

Decision **PROPOSED DECISION OF ALJ MCKENZIE** (Mailed 11/16/2004)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its Coronado District to increase revenues by \$352.9 or 2.86% in the year 2005, to decrease revenues by (\$43.1) or (0.34%) in 2006, and to decrease revenues by (\$28.4) or (0.22%) in 2007.

Application 04-03-023  
(Filed March 22, 2004)

In the Matter of the Application of California-American Water Company (U 210 W) for an order authorizing it to change its rates for water service in its Village District to decrease revenues by (\$1,254.0) or (6.36%) in the year 2005, to decrease revenues by (\$24.9) or (0.13%) in 2006, and to increase revenues by \$4.7 or 0.03% in 2007.

Application 04-03-024  
(Filed March 22, 2004)

**OPINION RESOLVING GENERAL RATE CASES****(See Appendix C for List of Appearances)**

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**OPINION RESOLVING GENERAL RATE CASES****1. Summary**

This opinion adopts, except for a proposed low-income discount, two settlement agreements entered into by applicant, the California-American Water Company (Cal-Am), with the other parties to these proceedings. The first agreement is with the Commission's Office of Ratepayer Advocates (ORA) and resolves all of the issues raised in ORA's protests of these two applications; it is attached to this decision as Appendix A. The second agreement is between Cal-Am and the City of Thousand Oaks (Thousand Oaks or City).

Thousand Oaks is the principal geographic area served by Cal-Am's Village District, and City was a protestant in Application (A.) 04-03-024. The settlement agreement with Thousand Oaks, which is attached to this decision as Appendix B, resolves all of the issues raised by the City.

Pursuant to the settlement agreements, Cal-Am is authorized to change the rates for its Coronado District so as to increase revenues by \$132,700, or 1.07%, in 2005; to increase revenues by \$10,600, or 0.08%, in 2006; and to increase revenues by \$10,700, or 0.09%, in 2007. For the Village District, Cal-Am is authorized to change rates so as to reduce revenues by \$1,892,200, or 9.6%, in 2005; to increase revenues by \$42,100, or 0.23%, in 2006; and to increase revenues by \$42,000, or 0.23%, in 2007.

Pursuant to the requirements of Decision (D.) 02-12-068 (the decision whereby we conditionally approved a settlement agreement transferring control of Cal-Am's corporate parent to RWE Aktiengesellschaft),<sup>1</sup> the rate decrease for

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<sup>1</sup> See, D.02-12-068, *mimeo.* at 19-21; Conclusion of Law 4; Appendix B, Commission

*Footnote continued on next page*

the Village District will go into effect on January 1, 2005, but the increases for that district authorized for 2006 and 2007 will not go into effect until January 1, 2007 and January 1, 2008, respectively. For the Coronado District, the rate increase authorized for 2005 will go into effect on January 1, 2006, the increase authorized for 2006 on January 1, 2007, and the increase authorized for 2007 on January 1, 2008.

For both the Coronado and Village Districts, the adopted rates are based on a return on rate base (ROR) of 8.46%, and a return on common equity (ROE) of 10.10%.

## **2. The Applications**

The applications in these proceedings were filed on March 22, 2004. In its application for the Coronado District, Cal-Am sought authority to increase revenues by \$352,900, or 2.86%, in 2005; decrease revenues by \$43,100, or 0.34%, in 2006; and to decrease revenues by \$28,400, or 0.22%, in 2007. In the application for the Village District, Cal-Am sought authority to decrease revenues by \$1,254,000, or 6.36%, in 2005; to decrease revenues by \$24,900, or 0.13%, in 2006; and to increase revenues by \$4,700, or 0.03%, in 2007. Customers were advised of these proposed rate changes through newspaper publication and bill inserts.

## **3. The Coronado and Village District Systems**

The Coronado District serves approximately 20,200 customers, about one-third of whom reside in the City of San Diego (San Diego), and two-thirds of whom reside in the City of Imperial Beach (Imperial Beach), which is adjacent to

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Comment on Condition 1.

San Diego.<sup>2</sup> Virtually all of the water used by customers in the Coronado District is supplied by San Diego; under a contract dating back to 1912, Cal-Am has the right to purchase from that city all of the potable water needed by the Coronado District's customers. Cal-Am also has emergency agreements with three other water systems.<sup>3</sup>

Cal-Am is now negotiating a new agreement with San Diego, since the existing agreement (which was last amended in 1998) gives that city the option not to renew Cal-Am's franchise. Once the new agreement has been finalized and becomes effective, Cal-Am intends to pass the costs of the new agreement on to the Coronado District customers through an offset advice letter filing.

The Village District serves approximately 20,000 customers,<sup>4</sup> virtually all of whom reside in the western part of Thousand Oaks, particularly in an area known as Newbury Park. The Village District and the other two water systems that serve Thousand Oaks<sup>5</sup> each obtain all of their water from Calleguas Municipal Water District (Calleguas), and then store it and distribute it in their own systems. Although Calleguas has been able to meet all of the demand for

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<sup>2</sup> Of the 20,200 customers, about 18,200 are residential and 2,000 are commercial.

<sup>3</sup> The emergency agreements are a 1983 contract with the Otay Water District, a 1983 contract with the Sweetwater Authority, and a 1979 contract with the U.S. Navy. (Ex. 1, Direct Testimony of David Stephenson, p. 4.)

<sup>4</sup> Of the 20,000, about 19,000 are residential, 725 commercial, 175 public authority, and 175 industrial.

<sup>5</sup> Thousand Oaks has about 120,000 residents and 42,000 water customers. A public water system owned by City serves approximately 16,000 customers in the central area, and about 7,000 customers in the eastern portion of Thousand Oaks are served by California Water Service Company (Cal-Water), a private water company. (Thousand Oaks Protest, p. 5.)

water in Thousand Oaks up to now, both Cal-Am and City recognize that this situation may change soon.

