Decision **PROPOSED DECISION OF ALJ BUSHEY (Mailed 5/20/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of California Water Service Company (U 60 W), a Corporation, for an Order Authorizing It to Increase Rates Charged for Water Service at Each of Its Operating Districts to Recover Increased Operating Expenditures at Its General Office.	Application 01-09-062 (Filed September 10, 2001)
And Related Matters.	Application 01-09-063 Application 01-09-064 Application 01-09-065 Application 01-09-066 Application 01-09-067 Application 01-09-068 Application 01-09-069 Application 01-09-070 Application 01-09-071 Application 01-09-072 Application 01-09-073 Application 01-09-074

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James Weil, for Aglet Consumer Alliance, interested party.
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OPINION AUTHORIZING RATE INCREASES

1. Summary

California Water Services Company (Cal Water), is authorized to increase rates as follows:

Bear Gulch District

$514.50 (or 3.67 %) for test year 2002
$461.50 (or 3.18 %) for test year 2003
$423.30 (or 2.83 %) for attrition year 2004
$423.30 (or 2.75 %) for attrition year 2005

Chico District

$1,320.14 (or 15.39 %) for test year 2002
$335.30 (or 3.39 %) for test year 2003
$116.50 (or 1.14 %) for attrition year 2004
$116.50 (or 1.13 %) for attrition year 2005

Dixon District

$74.53 (or 7.21 %) for test year 2002
$34.60 (or 3.12 %) for test year 2003
$25.40 (or 2.22 %) for attrition year 2004
$25.40 (or 2.18 %) for attrition year 2005

East Los Angeles District

$1,176.44 (or 6.76 %) for test year 2002
$321.40 (or 1.73 %) for test year 2003
$283.20 (or 1.50 %)for attrition year 2004
$283.20 (or 1.48 %) for attrition year 2005

Hermosa-Redondo District

$1,838.84 (or 12.14 %) for test year 2002
$210.40 (or 1.24 %) for test year 2003
$105.70 (or 0.61 %) for attrition year 2004
$105.70 (or 0.61 %) for attrition year 2005

King City District

$156.04 (or 14.84 %) for test year 2002

$75.20 (or 6.23 %) for test year 2003
$44.3 (or 3.45 %) for attrition year 2004
$44.3 (or 3.34 %) for attrition year 2005

Livermore District

$98.07 (or 1.02 %) for test year 2002
$370.40 (or 3.79 %) for test year 2003
$202.10 (or 1.99 %) for attrition year 2004
$202.10 (or 1.96 %) for attrition year 2005

Los Altos District

$786.01 (or 6.63 %) for test year 2002
$357.10 (or 2.83 %) for test year 2003
$295.70 (or 2.28 %) for attrition year 2004
$295.70 (or 2.23 %) for attrition year 2005

Marysville District

$246.92 (or 19.22 %) for test year 2002
$130.90 (or 8.55 %) for test year 2003
$125.60 (or 7.55 %) for attrition year 2004
$125.60 (or 7.02 %) for attrition year 2005

Mid-Peninsula District

$901.71 (or 5.09 %) for test year 2002
$191.20 (or 1.03 %) for test year 2003
$144.00 (or 0.77 %) for attrition year 2004
$144.00 (or 0.76 %) for attrition year 2005

Stockton District

$1,238.71 (or 7.53 %) for test year 2002
$328.40 (or 1.86 %) for test year 2003
$271.40 (or 1.51 %) for attrition year 2004
$271.40 (or 1.48 %) for attrition year 2005

Visalia District

$452.89 (or 5.01 %) for test year 2002
$312.80 (or 3.30 %) for test year 2003
$116.70 (or 1.19 %) for attrition year 2004
$116.70 (or 1.18 %) for attrition year 2005

Westlake District

$655.31 (or 8.49 %) for test year 2002
$97.60 (or 1.17 %) for test year 2003
$47.30 (or 0.56 %) for attrition year 2004
$47.30 (or 0.56 %) for attrition year 2005

Willows District

$93.38 (or 10.91 %) for test year 2002
$32.20 (or 3.39 %) for test year 2003
$24.50 (or 2.50 %) for attrition year 2004
$24.50 (or 2.44 %) for attrition year 2005

These increases reflect an 8.9% rate of return in all years. Although we have set attrition increases for 2005, implementation of the increases is subject to change as part of the proceeding required by § 455.2, as discussed below. The low-income assistance rate proposed by Cal Water is rejected due to failure to meet applicable standards.

