*, p. 5.
- ²⁰⁰ *Id.*, p. 7.
- ²⁰¹ CALAM-TWC-001, p. 5.

¹⁹³ CALAM-BV-001A, p. 12.

¹⁹⁴ CWEP-MAD-001, p. 8.

¹⁹⁵ CALAM-TWC-001, Attachment 2, p. 25.

¹⁹⁶ CALAM-TWC-001, Attachment 2.

¹⁹⁷ *Id.*, Attachment 2, pp. 24-26.

²⁰² D.21-11-018, pp. 156-157.

Mitchell studied the performance of the ACAM and a weather-adjusted ACAM against GRC sales forecasts and found that the mean absolute percentage error ("MAPE") for the ACAM and weather-adjusted ACAM was much lower. In the case of the weather-adjusted ACAM, the performance was 50% better in terms of forecast accuracy over the GRC sales forecasts for the 12-year period of his study.²⁰³

While, as discussed above, the ACAM is necessary whether or not the CPUC adopts the WRSP, it is particularly helpful in reducing balances related to decoupling. For example, if the ACAM had been in effect during the years 2010-2015, it would have reduced the net WRAM/MCBA undercollection for the Monterey District by \$10.3 million.²⁰⁴ Indeed, in contrast to the multi-million-dollar WRAM/MCBA balances that CAW accrued prior to the ACAM, the WRAM/MCBA for 2021 for the Monterey District was net under-collected by only \$161,640.²⁰⁵

The ACAM benefits both CAW and its customers by updating sales forecasts during the GRC period. By reducing balances related to decoupling, the ACAM lowers rates to customers by shortening the period that the balancing account accrues interest. As such, it is a key component of the WRSP. Without the ACAM, the WRSP would run into the same issues regarding large balances that water utilities and customers face when the WRAM/MCBA was first implemented.

PAO did not address any of CAW proposed modifications to the ACAM. Instead, PAO witness Mukunda Dawadi, Program and Project Supervisor in the Water Branch, argues that the CPUC should not authorize the ACAM because modification of the sales forecast in between GRCs is a significant departure from the CPUC's Rate Case Plan.²⁰⁶ The CPUC, however, has already rejected PAO's arguments regarding adjusting rates between GRCs. In D.16-12-003, the CPUC stated, "in establishing just and reasonable rates we have adopted special mechanisms to handle particularly volatile revenues and expenses since at least the 1970s… a well designed and implemented ACPP/CAM will not unreasonably be based on a single issue, nor produce rates that are unjust and unreasonable."²⁰⁷

PAO also claims that the ACAM will create "administerial issues for the CPUC." As noted above, however, similar mechanisms have been in place for energy utilities for decades, for California Water Service Company since 2015, and for CAW since 2019.²⁰⁸ The smooth implementation of the ACAM belies PAO's claims of "administerial issues." Moreover, although PAO also argues that the ACAM results in "continually adjusted water bills,"²⁰⁹ the

²⁰³ CALAM-DM-001, Attachment 2, p. 20.

²⁰⁴ CALAM-JTL-001, Attachment 1.

²⁰⁵ *Id.*, p. 31.

²⁰⁶ CALAD-MD-001, p. 49.

²⁰⁷ D.16-12-003, p. 69; see CALAM-SWO-002A, p. 74.

²⁰⁸ CALAM-SWO-002A, pp. 76-77.

²⁰⁹ CALAD-MD-001, p. 49.

current ACAM rate changes are implemented in conjunction with GRC or step-rate changes, and the proposed second ACAM rate changes would align with purchased water offset filings. Therefore, the ACAM would not result in additional rate changes for customers, let alone "continual adjustments."

The proven success of the ACAM shows that it provides a significant benefit to customers. CAW's proposed modifications will only increase its beneficial impact. The CPUC should authorize CAW to implement the modified ACAM as part of the WRSP.

c. The WRSP Amortization Component Will Further Protect Against Excessive Balances

As discussed above, under the settlement filed on November 17, 2023, CAW and PAO agreed to the continuation of the 15% cap of the authorized revenue requirement for recovery of the under-collected WRAM/MCBA balances.²¹⁰ The parties did not reach agreement on CAW's Special Request 14 to collect balances beyond the 15% cap if under-collected WRAM/MCBA or WRSP balances grow large enough that they cannot be recovered in less than 24 months.