#### **4. Procedural History**

By Resolution ALJ 176-3131 dated April 1, 2004, the Commission preliminarily determined the captioned applications to be “ratesetting,” with hearings indicated. On April 21, 2004, ORA filed protests to both applications, and on April 22, 2004, City filed a limited protest to A.04-03-024.

A prehearing conference (PHC) was held on May 19, 2004 to establish the issues and a hearing schedule. Upon the joint motion of applicant and ORA, the two applications were consolidated. On June 4, 2004, Assigned Commissioner Michael R. Peevey issued a scoping memo and ruling that set a hearing schedule which called for one public participation hearing (PPH) in Thousand Oaks and an evidentiary hearing. The scoping memo designated Administrative Law Judge (ALJ) A. Kirk McKenzie as the principal hearing officer.

The PPH was held in Thousand Oaks on June 29, 2004. About 40 ratepayers from the Village District attended the PPH, and about half of them spoke.<sup>6</sup> Many of these customers noted that Cal-Am’s rates were significantly higher than those charged by City or Cal-Water, and almost all of the speakers were critical of Cal-Am’s response to two emergencies that had occurred in the Spring of 2004, one involving an “algae bloom,” and the other a water main break that took place the night before the PPH. Several speakers complained that when they telephoned Cal-Am’s national call center (which is located in Alton,

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<sup>6</sup> In addition to 19 ratepayers, Dennis Gillette, a member of the Thousand Oaks City Council, and Scott Mitnick, the Assistant City Manager of Thousand Oaks, spoke at the PPH.

Illinois) on June 28, they were either put on hold for long periods, treated rudely by service personnel while trying to describe the problems in their areas, or had their phone calls cut off.

On July 6, 2004, ORA distributed two reports concerning the applications. ORA's report on the Coronado District is Exhibit 12 in this proceeding, and its report on the Village District is Exhibit 13. For both districts, ORA recommended substantially lower revenues than those proposed by Cal-Am. For the Coronado District, ORA recommended a revenue decrease of \$80,400 (or 0.65%) in 2005, with smaller decreases in 2006 and 2007. ORA stated that its recommendations for the Coronado District amounted to an overall rate decrease of 0.78%. For the Village District, ORA recommended a revenue decrease of about \$2.025 million in 2005, a small increase of \$17,000 in 2006, and a decrease of \$171,500 (or 0.96%) in 2007. ORA stated that overall, its recommendations for the Village District translated into a net revenue decrease of 10.5%.

On July 6, 2004, two witnesses served testimony on behalf of Thousand Oaks. The testimony of Donald Nelson, the Public Works Director of Thousand Oaks, asserted that the application failed to present adequate data about the capital improvements Cal-Am was proposing to make between 2005 and 2007. Nelson also contended that Cal-Am had failed to meet City's standards with respect to fire flow and/or water pressure in a number of geographic areas and commercial locations, including Conejo Oaks, Warwick Avenue, the Los Robles Regional Medical Center and the Oaks Mall (the last of which is the major shopping center in Thousand Oaks). The testimony of Scott Mitnick, the Assistant City Manager of Thousand Oaks, also noted that significant amounts of data were missing from the application, and Mitnick suggested that it was likely a much larger rate decrease was justified

than the one proposed by Cal-Am. He also elaborated upon the problems with the national call center that had been described at the June 29 PPH.



On July 21, 2004, Cal-Am served rebuttal testimony addressing all of the points covered in the testimony of ORA and Thousand Oaks.

Under the procedural schedule set forth in the scoping memo, the parties had set aside the last week of July to conduct settlement discussions. On July 29, they sent e-mail messages to ALJ McKenzie informing him that while no agreements had yet been reached, their discussions had made significant progress and would continue. On August 6, 2004, Cal-Am informed the ALJ that it had reached settlements with ORA concerning a significant number of issues for both the Coronado and Village Districts, and that settlement discussions would continue. Cal-Am also noted that while it had not yet settled any of the issues raised by Thousand Oaks, discussions with City would also continue.

On August 13, 2004, Cal-Am electronically distributed two agreements providing for the settlement of all issues that had been raised in the case. On August 16, a brief evidentiary hearing was held, during which the ALJ questioned the witnesses for Cal-Am, ORA and Thousand Oaks about various provisions in the settlement agreements. On August 19, 2004, Cal-Am filed the final versions of the agreements along with corrected tables, as well as a motion for their adoption.

After the hearing, the only issue remaining was whether a separate application would be necessary under Pub. Util. Code § 854 to obtain Commission approval of a proposed exchange of service territories between Cal-Am and Thousand Oaks. Under the exchange proposal (which is discussed in more detail below), Cal-Am would take over from City the responsibility for serving the Academy area in the northwestern part of Thousand Oaks, and City's water system would take over from Cal-Am the responsibility for serving the Conejo Oaks area. At the August 16 hearing, Cal-Am's counsel argued that no

application was necessary under the language of § 854, because under the proposed exchange arrangement, Thousand Oaks and Cal-Am would each be assuming responsibility for areas contiguous to their existing service territories. On August 27, 2004, counsel for Cal-Am informed the ALJ that the company had agreed with ORA that a separate application would be filed regarding the proposed exchange, so that briefing on the statutory issue would not be necessary. In light of that agreement, the proceedings were deemed submitted on August 31, 2004.