We have evaluated numerous issues that reflect and relate to the way Cal Water operates its business. Overall, we find that Cal Water is successful in providing safe, reliable, and reasonably priced water service to its customers. Cal Water also has persuaded us that it needs to increase its level of capital projects to ensure the long-term sustainability of its system. Preserving and enhancing the water system is in the best interests of both Cal Water's customers and its shareholders. Because we are authorizing an unprecedented level of capital expenditures, Cal Water must be more forthcoming and comprehensive in its presentations to the Commission so that we can monitor its efforts to see that the programs we authorize come to fruition. Improving its presentations will also assist the Office of Ratepayer Advocates (ORA) and intervenors in performing their duties.

In today's decision, we also find that Cal Water has not been persuasive on several cost components, particularly general office expenses. These costs have been relentlessly increasing. Such increases require thorough and detailed explanations, which have not yet been presented. We encourage Cal Water to review these expenditures and, to the extent management believes that the expenses will benefit ratepayers, to articulate a well-supported rationale in future rate cases.

2. Description of Proceeding

This consolidated proceeding resolves applications for rate increases in 15 out of the 24 districts in which Cal Water provides water service, and will affect water rates for 286,689 customers. The 15 districts are located throughout most of the state – from East Los Angeles to Chico – and present different service challenges to Cal Water. For example, the King City District has experienced significant customer growth, while the Stockton District's most pressing issue is decontaminating wells. The various districts also have different regulatory histories before the Commission. Some districts, such as Bear Gulch, have relatively recently (2000) been through a general rate case with resulting test year data. Other districts, such as Mid-Peninsula, have not been through a general rate case since test year 1994. Consequently, each district must be looked at individually to evaluate the proposed rate increases.

In addition to district-specific items, each district is allocated a share of Cal Water's general office costs. These are the costs associated with Cal Water's headquarters, where the operational functions of accounting, engineering, water quality control, purchasing/stores, and customer billing are performed. Administrative and general (A&G) functions are also performed at the headquarters.

In the Rate Case Plan[1], the Commission set a three-year schedule for the larger regulated water utilities to make general rate case filings. Each utility or each district of a multi-district was allocated a time for filing once every three years. For multi-district filings, the time line for completing the proceeding increases with the number of districts filed simultaneously. The Commission also directed that the filing schedule be updated annually "to assure that each utility has a fair opportunity to file a general rate case . . . and to assure that the Commission's workload is balanced over time." Id. at 188. The schedule adopted provided for Cal Water to file rate cases for its districts in three equal increments over a three-year span. The Rate Case Plan also allowed for the utility to request waiver of the time schedules, and for the ALJ to revise the schedule for cause.

In contrast to the Rate Case Plan schedule, this consolidated proceeding includes 15 of Cal Water's 24 districts. This unprecedented number of districts filed simultaneously is not consistent with the Rate Case Plan and Cal Water did not seek a waiver of the schedule. The challenges presented by the proportions of this proceeding have been exacerbated by the skeletal direct case filed by Cal Water. As we discuss in detail below, the deficiencies of Cal Water's direct case required significant rebuttal testimony, presenting new and substantial factual evidence. Further delay in the proceeding resulted from the comparison exhibit being filed two months later than scheduled and the need for the ALJ to request supplemental information from the parties on two occasions. For these reasons,

[1] Re Schedule for Processing Rate Case Applications by Water Utilities, 37 CPUC 2d 175, (D.90-08-045).

we find that good cause exists to modify the Rate Case Plan schedule to accommodate the extraordinary facts of this case.

On September 30, 2002, the Governor signed into law Assembly Bill 2838, to be codified as § 455.2, which requires that the Commission review and revise the Rate Case Plan to provide for mandatory general rate case filings on a three-year cycle. The Commission's review of the Rate Case Plan will establish the future filing schedule for water utilities and districts, including the 15 Cal Water districts considered in this proceeding. Consistent with the current Rate Case Plan, this proceeding sets rates for two test years and two attrition years. As some of the districts may be scheduled in the revised Rate Case Plan for another rate case filing prior to the final attrition year, we will make the 2005 attrition year increase contingent upon the revised Rate Case Plan.

