

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Application of California American Water Company (U210W) for Authorization to Implement the Carmel River Reroute and San Clemente Dam Removal Project and to Recover the Costs Associated with the Project in Rates.

A.10-09-018
(Filed September 22, 2010)

**APPLICATION FOR REHEARING OF THE DIVISION OF RATEPAYER
ADVOCATES OF DECISION 12-06-040**

I. INTRODUCTION

On June 27, 2012, the Commission issued its “Decision Authorizing California-American Water Company to Implement the Carmel River Reroute and San Clemente Dam Removal Project.” Pursuant to Rule 16.1 of the Rules of Practice and Procedure of the California Public Utilities Commission (“Commission”),¹ the Division of Ratepayer Advocates (“DRA”) respectfully submits this Application for Rehearing (“Application”) of Decision (“D.”) 12-06-040 (“the Decision”).

DRA wholeheartedly supports the California American Water Company (“Cal Am”) Carmel River Reroute and San Clemente Dam Removal Project (“Project”) in order to eliminate the seismic safety hazard, restore the natural character and function of the valley bottom, and restore steelhead fish passage. This Application does not seek to deter or impede the Project from moving forward, and DRA agrees that ratepayers should pay the reasonable expenses of the San Clemente Dam reroute and removal project. So, to be clear, DRA does not challenge the Decision insofar as it authorizes Cal Am to recover from ratepayers the reasonable expenses of the Project.

¹ Rule 16.1 provides that an application for rehearing shall be filed within 30 days after the date the Commission mails the order or decision. D.10-09-018’s date of issuance was June 27, 2012.

The Decision, however, also authorizes Cal Am to recover from ratepayers a return, equivalent to its authorized rate of return on capital investment in utility plant, on the going forward forecasted expenses of the Project. (Conclusions of Law 8 and 12.) In other words, although the Project consists of *removing* the dam (which the Decision also finds has been and is “used and useful” despite evidence to the contrary) and rerouting the Carmel River, the Decision authorizes Cal Am to earn a profit on the Project costs as though the Project were *adding* utility plant. The Decision authorizes Cal Am ultimately to add those expenses to rate base and earn a profit on them for years to come.

To authorize Cal Am to earn a full rate of return on Project expenses that will indisputably result in no used and useful asset is contrary to law, is unsupported by adequate findings and by the evidentiary record, and constitutes an abuse of discretion. These are all grounds for reversal pursuant to Public Utilities Code section 1757. The Commission can and should rectify this error.

II. STANDARD OF REVIEW

Public Utilities Code Section 1757 provides that a Commission decision may be vacated by a reviewing court when “the findings in the decision of the commission are not supported by substantial evidence in light of the whole record.”² Findings that are not supported by substantial evidence constitute a prejudicial abuse of discretion.

Rule 16.1 directs applicants for rehearing to “set forth specifically the grounds on which the applicant considers the order or decision of the Commission to be unlawful or erroneous.”³ “The purpose of an application for rehearing is to alert the Commission to a legal error, so that the Commission may correct it expeditiously.”⁴

² Public Utilities Code §1757(a)(1) and (a)(4).

³ Rule 16.1(c) Application for Rehearing.

⁴ Rule 16.1(c) Application for Rehearing.

III. ARGUMENT

A. The Decision Erred In Finding That the Dam Has Been And Is Used and Useful

The Decision concludes that the Dam “has been and is a used and useful asset.” (Conclusion of Law No. 2.) This conclusion is unsupported by the record and contrary to law and therefore constitutes legal error. DRA presented arguments on this point in its comments on the Alternative Proposed Decision.

The Decision does not appear to rely on this legal conclusion to authorize a return on equity for the going forward costs of the Project. It relies on other grounds. See Conclusion of Law No. 8. (Those grounds, also unsupported by the law and the facts, are discussed in another section of this Application.).