## **5. The Settlement Agreement Between ORA and Cal-Am**

### **A. Cost of Capital**

One of the most important provisions in the settlement agreement between Cal-Am and ORA is the provision relating to cost-of-capital. For example, on the question of capital structure, Cal-Am originally advocated a long-term debt ratio of 46 to 49% (increasing from 2005 to 2007), whereas ORA had advocated a ratio of 57 to 58%. In their settlement agreement, the parties agreed upon a ratio of 55% long-term debt to 45% common equity for both the Coronado and Village Districts for all three years. Cal-Am had also advocated a return on equity (ROE) of 10.50% for each of the three years, while ORA had advocated an ROE of 9.34%; in their settlement agreement, the parties agreed to use an ROE of 10.10% for both districts for each of the three years.

The stipulations regarding cost of capital had a significant effect on the parties' ultimate agreement as to revenue requirement. For example, David Stephenson of Cal-Am testified that about half of the \$641,000 difference between Cal-Am's original position on the 2005 Village District revenue requirement and

the figure the company ultimately accepted was accounted for by the stipulation reducing ROR. (August 16 Transcript, pp. 133-34.)<sup>7</sup>

The table below shows each party's original position on revenue requirement, along with the figures they ultimately agreed to:

	<b>Cal-Am</b>	<b>ORA</b>	<b>Settlement</b>
	\$ (000s)	\$ (000s)	\$ (000s)
<b>Coronado</b>			
2005	12,707.0	12,275.0	12,483.0
2006	12,680.4	12,284.0	12,510.0
2007	12,652.0	12,251.1	12,520.7 <sup>8</sup>
<b>Village</b>			
2005	18,463.3	17,693.7	17,822.3
2006	18,574.5	17,883.7	18,042.3
2007	18,579.2	17,712.2	18,084.3 <sup>9</sup>

<sup>7</sup> Stephenson also testified that another \$275,000 of the \$641,000 difference for the Village District was attributable to an error in the manner in which Cal-Am accounted for developer contributions. This error was not made in the Coronado District calculations. (*Id.*)

<sup>8</sup> Based on attrition allowance set forth in Appendix A, Table 11-2 (Revised) for the Coronado District.

<sup>9</sup> Based on attrition allowance set forth in Appendix A, Table 11-2 (Revised) for the Village District.

**B. Noteworthy Provisions Concerning  
Coronado in the ORA Settlement  
Agreement**

For the Coronado District, a small part of the difference between what Cal-Am originally sought as a revenue requirement and what it stipulated to be accounted for by certain adjustments to Operations and Maintenance (O&M) and Administrative and General (A&G) expenses. Although Cal-Am generally accepted ORA's estimates of O&M and A&G expenses for Coronado, there were certain departures from this pattern. The departures are described in paragraphs 4.1-4.3 and 5.1-5.2 of the settlement agreement with ORA.

Two off-setting items concerning plant additions deserve mention. In its application, Cal-Am had proposed to spend \$150,000 to construct a building at the Third and Calla Street station in Imperial Beach. In the settlement discussions, Cal-Am agreed with ORA that because the project cannot be completed in 2007 due to the time needed for regulatory approvals and building permits, the project should be considered beyond the scope of this application. (ORA Settlement Agreement, ¶ 7.1.) However, ORA ceased opposing the inclusion of \$150,000 in costs for installing 530 feet of 8-inch water main on Palm Avenue in Coronado, because ORA accepted Cal-Am's position that water pressure in the area currently falls below Commission standards from time to time. (*Id.* ¶ 7.2.)<sup>10</sup>

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<sup>10</sup> Cal-Am and ORA also agreed that they should assume \$600,000 in plant additions for 2006, but that this expense would be offset by an equal increase in developer contributions. Thus, the assumed 2006 additions will have no effect on the rate base for the Coronado District. (*Id.*, ¶ 7.3.)

Another issue between the parties was how a sale of land containing a tank should be accounted for. The land was sold in 2000, but had been classified as non-operating property in 1982. ORA took the position that as a result of the sale, Cal-Am should be required to increase its contributions owing to net plant gain. In the settlement agreement, Cal-Am agrees that because this general issue is likely to be considered in the recently-instituted proceeding concerning gain-on-sale, Rulemaking (R.) 04-09-003, Cal-Am will reduce its 2005 and 2006 ratebase, for purposes of this ratecase only, by \$86,600. (*Id.* ¶ 7.4.)

As noted in the introduction, one of the major issues for the Coronado District in future years will be the development of additional water supplies. To address this, Cal-Am proposed to establish a memorandum account to track the costs of its participation in a study of supply alternatives for the San Diego region (which is known as Region 4) being promoted by the Metropolitan Water District (MWD). ORA opposed the request, partly because ORA believed the expenses of the study did not meet the criteria for memorandum accounts set forth in D.02-08-054. In their settlement, the parties have agreed that all charges related to the regional study will be accounted for as “preliminary survey and investigation” and not included in rates at this time. (*Id.*, ¶ 6.1.) However, in response to questioning by the ALJ, David Stephenson stated that Cal-Am would be free under the settlement agreement to seek recovery of the costs associated with the Region 4 water supply study in future rate cases. (Tr., pp. 128-29.)

The parties reached a somewhat different result with respect to the memorandum account Cal-Am had requested to cover additional purchased water expense in the event that San Diego (which has not read its meters in several years) were to back-bill Cal-Am for additional water. ORA had opposed this request, partly on the ground that Cal-Am’s existing balancing account for

purchased water costs was sufficient. In their settlement, the parties agreed to use a 0.54% water loss factor, and also agreed that Cal-Am could establish a separate memorandum account to track additional purchased water expense above the 0.54% factor. However, the amount that the can be booked in the new account is capped at 1.54%; *i.e.*, 100 basis points over the water loss factor that the parties have otherwise agreed to. (ORA Settlement Agreement, ¶ 6.2.)