3. Background and Procedural History

On July 31, 2001, Cal Water filed its Notices of Intention to File General Rate Increase Applications in each of the listed districts. Customers were advised of the proposed rate increase through publication and bill inserts. On September 21, 2001, Cal Water filed the above-captioned applications seeking rate increases in each district to produce an overall rate of return of 9.41% in 2002, 9.46% in 2003, 2004, and 2005. These rates of return produce a return on equity of 10.75% in each of the four years. Cal Water stated that it considered these returns on rate base as the minimum rates necessary to enable it to maintain its credit rating, obtain new capital at a reasonable cost and provide a fair and reasonable return on equity.

Cal Water also stated that the principal factor behind its rate increase requests is that the additional revenue generated by increased numbers of customers or increased consumption is more than offset by the resulting increases in costs to serve such usage.

Notice of filing of the applications appeared in the Commission's Daily Calendar on October 18 and 19, 2001. In Resolution ALJ 176-3074, the applications were preliminarily categorized as ratesetting.

On November 19, 2001, ORA filed its protests to each of the applications. In each protest, ORA stated that it was conducting discovery, investigation, and analysis to address issues such as whether the estimated levels of revenues, expenses and rate base were just and reasonable and in the public interest.

On December 11, 2001, the North Ranch Country Club (North Ranch) filed its protest of the application for the Westlake District, A.01-09-074. North Ranch contended that Cal Water's requested increase in reclaimed water rates was excessive and might result in reclaimed water customers subsidizing other customer classes.

The assigned ALJ held a Prehearing Conference (PHC) on November 26, 2001, February 4, 2002, and April 22, 2002. At the first two PHCs, ORA and Cal Water resolved outstanding discovery issues and set a procedural schedule for the remainder of the proceeding. At the April PHC, the parties resolved procedural issues related to the participation of the Aglet Consumer Alliance (Aglet).

On March 25, 2002, the Assigned Commissioner issued a ruling consolidating the applications into one proceeding, determining that a hearing was necessary, and designating the assigned ALJ as the principal hearing officer.

The Commission held a Public Participation Hearing in each of the captioned 13 districts, including one in each of three smaller districts comprising Cal Water's Northern District, for a total of 15. The members of the public who offered comments generally opposed the magnitude of the proposed increases, particularly in this time of economic downturn. One commenter sought information and notices that were understandable to members of the public and not full of acronyms. Customers on metered use charged that customers who pay a flat rate regardless of usage were wasting water. Certain commenters noted that Cal Water's income from unregulated operations was not included in calculating rate of return, and that the number of unregulated customers had more than doubled from 1997 to 2000. Customers also questioned Cal Water's plans for expanding its service territory and how Cal Water would meet the needs of these new customers without increasing rates for existing customers. The existence of and costs for treating contaminated water sources also drew several comments.

On March 29, 2002, ORA distributed its Reports for each district in which Cal Water had requested rate increases. ORA recommended decreases in rates for some of the districts and modest increases for others. A comparison of the rate increases requested by Cal Water and ORA's recommendations is set out in Attachment A. On March 27, 2002, North Ranch distributed its direct testimony on the issue of reclaimed water rates in the Westlake District.

Evidentiary hearings were held in San Francisco April 18, 19, 22, 23, 25, and 26, 2002. During the hearings, ORA and Cal Water were able to resolve their differences on many issues and to present a Joint Recommendation. The Joint Recommendation is Attachment B. The increases provided by the Joint Recommendation are shown in Attachment A. Aglet joined in certain portions of the Joint Recommendation, and took no position or opposed other portions. Also during the evidentiary hearings, all parties reached agreement on a

Reclaimed Water Rate Joint Recommendation.
(*See* Attachment C.)

4. Removal of Salinas District from Consolidated Proceedings

In D.03-01-081, the Commission found that Cal Water was providing public utility water service in two areas formerly served by mutual water companies but now included as unapproved portions of Cal Water's Salinas district. Cal Water acquired Indian Springs Mutual Water Company on March 12, 1997; it is not hydraulically connected with but is adjacent to Cal Water's Salinas district system and has 175 customers. Cal Water acquired Country Meadows Mutual Water Company on March 9, 2000, and it has 108 customers in Monterey County. It is neither hydraulically connected with nor adjacent to Cal Water's Salinas district system.