Objecting this request, Mr. Dawadi characterizes WRAM surcharges as a topic of "frequent complaint" by customers.²¹¹ As CAW witness Jonathan Morse²¹² explained, however that CAW has only received seven complaints about the WRAM in the last five years, and only a small portion of the public comments in this docket mention the WRAM. Since CAW serves approximately 187,000 customers this hardly constitutes "a frequent complaint."²¹³ Mr. Dawadi also asserts that removal of the 15% cap in extraordinary circumstances would "be inconsistent with reasonable rates."²¹⁴ Since WRAM surcharges simply allow CAW to recover revenue that the CPUC has already determined is just and reasonable, however, his assertion has no basis.

As discussed previously, water sales have a high degree of variability, and factors out of CAW's control, such as weather and availability of water can significantly impact sales and lead to large undercollected balances.²¹⁵ With the existing 15% cap, it could take several years for CAW to collect WRAM balances, leading to intergenerational inequities for customers.²¹⁶ This special request would align recovery more closely to when costs

²¹³ CALAM-JM-002, p. 7.

²¹⁰ Settlement Agreement Motion, Exhibit A, pp. 34-35.

²¹¹ CALAD-DM-001, p. 51.

²¹² Mr. Morse has more than a decade of experience in utility regulation and is the Senior Manager of Rate and Regulatory for CAW. He previously worked as a consultant on projects related to rate design, sales forecasting, and conservation, as an economist for the District of Columbia Public Service Commission. CALAM-JM-001, p. 2.

²¹⁴ CALAD-DM-001, p. 51

²¹⁵ CALAM-JTL-002, p. 13.

²¹⁶ *Id*., p. 13.

are incurred.²¹⁷ The CPUC should approve Special Request 14 so that CAW can shorten the amortization period under extraordinary circumstances.

d. The WRSP Benefits Low-Income Customers

As discussed above, the M-WRAM creates an incentive for water utilities to increase sales and to mitigate revenue risk. Both of these factors encourage the utility to want to recover more revenue through service charges and flatten the tiers in their rate design. This will lower the marginal cost of water faced by the highest-volume water users and raise it for those customers already using the least amount of water.²¹⁸ Low-volume customers will pay more for water service while high-volume customers can expect to pay less.²¹⁹ Customers enrolled in low-income assistance programs use less water, on average, than other customers, and thus are disproportionately impacted by higher fixed service charges.²²⁰ Although the WRSP is not designed to be a low-income assistance program, low-income customers will fare better under decoupling than the M-WRAM.

e. The Record Evidence Does Not Support PAO's Claims of Customer Harm In his testimony, Mr. Rauschmeier makes multiple claims regarding the ways in which decoupling can harm customers. As discussed below, however, his claims are grossly exaggerated and contradicted by the evidence in the record of this proceeding.

(1) The WRSP Will Not Have Significant Impact on Customer Bills Mr. Rauschmeier claims that the WRSP will have a significant impact on customer bills.²²¹ In support of this claim, Mr. Rauschmeier asserts that from 2010-2021, CAW amassed as cumulative WRAM balance of nearly \$300 million in ratepayer surcharges, as shown in Figure 3 of his testimony.²²² As with Mr. Rauschmeier's calculations of water usage discussed previously, however, his calculation of cumulative net WRAM surcharges includes a very basic error.

The WRAM/MCBA calculates the difference between authorized revenues (including sales and production costs) and actual revenues. The WRAM/MCBA balance reflects this difference and the surcharge or surcredit is how CAW collects or refunds the balance.²²³ WRAM/MCBA surcharges implemented to recover undercollected WRAM/MCBA balances reduce the undercollected WRAM/MCBA balance.²²⁴ In Figure 3, Mr. Rauschmeier sums

²¹⁷ CALAM-JM-002, p. 8.

²¹⁸ CALAM-DM-002, p. 23.

²¹⁹ The analysis by Mr. Mitchell and Dr. Chesnutt indicates this is how it has in fact played out between the fully decoupled utilities and those operating under the M-WRAM. CALAM-DM-002, Attachment 2, p. 7.

²²⁰ CALAM-DM-002, p. 11.

²²¹ CALAD-RR-001, p. 8.

²²² *Id.*, pp. 9-10, Figure 3.

²²³ CALAM-SWO-002A, p. 38.