Apart from the issue of rate assistance for low-income customers (a question discussed separately below), the only other point in the Coronado settlement that needs to be mentioned is the parties' agreement on how franchise fees should be treated. In its application, Cal-Am had requested as a special condition that the franchise fee it now pays to Imperial Beach (and the one it expects will soon have to be paid to San Diego) should no longer be treated as part of the utility's revenue requirement, but should instead be treated as a surcharge and shown as a separate line item on customer bills. (Coronado Application, pp. 6-7.) In its report, ORA opposed the request, arguing that it was contrary to long-standing Commission policy. In the settlement agreement, ORA agreed to Cal-Am's proposal, owing to the use of this approach elsewhere in the company, and to the fact that only two of the three jurisdictions in the Coronado District charge franchise fees. (ORA Settlement Agreement, ¶ 11.1.)

### **C. Noteworthy Provisions Concerning the Village District in the ORA Settlement Agreement**

With a few exceptions, ORA and Cal-Am resolved their differences over the Village District application by using the same approaches employed in the Coronado settlement. For example, the parties agreed to the same cost-of-capital provisions described above, and also agreed that the Village District would treat franchise fees as a surcharge on customer bills, rather than treating them as part

of the revenue requirement. (ORA Settlement Agreement, ¶¶ 2, 20.1.) Cal-Am also accepted ORA's estimates for expenses, except for the matters set forth in ¶¶ 15.1 to 15.5, where Cal-Am provided ORA with more up-to-date information.<sup>11</sup>

Two items concerning plant additions deserve special mention. First, ORA had opposed Cal-Am's proposal to replace 1.9 miles of 12-inch main along Price Road serving the Los Pasos area. ORA argued that in view of estimated annual repair costs of \$24,000, the \$1,350,000 price tag for a new main could not be justified. (Exhibit 13, ¶ 5.3.) In his rebuttal testimony, Benjamin Lewis of Cal-Am argued that this was short-sighted, in view of the possible loss of electric power, large quantities of mud and other problems that a serious break in the existing main could create. (Ex. 11, pp. 5-6.) In the settlement agreement, ORA agreed that replacement of the main along Price Road was reasonable, and that upon completion of the project, Cal-Am could file an advice letter for no more than \$1,350,000 to cover the costs of the project. (ORA Settlement Agreement, ¶ 16.2.)

Cal-Am also proposed spending \$150,000 in 2005 to create an interconnection with Thousand Oaks at the eastern end of the El Dorado Zone, so that fire flow could be increased to 1,000 gallons per minute (gpm) from the current 600 gpm. In their settlement agreement, the parties agreed that in view of Cal-Am's tentative agreement with Thousand Oaks to exchange the Conejo Oaks and Academy service areas, the interconnection project is not needed at this time. (*Id.*, ¶ 16.3.)

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<sup>11</sup> On the maintenance of general plant, Cal-Am mistakenly did not include these expense items in its tables. In ¶ 15.6, ORA agreed they should be included.

**D. The Parties' Settlement Concerning Rate Assistance for Low-Income Customers**

In D.02-12-068, the Commission conditionally approved a settlement agreement that had the effect of transferring control of Cal-Am's corporate parent, the American Water Works Company, to RWE Aktiengesellschaft, a German industrial company that is an international provider of water, gas, electricity and other utility services. One of the conditions approved in D.02-12-068 was a commitment by Cal-Am to spend \$50,000 of shareholder funds per year for five years to help establish a low-income assistance program for its ratepayers. (*Mimeo.* at 21-23.)

To help meet this commitment, Cal-Am proposed the same low-income assistance program for the Coronado and Village Districts that it has proposed for other districts. Eligibility for the program would be limited to water end-users (a broader group than Cal-Am customers) with incomes not exceeding 175% of federal poverty guidelines. In cases where the user was a Cal-Am customer, the company proposed that the program would work as follows:

“[T]he user would receive a reduction in their monthly water bill equal to the lower of their monthly basic service charge, or \$10. This amount would be shown as a reduction on their bill. Any user on a flat rate service (primarily in Cal-Am's Sacramento District) would receive a reduction of half of their monthly service charge, or \$10, whichever is greater.”  
(Stephenson Direct Testimony, Ex. 1, p. 28.)



In cases where the water user was not a direct Cal-Am customer because the user rented a home or apartment that was individually metered, Cal-Am proposed that the program work as follows:

“These users would receive a credit against their rent. Their credit would be equivalent to the lower of the monthly service charge paid by a 5/8” metered Cal-Am customer in this district, or \$10. Users on a flat rate service will receive half of that monthly charge, or \$10, whichever is greater. The user would need to get an agreement with the landlord to lower their rent and then provide Cal-Am with a certified statement to that [e]ffect. The Company would then lower the water bill to the landlord by the appropriate amount. This certification would need to be renewed annually.” (*Id.* at 29.)

In cases where the low-income user rented an apartment in a master-metered complex without submetering, Cal-Am proposed that the program work in the same way, except that it would be the *landlord’s* water bill that would be lowered by the appropriate amount, with the landlord being obliged to pass this reduction on to the tenant. (*Id.*) Cal-Am also proposed that users taking advantage of its low-income assistance program be required to install conservation kits, including toilet dams and faucet flow reducers. (*Id.* at 32.)

In its July 6, 2004 reports on the Coronado and Village applications, ORA opposed Cal-Am’s proposal as overly complex and burdensome. ORA suggested that Cal-Am would be taking on too many additional burdens by having to identify all qualified non-customer users, verifying the validity of landlord-tenant agreements, distributing and tracking assistance coupons to eligible users, and ensuring that promised decreases in rent were actually passed on to tenants. ORA was also concerned that the additional costs of conducting these activities could dramatically increase the costs of the low-income assistance

program, costs that would have to be borne by higher-income customers. (Ex. 12, ¶¶ 13.6-13.10; Ex. 13, ¶¶ 9.20-9.22.)