Cal Water has not complied with the Commission's requirements for obtaining approval of either acquisition or rates being charged these new customers. In D.03-02-081, the Commission set a briefing schedule to resolve the issues of refunds and penalties arising from Cal Water's actions.

These unapproved acquisitions also implicate Cal Water's revenue requirement for the Salinas District. The Water Division is reviewing Cal Water's late-filed advice letters (Cal Water 1514 and 1515) for these acquisitions and is carefully scrutinizing any effects on the Salinas district's revenue requirement.

Finally, we note that pending approval of the acquisitions, Cal Water does not have authority to serve these customers, all of which have been included in its revenue requirement calculations for this rate case.

Issues regarding unauthorized acquisition of systems are not present in other districts in this consolidated proceeding. We, therefore, determine that the Salinas district general rate case application (A.01-09-071) should be removed from this consolidated proceeding and processed separately. All issues relating to the Salinas district will be resolved in the separate docket.

5. Decision Setting Effective Date

On April 3, 2003, the Commission issued D.03-04-033, which set the effective date for the test year 2003 results of operations and rates to be adopted in this proceeding. That decision applied to all districts in this consolidated proceeding except Salinas. Thus, the effective date for the rates adopted in today's decision shall be April 3, 2003. Cal Water shall file tariffs that recover the retroactive amounts over no less than one year.

6. Organization of this Decision

As discussed above, Cal Water's service territory is organized into districts, and rates are set on a district-specific basis. The revenue requirement for each district is comprised of costs incurred in the district plus a share of the costs of administrative and engineering services provided by Cal Water's general office. Accordingly, certain issues affect a specific district while other "general office" issues affect all districts. We begin this decision with a discussion of the applicable legal standards. We then address the issues affecting all districts, and finally address the district-specific issues.

7. Applicable Legal Standards

7.1 Burden of Proof

As the applicant, Cal Water bears the burden of proving that the proposed rates are just and reasonable. No party disputes this assignment of the burden of proof.

In its opening brief, Cal Water acknowledges that § 454[2] requires that Cal Water prove that its proposed rate increase is "justified." As the party bearing the burden of proving that the proposed rate increase is "justified," Cal Water must present a prima facie showing that meets this burden. Simply put, Cal Water's evidence presented on the record must justify the rate increase.

As a general matter, Cal Water's reports in this proceeding do not meet this standard. Cal Water's reports consist of boilerplate descriptions of various tables of historical data and future projections. Specific increases are not identified, much less explained. No analysis of specific data is included. No explanations of the forecasting methods are presented. For example, these applications request 40 additional employees for Cal Water. The requested employee positions were neither listed, described, nor explained on the record. Similarly, Cal Water's tables showed over $6 million in capital additions to general office. These projects were not listed or explained in the record. The most extreme example is Cal Water's proposed low-income tariff, where it presented <u>no</u> record evidence whatsoever.

Identification of the significant issues underlying the requested rate increase has fallen on ORA. Apparently through the use of discovery and workpapers, all of which are outside the record, ORA was the party responsible for recognizing and articulating the major changes leading to the requested increase. ORA's reports contain the first and, in some instances, the only descriptions of Cal Water's positions on many issues. More troubling are the issues that ORA identifies and resolves with Cal Water completely outside the

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[2] All statutory citations are to the Public Utilities Code unless otherwise indicated.

record, for example, the adjustment to rate base for non-regulated operations discussed below. This significant reduction to general office rate base, 7%, was completely unexplained and unsupported in the record prior to the ALJ ordering that such an explanation be provided.

To the extent ORA raises issues in its testimony, Cal Water then has the opportunity to present rebuttal testimony. As a result, Cal Water makes its case only on the issues that ORA raises and that Cal Water is unable to resolve through discovery or off-the-record negotiations. The resulting record, however, is far from ideal.

The tank painting issues illustrate this scenario well. For example, in the Hermosa-Redondo district, Cal Water's rate base table 8-B shows net plant additions of slightly more than $2 million for each test year. The projects that make up this amount are neither listed, explained, nor justified. In ORA's report, we find a listing of the disputed projects, including certain proposed tank painting, which totals about $1 million. Cal Water's rebuttal testimony then addresses some but not all of ORA's disputed issues, from which we infer that Cal Water has accepted ORA's disallowances for the projects not addressed. Thus, for a large share of the proposed additions, the record contains no evidence, other than ORA's acquiescence to Cal Water's proposal or Cal Water's acquiescence to ORA's disallowances.