²²⁴ *Id.*, p. 40.

the cumulative WRAM/MCBA balances and then sums the cumulative WRAM/MCBA surcharges and surcredits on top of that.²²⁵ As such, Mr. Rauschmeier in effect double counts what he calls "Cumulative net WRAM surcharges" because he sums WRAM/MCBA balance activity for a given year <u>and</u> surcharge activity for that year.²²⁶

Mr. Rauschmeier also claims that the WRSP would require an increase in average system rates greater than \$1 million more than under the M-WRAM.²²⁷ The difference that Mr. Rauschmeier refers to is caused by the lower sales forecast under the WRSP due to the impact of the WRSP's more conservation-oriented rate design. This reduction in sales forecast leads to a lower present rate revenue of approximately \$1.6 million which makes the dollar rate increase higher.²²⁸ This is not an increase to the proposed revenue requirement, however. In fact, the WRSP proposed revenue requirement (\$344.2 million) is approximately \$600,000 lower than the revenue requirement under the alternative M-WRAM proposed revenue requirement (\$344.8 million).²²⁹ The data simply does not support Mr. Rauschmeier's claim that the WRSP will have a very significant impact on customer bills.

(2) The WRSP Will Not Allow CAW to Generate "Extraordinary Profit" Mr. Rauschmeier claims that decoupling is being used "to generate extraordinary profits."²³⁰ CAW's actual experience, however, disproves Mr. Rauschmeier's claim. During the period 2010-2022, CAW averaged an actual ROE approximately 131 basis points <u>below</u> CPUC-authorized levels.²³¹ CAW achieved ROEs below CPUC authorized levels in 11 of the 13 years, meaning that in those years CAW did not even achieve CPUC authorized levels of profit, let alone "extraordinary profits."²³² Without the decoupling WRAM/MCBA, CAW would have averaged an actual ROE of approximately 412 basis points below the CPUC authorized levels, and it would have been impossible for CAW to maintain, aggressive conservation rate designs, proactive conservation programming and messaging, and continued the level of capital investment without sustaining harmful financial impacts.²³³

Ignoring the actual data available to him, Mr. Rauschmeier instead relies on an ill-conceived hypothetical in which a utility does not recover five percent of its the authorized revenue, while at the same time achieving nonsupply-related cost savings equal to ten percent of the authorized revenue requirement and providing shareholders their full adopted return in the reduced revenue. Mr. Switzer's analysis of what would be necessary to achieve such

²²⁵ *Id.*, pp. 38-40.

²²⁶ *Id.*, pp. 40-43. WRAM balances peaked during 2016-2018 due the impact of the drought and the inclusion of the recently metered Sacramento district in the WRAM/MCBA, and that CAW's 2021 WRAM balances are lower than any year since 2010. ²²⁷ CALAD-RR-001, p. 10.

²²⁸ CALAM-SWO-002A, p. 47.

²²⁹ *Id.*; see CALAM-BP-002, Attachment 1.

²³⁰ CALAD-RR-001, p. 10.

²³¹ CALAM-SWO-002A, pp. 56-57.

²³² *Id.*, p. 56. CAW did earn slightly above its authorized ROE in two years, but that was due to one-time items and will not likely be repeated.

²³³ *Id.*, p. 59.

savings indicates that while Mr. Rauschmeier's hypothetical may be mathematically possible, it is not realistically achievable.²³⁴ Additionally, Mr. Owens provides a real-world example of how the fluctuations in usage would have prevented CAW from recovering 35% of the CPUC-authorized fixed costs in the Ventura County District absent a decoupling mechanism.²³⁵ Finally, Mr. Rauschmeier's characterization of decoupling as mainly a way for investor-owned water utilities to "generate extraordinary profits" is inconsistent with the adoption of decoupling by public water agencies across the country, discussed previously.

(3) The WRSP Eliminates Risks for both CAW and its Customers

Mr. Rauschmeier inaccurately claims that decoupling shifts forecasting risks from CAW to its customers. The CPUC, however, has already determined that decoupling does not cause such a shift with respect to forecasting risk. "The WRAM/MCBA mechanism removes most of those consequences from the water utility and removes most of the risk from customers, by adding a means to adjust future rates to meet the approved revenue requirement."²³⁶

Mr. Rauschmeier acknowledges that the variations around water demand levels are not symmetric.²³⁷ As CAW witness Bente Villadsen²³⁸ explained, CAW's authorized rate of return does not compensate for asymmetric risk of the sort generated by California's climate and hydrology.²³⁹ Moreover, the fact that CAW has a greater exposure to demand risk than customers does not mean that the WRSP treats CAW more favorably. Equitable treatment of risk does not require that the risks be evenly distributed, as Mr. Rauschmeier contends.²⁴⁰

Allowing CAW to recover the revenue that the CPUC has determined is just and reasonable and necessary for safe and reliable service, is not a "risk" to customers. As Dr. Villadsen explained, "Whether such authorized costs are recovered in a current period as, for example, a fixed charge or in a future period through a surcharge does not change the nature of such costs nor the fact that they are part of the authorized revenue requirement."²⁴¹

f. The WRSP Provides Better Outcomes for Customers than the M-WRAM As discussed above, as compared to the M-WRAM, the WRSP better protects customers by preventing CAW from realizing "revenue windfalls" due to consumption fluctuations, and will lead to long-term customer

- ²³⁹ CALAM-BV-001A, pp. 5-8.
- ²⁴⁰ CALAM-DM-003, p. 61.