As an alternative, ORA proposed the same low-income assistance program it had advocated in Application (A.) 03-07-036. Under this program, customers of Cal-Am with incomes no greater than 175% of the federal poverty guidelines would receive a 15% discount on their bill. The discount would also be available to low-income consumers residing in mobile home parks or multi-unit complexes where the Cal-Am customer was the landlord, but tenants were billed for their individual water usage through sub-meters. ORA's program would *not* be available for low-income consumers living in multi-unit dwellings that were not individually sub-metered, since ORA thought that situation presented too many complexities. ORA's program did not require any conservation measures by customers, since ORA thought the program was unlikely to induce additional consumption. ORA also proposed the creation of a memorandum account in which revenue shortfalls associated with the program would be booked, with Cal-Am being free to seek rate recovery of these amounts later. (Ex. 12, ¶¶ 13.11-13.18; Ex. 13, ¶¶ 9.24-9.30.)

In their settlement agreement, the parties agreed to adopt ORA's proposal, but made clear this was done only as an interim expedient:

“[Cal-Am] agrees to this proposal as a pilot project for this proceeding only, and the acceptance of it here does not limit [Cal-Am's] ability to request modification, alteration or elimination of this program in the future. The Parties agree that an industry-wide program is preferable and should be the subject of further discussions and investigations.” (ORA Settlement Agreement, ¶¶ 12, 20.2.)

## **6. The Settlement Agreement Between Cal-Am and Thousand Oaks**

As noted in the introduction, Cal-Am entered into a separate settlement agreement with Thousand Oaks. This agreement, which incorporates by reference the revenue changes agreed to between Cal-Am and ORA, was the subject of extensive questioning at the August 16 hearing and is attached to this decision as Appendix B.

The most significant provisions of the settlement with Thousand Oaks concern Cal-Am's agreement to exchange its Conejo Oaks service area for the Academy service area currently served by City. The idea of an exchange was suggested by Thousand Oaks in the direct testimony of Donald Nelson (Ex. 16, p. 5), but rejected by Cal-Am in Benjamin Lewis's rebuttal testimony (Ex. 11, p. 8). However, in their settlement agreement, City and Cal-Am have agreed to undertake the steps that would be necessary for such an exchange of territories to be effective for all purposes on January 1, 2008, the date that new rates approved in the Village District's next rate case are expected to take effect. These steps include approval of the exchange by the Thousand Oaks City Council and this Commission. (Thousand Oaks Settlement Agreement, ¶¶ 3.1 and 3.2.) In addition, Cal-Am and City agree that within three months after approval of their settlement agreement, they will agree upon a transition plan that includes milestones necessary to make the exchange come about. These milestones include:

- exchange of information on improvements, water sales, etc. within the two systems;
- a physical assessment and inventory of the plant of the Conejo Oaks and Academy water systems;

- identification of and scheduling for improvements to be constructed in the Conejo Oaks service area by City in order to provide service that meets the fire flow and domestic service requirements of Thousand Oaks;
- community meetings to describe the proposed exchange and obtain the input of affected residents on it;
- an analysis of the need for interim improvements to eliminate minimum flow penalties in the Conejo Oaks service area, with the understanding that any such interim improvements would be constructed at Cal-Am's option; and
- itemization of the actions necessary to transfer all interests in the Academy Mutual Water Company to Cal-Am. (*Id.*, ¶ 3.4.)

Cal-Am and City also agree that prior to consummation of the exchange, they will operate and maintain the two service areas “with normal and customary practices and care.” (*Id.*, ¶ 3.6.)

At the August 16 hearing, witnesses for both Cal-Am and City answered questions about the exchange agreement. First, Donald Nelson noted that the staffs of Cal-Am and Thousand Oaks have been discussing the possibility of an exchange for nearly a decade, so each is familiar with the other's system. Thus, even though it is theoretically possible under the language of ¶¶ 3.1-3.5 that the City Council of Thousand Oaks could get cold feet and not approve the exchange, Nelson considered that to be very unlikely. (Tr. at 82.) He also acknowledged that the intent of the settlement agreement is that if such problems do arise, they will be dealt with in the future and will not constitute grounds for rescinding or modifying the settlement in this rate case. (*Id.* at 86-87.)

Benjamin Lewis testified that although there are references in Nelson's testimony to penalties of \$11,000 per month being imposed on Cal-Am because of

unacceptably low fire flows in the Conejo Oaks area,<sup>12</sup> this figure is not correct. According to Lewis, the actual amount of the penalties is approximately \$7000 per year, and the explanation for the difference is that when Nelson was preparing his testimony, he was unaware of certain improvements by Cal-Am that have improved fire flows in the area. (*Id.* at 86.)

A second important part of the settlement agreement between City and Cal-Am is the latter's agreement to improve the performance of its national call center, which is located in Alton, Illinois. As noted above, many customers who spoke at the PPH complained about the call center's performance with respect to the water main break that occurred on June 28, 2004.