For today's decision, we have been able to satisfy ourselves that the record is sufficient to support this decision. To accomplish this, however, the record was supplemented twice at the direction of the ALJ. Aglet provided copies of significant portions of Cal Water's workpapers as part of its evidence for the record, and ORA presented much of Cal Water's analysis of issues in ORA's testimony. These means of completing the record, while sufficient for now, are not acceptable on an on-going basis.

Procedurally, we believe that use of a motion to dismiss the entire application, or parts of the application, for failure to present a prima facie case is a useful device for identifying evidentiary deficiencies early on in the process.

Such motions will alert the applicant to potential deficiencies, and allow the applicant to seek the opportunity to cure the deficiencies.

We are also concerned about the use of "updated tables" for certain portions of the initial showing. These tables are provided without explanation for the record. Changes are not identified, thus making it extremely difficult to evaluate the propriety of the updates.

For guidance on preparing its next applications, we note the following requirements:

1. NOI. –The Rate Case Plan requires that the major changes that led to the requested rate increase be identified and quantified. Each issue should include explanations and justifications for the requested change, with cross-references to evidentiary support. Specifically, the Rate Case Plan[3] requires that the NOI contain "a brief statement of the amount and percent of the increases sought and the reasons for the proposed increases. Documentation constituting the utility's proposed showing in support of the results of operations and rate of return, including draft prepared testimony and draft exhibits with complete explanations and summaries, shall be annexed to the NOI."

2. Application. The Rate Case Plan carries through the NOI requirements by specifying that the application "include all exhibits, prepared testimony, and other evidence constituting applicant's showing, and shall also include a comparison exhibit showing any differences between the NOI and the showing submitted with the application and explaining the differences." Compliance with this rule would obviate the need for project justifications for the first time in rebuttal testimony. The Rate Case Plan requires summaries, explanations, and comparisons

[3] Re Schedule for Processing Rate Case Applications by Water Utilities, 37 CPUC 2d 175, 190-1, (D.90-08-045)(emphasis added).

because unexplained data have little value in assessing whether a utility has met its burden. Comparison of current projections to historical information, as well as a description of the forecasting method used is necessary. Where available, references to external, objective support for the forecasts should be provided. Where relied on, professional judgment should be acknowledged.

3. Amending the Application. Rule 23 of the Commission's Rules of Practice and Procedure (Rules) sets out the requirements for rate increase applications. Rule 23(k) also requires that if the applicant desires to "revise the level of rates shown in its original application before hearing on the same, the applicant shall file an Amendment to Application in accordance with Rule 2.6." Thus, all changes to the original rate increase request[4] must be made with a filing pursuant to Rule 2.6.

7.2 Standard of Proof

With the burden of proof placed on Cal Water, we must next determine the degree of certainty to which Cal Water must demonstrate that its rates are just and reasonable. California law provides for three common levels of certainty, and refers to these differing levels as standards of proof. In descending order of certainty, the three are: beyond a reasonable doubt, clear and convincing, and preponderance of the evidence.

Aglet stated that the applicable standard of proof is clear and convincing, and that the preponderance of the evidence is "not good enough." Aglet cited several Commission decisions adopting the clear and convincing standard for electric and gas rate cases, and stated that there was no legitimate reason to treat the energy and water industries differently.

[4] After the update provided by the Rate Case Plan.

Cal Water argued that the Commission has not explicitly applied the clear and convincing standard to an entire water utility rate case but only to selected issues. Cal Water did not affirmatively suggest that an alternative standard applied, but concluded that "its strong evidentiary showing justifies the rate relief that the company has sought in this proceeding under any standard."

In evaluating a request for a rate increase, the Commission's ultimate objective is to ensure that all rates charged are "just and reasonable" as required by § 451. The Commission is also bound by § 454 to determine whether a rate increase is "justified." These statutes, and the Commission's decisions interpreting them, require Cal Water to convince the Commission, with clear evidence, that its rate increase is justified. As we demonstrate throughout today's decision, we apply this standard exactingly to each issue and determine that in some cases Cal Water has met its burden and in some cases it has not. As so modified, we find that the resulting rates meet the statutory standard of being just and reasonable.