The Decision finds that the existing San Clemente Dam is presently a “used and useful” utility asset because: (1) Cal Am has maintained water permits that allow it to use the Dam as source of water supply to customers pursuant to existing water permits; (2) Cal Am also has permits to divert water in emergencies; and (3) the Dam holds in place accumulated sediment thereby minimizing downstream impact to fishery and frog habitat and to property owners.⁵ As stated above, the Decision does not appear to rely on this conclusion in authorizing Cal Am to earn its authorized cost of capital on project costs. Nevertheless, the erroneous conclusion should be corrected.

A water utility may only earn a return on “used and useful” utility assets.⁶ To be “used and useful” an asset must be used and useful for providing utility service.⁷ The Decision omits that crucial element of a “used and useful” public utility asset by defining it “as one that provides direct and ongoing benefits to ratepayers” (pointing also to permits allowing the utility to divert water in an emergency situation.)⁸ The Dam has

⁵ D.12-06-040, pp. 13-17 and Conclusion of Law 5.

⁶ D. 85-08-046; Cal. Pub. Utils. Code § 790; 701.10(a).

⁷ Cal. Pub. Utils. Code §§ 790, 701.10, 7.27.5(a).

⁸ Decision, p. 16.

not been used to provide service since 2003. The Decision's failure to consider whether the Dam is used in providing service is therefore material and constitutes legal error.

B. The Project Will Not Result In Plant That Is Used and Useful In The Future

It is undisputed that once the San Clemente Dam is removed and no longer exists, it will not be used and useful in providing utility service to Cal Am's customers. The Decision makes no finding that the Dam will be used and useful in providing utility service to Cal Am's customers once it is removed. Authorizing Cal Am to earn a rate of return on expenses for removing the San Clemente Dam will not be used and useful going forward is legal error.

We summarize the relevant facts. In 1995, the State Water Resources Control Board ("SWRCB") determined that Cal Am was diverting 10,730 acre-feet per year ("afy") without a valid water right. SWRCB Order 95-10 noted that "Cal Am, extracts, on average 14,106 afa via 21 wells from the alluvial aquifer along the Carmel River. Cal Am claims the right to divert and use this water under pre-1914 appropriative, riparian, proscriptive and rights acquired under License 11866." Of this 14,106 afy, the SWRCB determined that Cal Am had a legal right to divert only 3,376 Acre-Feet per year ("afy") from the Carmel River.² This consisted of 1,137 afy in pre 1914 appropriative rights, 60 afy in riparian rights, and 2,179 afa under SWRCB License 11866 which sum to 3,376 afy. Order 95-10 further required Cal Am to satisfy the demands of its water customers "by extracting water from its most downstream wells, to the maximum extent possible without degrading water quality or significantly affecting the operation of other wells."¹⁰

While Cal Am has reduced its withdrawals from the Carmel River since the issuance of Order 95-10, it still withdraws far in excess of its legal right of 3,376 afy from the Carmel River each year. These facts demonstrate that Cal Am can and does access the 3,376 afy from the Carmel River that it is legally entitled to without relying upon the non-functioning San Clemente Dam diversion point. The existing facilities are

² Order WR 95-10. This includes 1,137 afy in pre 1914 Appropriative rights, 60 afy in riparian rights, and 2,179 afa under SWRCB License 11866 which sum to 3,376 afy.

¹⁰ Order 95-10. In 1995, Cal Am had 21 wells on the Carmel River.

plainly more than adequate to draw water from the Carmel River.¹¹ The Project simply is not needed to supply water for utility service and that is not its purpose. Because the Project does not constitute utility plant and will not be used to provide service when it is completed, it will not result in an asset that is used and useful in the future.¹²

C. The Decision’s Finding That Shareholders Should Earn an Equity Return on the Project Is Unsupported By the Law and the Facts in Evidence

The Decision in Conclusion of Law 8 gives two reasons for authorizing an equity return on the San Clemente Dam Project expenses. The first is that the costs are for the removal of plant in service, and the second is that the amortization period is 20 years. DRA can find no basis in law or fact cited in the Decision to support allowing Cal Am to earn its authorized rate of return on the San Clemente Dam reroute and removal project for these reasons.