Pursuant to D.02-12-068, Cal-Am is required to make quarterly reports to this Commission concerning the performance of its call center for the so-called Western Region, which is comprised of California, Arizona, Hawaii, New Mexico and Texas. The settlement agreement states that hardware and software improvements are now being made that will allow the company to provide state-specific data on call center performance by the end of the first quarter of 2005. (Thousand Oaks Settlement Agreement, ¶ 10.1.) Once it has the capacity to do so, Cal-Am proposes to supplement its quarterly filings with the Commission to provide California-specific data on the information required by the quarterly reports; *i.e.*, the number of calls answered within 30 seconds, the number of calls lost within 30 seconds, and first-call effectiveness. (*Id.*, ¶ 10.2.) The company has also agreed to develop a program to provide information to Thousand Oaks on

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<sup>12</sup> See, Direct Testimony of Donald H. Nelson, Exhibit 16, p. 5.

the call center's performance, and to "follow up and resolve individual call center service complaints" promptly when they are made. (*Id.*, ¶ 10.3.)

A third important aspect of the settlement agreement between Thousand Oaks and Cal-Am is the latter's agreement to accept ownership and control of the pumping station in the Oakview Estates condominiums on Warwick Avenue, which Nelson claimed suffer from inadequate water pressure. (*Id.*, ¶¶ 8.1-8.2; Nelson Direct Testimony, Ex. 16, p. 6.) In his rebuttal testimony on behalf of Cal-Am, Lewis noted that when this project was constructed in the 1970s, the company did not think it was fair to pass on to its other customers the high long-term maintenance and power costs of the pumping station, which the project's high elevation clearly required. Accordingly, Cal-Am entered into an agreement with the condominium developer requiring the Oakview Condominium Association to own and maintain the pumping station. (Ex. 11, p. 9.) In the settlement agreement, the parties note that additional construction in the area will be the key to resolving the cost and water pressure problems on Warwick Avenue:

"The Parties recognize that the solution to the current water pressure and fire flow issues will come from the agreements with the owners/developers of projects fronting Warwick Avenue. The Parties will negotiate with the owners/developers of projects fronting Warwick Avenue . . . to arrive at a permanent water system that will deliver fire flow and domestic pressures meeting City requirements to the above-mentioned projects, as well as to the apartment building at 951 Warwick Avenue." (Thousand Oaks Settlement Agreement, ¶ 8.2.)

Under other provisions of the settlement agreement, Cal-Am also agrees to do the following to address other issues that were raised either in City's protest or at the June 29 PPH: (1) undertake a good-faith effort to conclude a new

franchise agreement with Thousand Oaks within six months; (2) draft a new “will serve” letter detailing the extent of Cal-Am’s obligation to serve the Oaks Mall; (3) give City a full opportunity to comment on Cal-Am’s new Comprehensive Planning Study, the company’s master plan for capital improvements; and (4) work with the Los Robles Regional Medical Center so that fire flow requirements for the hospital’s new medical facilities and parking structure can be met at reasonable cost. (*Id.*, ¶¶ 5, 7, 9 and 11.)

## **7. Discussion**

Taken together, the two settlement agreements before us represent an all-party settlement. In D.92-12-019 (46 CPUC2d 538), the Commission held that all-party settlement proposals will not be approved unless (1) the settlement commands the unanimous sponsorship of all active parties, (2) the sponsoring parties are fairly reflective of the affected interests, (3) no term of the settlement contravenes statutory provisions or prior Commission decisions, and (4) the settlement conveys sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests. (46 CPUC2d at 550-551.) In addition, Rule 51.1(e) precludes the Commission from approving a settlement or stipulation unless it is reasonable in light of the whole record, consistent with law, and in the public interest.

Except for the provisions adopting ORA’s proposal for low-income ratepayer assistance, we have no difficulty in concluding that the agreements before us meet these tests. All of the active parties participated in the negotiations that led to the agreements, and the two agreements – which are unopposed -- cross-reference each other. Moreover, apart from the provisions adopting ORA’s low-income assistance program, we believe the agreements represent a reasonable resolution of all the issues in this case. We also note that

with respect to the issues raised by City and the customers who spoke at the June 29 PPH, the Thousand Oaks Settlement Agreement appears to offer imaginative solutions to problems that have frustrated City and its residents for some time.

As noted in the summary of Cal-Am's agreement with ORA, the stipulations relating to cost-of-capital have a larger dollar effect than any other provision in the settlement agreements. For example, the stipulated amounts account for about half of the \$641,000 difference between the revenues that Cal-Am originally requested for the Village District in 2005 and what the parties ultimately agreed to. The 10.10% ROE that the parties agreed upon is only six basis points higher than the ROE we recently approved for Cal-Am's Los Angeles District in D.04-09-041 (*mimeo.* at 4),<sup>13</sup> and is 40 basis points less than the ROE Cal-Am originally requested in these applications. Thus, we have no difficulty in concluding that the cost-of-capital provisions in the ORA settlement agreement are reasonable and should be approved.

We also find reasonable the agreements between Cal-Am and ORA with respect to the individual issues raised by the Coronado application. In particular, we agree that Cal-Am should be free to seek recovery in the future of its participation in the future water supply study for San Diego County being promoted by MWD, and that the 0.54% water loss factor and memorandum account to record any additional water supply billing by San Diego are reasonable. We also agree that under the circumstances of the Coronado District,

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<sup>13</sup> We agree with David Stephenson that in view of the Federal Reserve Board's recent policy of slowly raising interest rates from their historically-low levels, the increase of six basis points over the ROE approved in D.04-09-041 is reasonable. (Tr. 126-27.)



it is reasonable to show franchise fees as a separate line item on customer bills.<sup>14</sup>

As our description of the settlement between Cal-Am and Thousand Oaks indicates, many of the issues for the Village District involve the reasonableness of capital expenditures needed to deal with problems such as low fire flows and water pressure. We accept ORA and Cal-Am's agreements with respect to these issues, and also agree with the treatment these parties have agreed upon for dealing with the costs of replacing the 1.9 miles of 12-inch main serving the Los Pasos area.