7.3 Standard for Evaluating Joint Recommendations

As noted above, two joint recommendations have been presented in this proceeding. All parties support the Reclaimed Water Joint Recommendation. Aglet supports some, opposes other, and takes no position on the remainder of proposals in the Joint Recommendation presented by ORA and Cal Water (Joint Recommendation).

The Commission reviews all Joint Recommendations pursuant to the standards also applicable to settlements. Both these types of agreements must be reasonable in light of the record, consistent with the law, and in the public interest. Rule 51.1(e); D.00-02-048.

8. General Office Issues

As noted earlier, Cal Water is organized into 24 districts, the rates for 15 of which are at issue in this proceeding. These rates charged to customers reflect costs incurred both at the district level and at Cal Water's general office. The general office provides accounting, engineering, water quality control, purchasing/stores, and customer billing. The districts provide all other services. All costs incurred at the district level are assigned to the specific district. Similarly, all costs incurred in the general office for the benefit of a particular district are directly allocated to the particular district.

On the other hand, expenses incurred for the benefit of all districts are called "indirect" costs and are allocated to all districts. Virtually all general office expenses are indirect and, thus, recovered from ratepayers via the allocation methodology.[5]

General Office expenses are comprised of five major categories: (1) operation and maintenance, (2) A&G, (3) miscellaneous, (4) taxes, and (5) depreciation. Of these five categories, A&G expenses are the highest.

The Joint Recommendation supports a $3 million (or 10% over test year 2000) increase in general office expenses to be allocated among the districts. Aglet challenges this increase, contending that Cal Water has not met its burden particularly with respect to the A&G category of expenses at the General Office. In its testimony, Cal Water did not describe how it arrived at its General Office

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[5] The four-factor allocation methodology uses: (1) gross utility plant, (2) payroll, (3) service connections, and (4) direct operations and maintenance expenses to calculate a weighting factor for allocating indirect costs across multiple districts. The four-factors are intended to reflect district size and, therefore, cost causation at the general office level.

A&G forecast. Aglet, however, provided for the record, as part of its work papers, a copy of a Cal Water data response setting out the process for forecasting A&G expenses.

Cal Water's data response states that its general approach for forecasting test and attrition year A&G expense is to take the average of recorded data and apply inflation factors. On the topics with which Aglet takes issue, however, Cal Water deviated from this general approach and used alternative forecasting methods. Cal Water offered vague rationales for these deviations; to the extent it offered any explanation at all. Each of those areas is discussed in detail below.

Prior to discussing the specific areas, we address a flaw identified by ORA in the overall allocation methodology that has not been adequately resolved by the Joint Recommendation. This flaw, the inadequate allocation of general office costs to non-regulated operations, results in significant misallocation of expenses and capital costs to ratepayers. We require Cal Water to make a detailed showing on this issue in its next general rate case.

8.1 Allocation of General Office Costs to Out-of-State and Affiliate Operations

In its general office, Cal Water incurs costs for providing services to: (1) the 15 districts at issue in this proceeding, (2) the 9 excluded districts, (3) out-of-state utility operations, and (4) unregulated corporate affiliates. Cal Water must allocate each group its fair share of general office costs. The record in this proceeding shows careful attention to the four-factor allocation to both included and excluded districts. Cal Water has not, however, presented evidence it has applied a similar level of attention to allocations to out-of-state utility and corporate affiliates.

In its testimony, ORA noted that Cal Water does not include out-of-state[6] operations in its allocation of indirect general office expenses. However, according to ORA, Cal Water had agreed that $2,803,050 of the total $26,044,358 indirect general office expenses should be allocated to out-of-state operations, as well as the districts. Specifically, Cal Water reviewed each general office department, estimated the share of overall department time spent on activities that included the out-of-state operations, and then used the four-factor test to allocate that share among the out-of-state operations and the districts. Application of this test still leaves the districts bearing almost all of these expenses. Cal Water determined that .35% should be allocated to Washington and .08% to New Mexico, for a total out-of-state allocation of .43% of the total general office costs.