1. CAL AM’s Water License and Permit Do Not Make The Dam Used and Useful.

Finding that the San Clemente Dam is “used and useful” because it is available as a source of water supply to customers with existing water permits is a misapplication of the “used and useful” principle. First, the Dam is neither necessary nor appropriate as a source of water supply to Cal Am customers.¹³ Second, it is not reasonable to burden ratepayers with a rate base treatment for multiple facilities performing or intended to perform the same function.¹⁴

¹¹ Order WR 95-10.

¹² The Federal Energy Regulatory Commission (“FERC”) , in an order regarding four water storage projects, has had occasion to apply the “used and useful” requirement in somewhat comparable circumstances. In one case, two dams had some effect on the stream in question, but the dams impounded only a small amount of water in the river system, which made them unlikely to have a material effect upon two other projects. From this information, FERC concluded that those two dams were “neither used and useful” nor “necessary and appropriate.” Union Water Power Co. Kennebec Water Power Co., 73 FERC ¶ 61296 (F.E.R.C. Dec. 8, 1995).

¹³ Union Water Power Co. Kennebec Water Power Co., 73 FERC ¶ 61296 (F.E.R.C. Dec. 8, 1995) (Dam facilities providing a small amount of water in the river systems were unlikely to have a material effect and were found neither used or useful nor necessary or appropriate. Such use would be “redundant surplusage.”).

¹⁴ D. 11-09-017 (2011) (“The Commission rejected Golden State’s rate base proposal because it is unreasonable to burden ratepayers with a rate base treatment for two facilities performing or intended to

The Federal Energy Regulatory Commission (“FERC”), in an order on jurisdiction regarding four water storage projects, provided clarification for the phrase “used and useful.”¹⁵ Two of the dams in question had some effect upon power generation, but both impounded only 6.79 percent of water in the river system.¹⁶ This small amount made these dams unlikely to have a material effect upon the other downstream projects.¹⁷ From this information, FERC concluded that these facilities were “neither used and useful” nor “necessary and appropriate.”¹⁸ Otherwise, all facilities would be “redundant surplusage.”¹⁹

Additionally, in D.11-09-017, the Commission held that “it is unreasonable to burden ratepayers with a rate base treatment for two facilities performing or intended to perform the same function.”²⁰ Otherwise, the Commission is asking ratepayers to pay twice while Cal Am only delivers water once.²¹

The San Clemente Dam was not built to be a point of diversion. It was built to be used and useful for storage so that water could be stored in the winter for release in the summer and historically it functioned that way for many years. Cal Am, ceased using the Dam as a diversion point in 2003.²² The fact that it could still be a diversion point under licenses from the SWRCB doesn’t make it used and useful.

These facts demonstrate that Cal Am can access the 3,376 afy from the Carmel River it is legally entitled to²³ without relying upon the non-functioning San Clemente Dam diversion point. It also demonstrates that the existing facilities for the provision of water from the Carmel River are adequate; new ones are not needed.

perform the same function and while it is reasonable to return the undepreciated balance, it is not reasonable for ratepayers to pay a return on equity.”)

¹⁵ Union Water Power Co. Kennebec Water Power Co., 73 FERC ¶ 61296 (F.E.R.C. Dec. 8, 1995).

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ D. 11-09-017 (2011).

²¹ *Id.* (Golden State “is asking its customers to pay twice, but is only delivering water once.”).

²² Exhibit 23, Attachment 4-2.

²³ Order WR 95-10.

Cal Am and MPWMD jointly hold appropriative rights of up to 2,426 afy of Carmel River Water under permit 20808A that can be diverted to storage in the Seaside Groundwater Basin in the winter months.