We also commend Thousand Oaks and Cal-Am for reaching an agreement-in-principle to exchange the Conejo Oaks and Academy service areas. This exchange (which the parties will have three years to pursue) will not only enable both Cal-Am and City's municipal water system to serve contiguous territories, but will also – as noted in ¶ 16.3 of the settlement agreement with ORA -- save Cal-Am's ratepayers the expense of upgrading the pressure regulating system at the El Dorado turnout. We hope that Cal-Am and City make steady progress in deciding whether to go forward with the proposed exchange, and when they are ready to proceed, we look forward to receiving Cal-Am's application for approval.

We are also pleased with and will approve the provisions of the Thousand Oaks settlement that relate to improving the reporting on, and the performance of, the national call center in Alton, Illinois. As noted above, the settlement agreement states that Cal-Am expects to have hardware and software

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<sup>14</sup> We also find reasonable and approve the provision for separate franchise fee billing in the Village portion of the settlement.

improvements in place by March 31, 2005 that will result in improved performance by the call center.

The customer complaints expressed at the June 29 PPH indicate that improvement in the call center's performance is needed. Our attitude toward the improvements referred to in ¶¶ 10.1 and 10.3 of the Thousand Oaks agreement is the same as the view expressed on behalf of City by Donald Nelson:

“I think from the city's point of view, what we are looking for here is improvement in the system. We understand that Cal-Am may have some limitations as to what they can do. And what we are looking forward to is improvement. And these conditions in the settlement agreement provide an opportunity for Cal American to demonstrate that to us. (Tr. at 108.)

The heart of the hardware improvements Cal-Am is making are (1) the installation of global positioning system (GPS) devices in Cal-Am's service vehicles, coupled with (2) the use of a “toughbook” to ensure that service personnel responding to trouble calls have all of the relevant information when they arrive. At the August 16 hearing, Benjamin Lewis described the interaction of these systems as follows:

“Also we are implementing our Service First Program. That is a program in which we are going to have a GPS located in our company vehicles such that when a customer calls into the call center and there is a main break, we will have the ability to know where that particular service main is located and actually dispatch them directly to that main break more efficiently. That will happen first quarter 2005 . . .

\* \* \*

“Also, what is going to happen is they are going . . . to have what we refer to as a Toughbook. And the Toughbook is what you see UPS carriers use which is a pad, electronic and wireless such that when the call center sends out a service order, it is

going to go directly to that Toughbook. They will be able to see all their information pertinent to that customer.

“So when they arrive at the customer’s home, . . . they will have everything in front of them in terms of what the customer needs are, the name, the location and actually what is the request of the customer. (Tr. 111-112.)

We agree that these improvements appear to represent a good start toward addressing the customer service problems described at the PPH. We will look to these measures, as well as the improved reporting referred to in ¶ 10.2 of the Thousand Oaks settlement agreement, in evaluating the quality of customer service in Cal-Am’s next rate case for the Village District.

As noted above, the only provisions that we cannot accept in the two settlement agreements before us are the provisions adopting ORA’s proposal for low-income ratepayer assistance. Under ORA’s proposal, Cal-Am customers with incomes not exceeding 175% of the federal poverty guidelines would receive a 15% discount on their bills. The discount would also be available to low-income consumers residing in multi-unit complexes or mobile home parks where the Cal-Am customer is the landlord, but tenants are billed for their individual water usage through sub-meters. The 15% discount would *not* be available to low-income consumers living in multi-unit complexes without individual sub-metering. ORA’s proposal, unlike Cal-Am’s, also does not require any conservation measures on the part of customers. (Ex. 12, ¶¶ 13.11-13.18; Ex. 13, ¶¶ 9.24-9.30.)

We recently disapproved an identical low-income assistance proposal in D.04-09-041, our decision on Cal-Am’s application for its Los Angeles District, A.03-07-036. In that decision, we began by noting that the ORA proposal the parties had agreed upon suffered from the same infirmities that had caused us to

reject a low-income assistance program for the San Gabriel Water Company. We described the infirmity as follows:

“[T]he rate would not be offered to users living in apartment buildings and mobile home parks. These tenants would not receive the rate because they are not customers of the utilities but instead pay for utilities as part of the rent or lease amount. Because many low-income individuals and families live in buildings or facilities with master meters, Cal-Am’s low-income rate would presumably not be available to a significant portion of its low-income customers.

“The settlement [in A.03-07-036] does not address how the shortfall from the low income discount would be allocated to other customers, deferring the issue and permitting the shortfall to be tracked in a memorandum account. The uncertainty regarding how the shortfall would be recovered imposes an additional risk on low income individuals and families who are tenants living in master-metered buildings or facilities. Those tenants may ultimately pay higher rates because of the low income discount if the shortfall from the discount is allocated to master meter customers and those customers may pass along the higher utility rates to their low-income tenants.

“We also share [Cal-Am’s] concern that providing discounts to any customer merits consideration of more aggressive water conservation efforts. In fact, the ability to conserve water – and thereby reduce utility bills – without compromising the quality of life should be one element of a program to meet the needs of low-income customers. Although we applaud the parties’ efforts to settle the case, these types of issues are not addressed in ways that satisfy our interest in promoting the interests of those who are similarly-situated, in this case individuals and families on limited incomes.” (*Mimeo.* at 6-7.)

All of the shortcomings mentioned in this quotation also apply to the low-

income assistance program adopted in the settlement agreement here between Cal-Am and ORA.<sup>15</sup> For the reasons stated in D.04-09-041, we decline to adopt these provisions of the ORA settlement agreement. However, as was true in D.04-09-041, we note that rejecting these low-income assistance provisions will not affect the rates resulting from the settlement, because “the shortfall from the [low-income] rate was not allocated to other classes of customers, and would have been included in future rates.” (*Id.* at 7.)