²³⁴ CWA-001, pp. 20-22.

²³⁵ CALAM-SWO-002A, pp. 53.

²³⁶ D.20-08-047, p. 73.

²³⁷ CALAD-RR-001, p. 12.

²³⁸ Dr. Villadsen has twenty-five years of experience working with regulated utilities on cost of capital and regulatory matters. She was a faculty member at Washington University in St. Louis, University of Michigan, and University of Iowa and served as the president of the Society of Utility Regulatory Financial Analysts. Dr. Villadsen is also co-author of the book Risk and Return for Regulated Industries.CALAM-BV-001A, Exhibit BV-1.

²⁴¹ CALAM-BV-001A, p. 10.

savings through conservation efforts. The WRSP does not harm customers, but instead merely allows CAW the opportunity to recover the fixed costs that the CPUC has already determined is just and reasonable. The CPUC should therefore adopt the WRSP.

3. The CPUC Should Adopt CAW's Proposed Rate Design

Above, CAW described its proposed rate designs under the WRSP and the M-WRAM, as well as PAO's proposed rate design. CAW's proposed rate designs are exclusive to each mechanism. In particular, the WRSP rate design is incompatible with the M-WRAM. As discussed in more detail below, CAW's rate designs are consistent with CPUC policy, were analyzed using sophisticated bill impact models to explicitly account for the interrelationship between quantity demanded and the price of service, and strike a reasonable balance between the competing objectives of revenue recovery and stability, conservation, and affordability. By contrast, PAO's rate design does not follow the CPUC's guidelines regarding recovery of fixed costs or to the design of residential inclining block rates. Moreover, PAO failed to provide a valid assessment of impacts of its proposed rate design on customer water use, bills and revenue recovery. Instead, PAO bases its analysis on assumptions about consumer behavior and the interdependence of quantity demanded and price that are demonstrably incorrect.²⁴² Quite simply, PAO failed to provide a workable rate design.

a. CAW's Rate Designs are Consistent with CPUC Guidance

At issue is the guidance provided by the CPUC with respect to two issues: (1) recovery of fixed costs in the service charge and (2) the appropriate level of usage allowed in the first tier of conservation rates.

As discussed above, in D.16-12-026 the CPUC established a 40% floor for cost recovery in the meter charge, with the flexibility to proposed collection of up to 50%, and an "out clause" for extraordinary local circumstances.²⁴³ Consistent with this guidance, under the M-WRAM CAW proposed to increase the percent of the fixed cost recovery in the meter charge to 50% of fixed cost recovery for all service areas except for the Monterey Central Satellite systems, where CAW proposed to set the meter charge at 35% of fixed cost recovery due to unique local circumstances.²⁴⁴ Under the WSRSP, CAW proposed to decrease the amount recovered through the fixed charge to 45% in multiple districts,²⁴⁵ remaining consistent with D.16-12-026

Although PAO's rate design witness Hubert Merida, a Public Utilities Regulatory Analyst IV, claimed that PAO's rate design proposal is consistent with this decision, PAO's rate design actually reflects service charge revenue recovery percentages that fall below the floor set by the CPUC in every CAW rate area except

²⁴² CALAM-DM-003, p. 43.

²⁴³ D.16-12-026, pp. 57, 88 (Ordering Paragraph 13).

²⁴⁴ CALAM-BP-001, p. 42.

²⁴⁵ CALAM-DM-003, p. 28.

Meadowbrook.²⁴⁶ Moreover, in five of these nine areas, PAO's rate design reduces service charge revenue recovery from CAW's current 40% level to a level between 34%-39%.²⁴⁷

In establishing the usage reflected in the first tier of its rate designs, CAW, with a few justified exceptions, follows the CPUC's guidance in D.20-08-047, which directs water utilities not to set the width of the first block of a residential inclining block rate lower than 6 ccf or average winter use, whichever is <u>greater</u>.²⁴⁸ The usage in the first block of CAW's inclining block rates (also referred to as the block width) either aligns with or slightly exceeds average winter use.²⁴⁹ Citing D.20-07-032, in which the CPUC established 6 ccf per month as the level of essential water service (but did not address rate design), Mr. Merida proposed to set the width of the first block in every system to 6 ccf.²⁵⁰ PAO's proposal is inconsistent, however, with the CPUC's directive to take into account average winter usage. PAO's proposal appears to have been motivated by expediency, not the needs of CAW's customers.