Cal Am already utilizes the maximum amount of water allowable from the Carmel River from its wells on the Carmel River and its rights to divert water from the San Clemente Dam are not exclusive to that location and have been used downstream. Further, the diversion point is in disrepair and is more of a potentiality than an actual diversion point. Therefore, the so-called diversion point provides no additional benefit to Cal Am water diversions within that river system and is not needed. Compelling Cal Am customers to pay for “redundant surplusage” is therefore unreasonable and is contrary to the purpose and meaning of the “used and useful” principle.²⁴

The San Clemente Dam is not only unnecessary and unused as a source of water for Cal Am, but the dam is nearly 100% silted up and has become a seismic hazard, thus necessitating its removal. In fact, these are the primary reasons for removing the Dam to begin with. Thus, rather than serving as a “used and useful” utility asset, San Clemente Dam has become a hazard.

If the existing water rights, which are not exercised through diversions from the San Clemente Dam, make the Dam “used and useful,” the Commission is asking Cal Am customers to pay for a redundant mechanism to supply water (that Cal Am already diverts from wells on the Carmel River.

Additionally, in D.11-09-017, the Commission held that “it is unreasonable to burden ratepayers with a rate base treatment for two facilities performing or intended to perform the same function.”²⁵ Finally, Cal Am is also currently pursuing a replacement long term water supply project that will provide a total of 15,250 afy to its customers from a desalination plant, expanded aquifer storage and recovery and a groundwater replenishment project.²⁶ The purpose of this project is to enable Cal Am to reduce its

²⁴ Under “used and useful” principles, ratepayers are required to bear only the reasonable costs of those projects, which are “used and useful” in providing adequate and reasonable service.

²⁵ D. 11-09-017 (2011).

²⁶ See A.04-09-019.

unlawful pumping on the Carmel River to its legal limit of 3,376 acre feet per year. In sum, Ratepayers are already receiving an adequate amount of water supply from existing facilities and will be obtaining replacement supplies to comply with SWRCB Order 95-10.

2. The Record Shows That the Dam Is Not A Source of Emergency Water Supply

One of the grounds that the Commission relied upon for finding that the San Clemente Dam is “used and useful” is that it can be used for water supply to customers in emergencies. This finding is a misapplication of the “used and useful” principle.

First, it is unlikely that Cal Am will use the Dam as water supply in an emergency in the foreseeable future.²⁷ The test generally applied with regard to inclusion in the rate base of property held by a public utility for future use is whether the time for using the property is so near that it may properly be held to have the quality of working capital.²⁸ Additionally, in *Re Ohio-Am. Water Co.*, a company witness, when asked whether a tank had holes in it, claimed that even though it was currently not being used, that it could be used.²⁹ The Commission found that this testimony was a tacit admission that the tank was not “used and useful” and should be excluded from the rate base.³⁰

Cal Am ceased using the Dam as a diversion point in 2003 and has never used it as an emergency source since the dam was constructed in 1921.³¹ Furthermore, the Dam does not have any facilities to provide emergency water supply and the possibility of doing so would require an “extreme emergency” and at least 24 hours to bring in a pump, connect it, and then ensure that the water quality emitted from it was acceptable for drinking.³² Moreover, Cal Am has other more readily available options for use in

²⁷ A “used and useful” review examines whether an investment will be capable of providing adequate service to the utility’s customers in the foreseeable future. *See* D.50909; D.88-04-068; D.05-04-055; D.98-12-049.

²⁸ *See* *Columbus Gas & Fuel Co. v. Public Utilities Commission of Ohio*, 292 U.S. 398, 54 S. Ct. 763, 78 L. Ed. 1327, 91 A.L.R. 1403 (1934); *Latourneau v. Citizens Utilities Co.*, 125 Vt. 38, 209 A.2d 307 (1965).

²⁹ *Re Ohio-Am. Water Co.*, 41 P.U.R.4th 406, 411 (Ohio P.U.C. 1981).

³⁰ *Id.*

³¹ Exhibit 23, Attachment 4-2.

³² Transcript, Volume 5 at 345-6.

emergency situations³³ and is currently seeking to provide a replacement water supply by implementing the Monterey Peninsula Water Supply Project.³⁴ Thus, utilizing the dam as a diversion point in an emergency is not only inadequate, but also unnecessary in the foreseeable future.