## **8. Comments on Proposed Decision**

The proposed decision (PD) of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Opening comments were filed on \_\_\_\_\_, and reply comments on \_\_\_\_\_.

## **9. Assignment of Proceeding**

Michael R. Peevey is the Assigned Commissioner, and A. Kirk McKenzie is the assigned ALJ in these proceedings.

## **Findings of Fact**

1. Cal-Am entered into a settlement agreement with ORA concerning both the Coronado and Village Districts. This agreement (ORA Settlement Agreement) is attached to this decision as Appendix A.

2. Cal-Am entered into a separate settlement agreement with Thousand Oaks concerning the Village District. This agreement (Thousand Oaks Settlement Agreement) is attached to this decision as Appendix B.

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<sup>15</sup> The criticisms of the ORA low-income assistance proposal in D.04-09-041 also parallel those set forth in Cal-Am’s testimony in this proceeding.

3. When considered together, the ORA Settlement Agreement and the Thousand Oaks Settlement Agreement resolve every issue raised by the parties in this proceeding.

4. When considered together, the ORA Settlement Agreement and the Thousand Oaks Settlement Agreement command the sponsorship of all active parties in this proceeding.

5. The active parties are fairly reflective of the affected interests in these consolidated proceedings.

6. When considered together, the two settlement agreements convey sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests.

7. The agreement between Cal-Am and Thousand Oaks to pursue an exchange of the Conejo Oaks and Academy service areas will enable Cal-Am to avoid the expense of making certain capital improvements during the years covered by this rate case.

8. The hardware and software improvements that Cal-Am expects to have in place by March 1, 2005 appear to be appropriate initial responses to the concerns about inadequate water pressure, inadequate fire flows and lack of response to service calls that were expressed at the PPH held in Thousand Oaks on June 29, 2004.

9. The low-income discount endorsed in ¶¶ 12 and 20.2 of the ORA Settlement Agreement would not be available to individuals and families who are tenants in master-metered dwellings that lack individual sub-metering.

10. The low-income discount endorsed in the ORA Settlement Agreement does not allocate the revenue shortfalls associated with the proposal to other customers, but instead permits these shortfalls to be tracked in a memorandum account for possible future recovery.

11. It is possible that if Cal-Am were to seek future rate recovery of the revenue shortfalls associated with the low-income discount agreed to by Cal-Am and ORA, some low-income consumers might end up paying higher water rates than if this discount were not implemented.

12. The low-income discount endorsed in the ORA Settlement Agreement does not require consumers entitled to the discount to institute any water conservation measures.

**Conclusions of Law**

1. The participation of Thousand Oaks in this consolidated proceeding has been limited to matters relating to the Village District.

2. Taken together, the ORA Settlement Agreement and the Thousand Oaks Settlement Agreement represent an uncontested settlement within the meaning of Rule 51(f), as well as an all-party settlement as defined in D.92-12-019.

3. Except for the provisions relating to low-income ratepayer assistance, no term in either the ORA Settlement Agreement or the Thousand Oaks Settlement Agreement contravenes any statutory provision or prior Commission decision.

4. Except for the provisions relating to low-income ratepayer assistance, the ORA Settlement Agreement and the Thousand Oaks Settlement Agreement are reasonable in light of the whole record, consistent with law, and in the public interest.

5. Except for the provisions relating to low-income ratepayer assistance, the ORA Settlement Agreement should be adopted.

6. The Thousand Oaks Settlement Agreement should be adopted.

7. Consistent with D.02-12-068, the rate increase for the Coronado District adopted in this decision for Test Year 2005 should be deferred until January 1, 2006, and the rate increases approved herein for the Coronado District for 2006 and 2007 should be deferred until January 1, 2007 and January 1, 2008, respectively.



8. Consistent with D.02-12-068, the rate decrease for the Village District adopted in this decision for Test Year 2005 should become effective on January 1, 2005, but the rate increases for the Village District approved herein for 2006 and 2007 should be deferred until January 1, 2007 and January 1, 2008, respectively.

9. This decision should be made effective immediately.

**O R D E R**

**IT IS ORDERED** that:

1. The settlement agreement between California-American Water Company (Cal-Am) and the Office of Ratepayer Advocates (ORA), which is attached hereto as Appendix A, is adopted except for the provisions relating to low-income ratepayer assistance set forth in paragraphs 12 and 20.2 thereof.

2. The settlement agreement between Cal-Am and the City of Thousand Oaks (Thousand Oaks), which is attached hereto as Appendix B, is adopted in its entirety.

3. The rates adopted herein for Cal-Am's Coronado District for 2005 shall go into effect on January 1, 2006, and the rates adopted for 2006 and 2007 for the Coronado District shall go into effect on January 1, 2007 and January 1, 2008, respectively.

4. The rates adopted herein for Cal-Am's Village District for 2005 shall go into effect on January 1, 2005, and the rates adopted for 2006 and 2007 for the Village District shall go into effect on January 1, 2007 and January 1, 2008, respectively.

5. Cal-Am is authorized to file in accordance with General Order 96-A, or its successor, and to make effective on not less than five days' notice, tariffs containing the rate changes authorized in this decision for the Coronado and Village Districts, consistent with Appendix A.

6. Cal-Am is authorized to establish memorandum accounts to track (a) costs associated with Cal-Am's participation in the regional water supply study for San Diego County, and (b) costs arising from additional charges for purchased water imposed by the City of San Diego, as described in paragraphs 6.1 and 6.2 of Appendix A.

7. This proceeding is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

**APPENDIX C  
LIST OF APPEARANCES**

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**(END OF APPENDIX C)**