b. PAO Failed to Address Price Elasticity

In developing its rate designs, CAW engaged Mr. Mitchell's firm, M. Cubed, to evaluate bill impacts of alternative designs using sophisticated bill impact models that explicitly account for the interrelationship between quantity demanded and the price of service.²⁵¹ Mr. Mitchell performed a sales simulation of the updated rate design using 2021 billing data and empirically derived price response parameters for both the M-WRAM and WRSP rate designs.²⁵²

Although PAO could have used Mr. Mitchell's estimated price elasticities to analyze the impact of its proposed rates on residential sales and water bills, or adopted elasticity estimates based on other research, it instead apparently assumed that demand is perfectly inelastic.²⁵³ Mr. Merida assumes that customers will demand the same amount of water whether they pay the single block uniform rate (the standard quantity rate or SQR) or a higher or lower inclining block rate. Mr. Merida's assumption, however, is inconsistent with the most fundamental tenet of economics, the law of demand, which stands for the principle that the quantity demanded of that good or service will decrease, and conversely, as the price of a good or service decreases, the quantity demanded of that

²⁴⁶ *Id.*, pp. 21, 28.

²⁴⁷ Id., p. 21, citing CALAD-HM-001, p. 22, Table 2-1.

²⁴⁸ D.20-08-047, pp. 76-77.

²⁴⁹ CALAM-DM-003, pp. 32, 33.

²⁵⁰ CALAD-HM-001, Attachment 2-2, footnote 68.

²⁵¹ CALAM-JTL-001, p. 103.

²⁵² CALAM-DM-001, Attachment 3; CALAM-DM-002, Attachment 2.

²⁵³ CALAM-DM-003, p. 38.

good or service will increase, all else being equal.²⁵⁴ The law of demand is one of the most widely accepted principles in economics and its application to residential water service is well-established.²⁵⁵

Mr. Merida's assumption is also inconsistent with the CPUC's presumption regarding inclining block rates, which is that they will cause customers to consume less water than they would when all units are priced at a single block standard quantity rate.²⁵⁶ Because PAO failed to evaluate the impact of his recommended rate design on sales volume and customer bills, CAW likely would not able to recover its authorized revenue requirement under Cal Advocate proposed rate design.

This is just one of the ways in which Mr. Merida's rate proposal reflects an inherent lack of understanding of fundamental rate design concepts. In rate design, different elements, such as tier breakpoints, consumption in each tier, and rate step-ups, are interconnected. They work together to send price signals to consumers and generate the revenue authorized by the CPUC.²⁵⁷ If you pick and choose different components from different rate designs, as Mr. Merida did, the result is an imbalanced rate design that does not allow the utility to recover the authorized revenue and fails to achieve intended policy goals.²⁵⁸ PAO's rate design is deeply flawed, unnecessarily confusing to customers, and inconsistent with revenue neutrality. The CPUC should reject PAO's rate design and instead adopt one of the rate designs proposed by CAW based on its decision regarding the WRSP.

4. The Preponderance of the Evidence Supports the Adoption of the WRSP

As discussed above, the preponderance of the evidence standard is met when the evidence in support of a proposal has more convincing force and the greater probability of truth when weighed with that opposed to it.²⁵⁹ Multiple expert witnesses with decades of water policy experience testified in support of the WRSP. As discussed above and as demonstrated by the record, the written testimony provided in support of the WRSP is grounded in fact, supported by data, and consistent with State and CPUC policy. By contrast, the testimony provided by PAO against the WRSP is not as convincing and has a lesser probability of truth. In particular, as discussed above, the testimony of Mr. Rauschmeier and Mr. Merida contains substantial errors and reflects a troubling lack of understanding of fundamental concepts. The CPUC should give such testimony little weight.

IV. CONCLUSION

For the reasons discussed above, and in keeping with the intent of the Legislature and State policy, the CPUC should adopt the WRSP.

²⁵⁴ *Id.*, p. 36, fn. 62.

²⁵⁵ *Id.*, p. 36, fn. 62.

²⁵⁶ *Id.*, P. 37, referencing D.08-02-036.

²⁵⁷ CALAM-BP-003, p. 32.

²⁵⁸ *Id.*, pp. 28-62.

²⁵⁹ D.18-12-021, p. 10.

Respectfully submitted,

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