The Commission must be particularly mindful of not allowing or maintaining investments in rate base that are not necessary to ensure that the utility can reasonably serve ratepayers with efficient service on a continuous basis. Ratepayers may never see the benefit of this potential emergency water source nor recoup the money expended. Therefore, ratepayers should not be expected to provide a rate of return when they are already paying for alternative water supplies (and could potentially be paying for more in the near future) that adequately address these concerns.

Second, even if there is a remote possibility that Cal Am could use the Dam for water supply to customers in emergencies, it is unreasonable to allow an emergency facility to remain in rate base without Cal Am attempting to bring it back into full service.³⁵ Finding a facility is “used and useful” based on speculation that in an extreme circumstance it might be capable of serving as a source of supply is a wholesale distortion of the concept of “used and useful” and should not be allowed to stand.

This Commission, in D. 83-08-006, found that water utility wells still valuable as an emergency water source were “used and useful.”³⁶ However, in that decision, if the wells were not placed in full service by applicant's next general rate case, the Commission required the utility to justify why the wells should remain in rate base.³⁷ This Commission expected the water utility to take all reasonable steps to bring the wells back on line.³⁸ Therefore, it is unreasonable for Cal Am customers to pay a return on facilities in which Cal Am has no intention of bringing back on line. If so allowed,

³³ See Exhibit 23 at 7-2 and DRA’s Opening Brief at 29.

³⁴ Cal Am estimates its ratepayers will face substantial rate increases in the next few years in order to fund Cal Am’s cost of obtaining additional water supply. See A.04-09-019.

³⁵ D. 83-08-006, 12 CPUC 2d 69.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

ratepayers are being forced to pay a return on an investment that may not be used for a considerable length of time, if at all, which is precisely what the “used and useful” principle aims to protect against.

3. Once The Sediment Is Removed, There Will No Longer Be Any To Hold Back

Although the Dam now holds in place sediment minimizing downstream impact, once the Project is completed and the Dam is removed, Cal Am should not be able to earn a rate of return.

Even if Cal Am acted prudently in the past,³⁹ once the sediment is moved into the disposal site and the dam is demolished, it cannot be said to be playing any kind of a meaningful role in providing water utility service to Cal Am’s customers nor will it in any way facilitate the provision of efficient and reliable utility service.

While it is reasonable for ratepayers to pay the incremental cost of debt on the Project, ratepayers should not be expected to compensate a utility for an asset that is incapable of providing utility service. It is economically irrational and legally unreasonable for Cal Am to earn a return on the entire Project simply because it moves sediment.

The interests of the ratepaying public may not be disregarded. Here, these interests are not met. If Cal Am earns a rate of return, it would more than double the estimated surcharge being authorized by 2014 due to the higher equity rate of return as well as the need to include a provision for additional taxes and uncollectibles in the revenue requirement. The difference in cost due to the higher equity rate of return is several million dollars more. If taxes and uncollectibles are added, it would increase the amount recovered from ratepayers by even more. Put another way, doing so will result in a rate increase in an average residential customer bill, substantially larger than the 6.7% listed in Table 2.1 of D. 12-06-040.

³⁹ DRA continues to maintain that Cal Am’s management of the San Clemente Dam facility was imprudent.

At the very least, ratepayers should not be required to provide cost recovery for more than the cost of the sedimentation removal. There is no rational basis to compel ratepayers to pay a return on the entire Project, when the only potential “used and useful” asset is a new diversion pond.

The assurance of full recovery gives the utility no incentive to minimize project costs and will result in rate shock to county of Monterey customers who are already faced with paying an enormous increase in rates resulting from this project.

IV. CONCLUSION

Based upon the foregoing legal and factual errors, DRA requests that the Commission grant this Application for Rehearing and correct D. 12-06-040 so that ratepayer cost responsibility for the Project is being properly allocated. It is reasonable for ratepayers to bear the reasonable costs of removing the dam and rerouting the river, but it is unreasonable to treat those costs as a utility asset that, in addition, earns a rate of return.

Respectfully submitted,

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