While we will accept the Joint Recommendation on out-of-state allocation of general office expenses,[7] that allocation does not follow sound billing and accounting practices, as discussed in many Commission decisions. Notably, in D.97-12-011, we approved Cal Water's application for a holding company structure. Cal Water and the Commission's Water Division had submitted a settlement that set out the conditions under which Cal Water could operate in a holding company structure. Under the section entitled "Allocation

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[6] ORA and Cal Water referred to these operations as "non-regulated" but the parties subsequently clarified that they were referring to out-of-state operations.

[7] In the Joint Recommendation, the parties agreed that Cal Water would conduct a six-month timekeeping study to evaluate the proper allocation of management time to out-of-state activities that are not subject to D.00-07-018. We discuss this component of the Joint Recommendation below.

of Common Costs," the parties agreed that the Commission's underlying philosophy of allocating common costs between regulated and unregulated (in this case, out-of-state) operations was that: "ratepayers of the utility should not subsidize affiliates of the utility." This requirement has not changed. In practical terms, we require that <u>all</u> costs attributable to any non-utility function be allocated directly to non-utility accounts. To the extent that direct cost allocation is not feasible, then a cost allocation methodology must be employed to fairly assess indirect costs. To do otherwise will result in ratepayers paying such costs through rates which would fail to meet the just and reasonable requirement.

The evidence does not show that Cal Water's methodology for determining the costs to be allocated to out-of-state operations is based on direct billing where feasible. All costs for all general office departments are allocated as if the costs were indirects. For example, one line item, "HR," which we assume to be human resources, shows total costs of slightly less than $1 million. Cal Water believes that only one half of this department's costs should be subject to allocation to out-of-state operations. Thus, only .43% of the approximately half million dollars is actually allocated to out-of-state operations and not recovered from California ratepayers. Costs directly attributable to human resources work for the out-of-state operations should be directly billed, and the out-of-state share of joint projects determined on a project-by-project basis and recorded. Such detailed cost allocation is necessary to ensure that California ratepayers are not subsidizing out-of-state operations.

A related topic not addressed at all in the record is any allocation of general office expenses to in-state non-regulated operations.[8] Our policy as stated in the settlement approved in D.97-12-011 requires that non-regulated operations conducted by affiliates be allocated a share of indirect costs. To exempt affiliate operations from sharing in these costs would result in ratepayers subsidizing non-regulated operations. The record in this proceeding shows no allocation of indirect costs to California affiliate operations. As but one example of potential cross-subsidization, we note that the Cal Water web site, discussed in more detail below, contains information on Cal Water's affiliate, CWS Utility Services (CWS). The telephone number listed to contact CWS, however, is the main telephone number for Cal Water's headquarters office. If the office space, telephone equipment, and receptionist's salary are allocated solely to Cal Water's ratepayers, then ratepayers are subsidizing CWS in violation of D.97-12-011. Where a regulated utility with a Commission-approved holding company structure nevertheless chooses to co-locate with its affiliates, the utility must maintain scrupulous records and cost accounting to demonstrate convincingly that ratepayers are not subsidizing affiliate operations. Such records are necessary to show compliance with the settlement approved in D.97-12-011, where Cal Water agreed to "establish procedures for prompt and fair compensation or reimbursement for all assets, goods, and services transferred between the utility and its affiliates." The record in this proceeding does not clearly demonstrate that Cal Water has complied. In addition to the co-located

[8] Cal Water and ORA did, however, provide for an adjustment to general office rate base of 7% to account for unregulated California and out-of-state operations, which we discuss below.

offices and apparently shared telephone service, the record does not show any management policies or service agreements between Cal Water and its affiliates to provide for separation and accounting to ensure that ratepayers do not subsidize affiliates.

In sum, the record shows no methodology for allocating indirect general office costs to affiliates. Similarly, the record does not show that Cal Water has a practice of maintaining strict physical or accounting separation between the water utility and affiliates. Under these circumstances, an allocation to affiliates is absolutely required.

While we believe that the record could support a variety of interim allocation factors, we will not adopt an explicit factor. We reach this conclusion because elsewhere in today's decision we make significant disallowances of general office expenses provided for in the Joint Recommendation. One of our primary reasons for these disallowances is the relationship of the subject expenses to affiliate and other non-regulated operations. In light of those disallowances, we will not devise an interim allocation factor.

We do, however, direct Cal Water to adopt management policies and accounting practices to comply with the letter and spirit of D.97-12-011. Direct billing and complete physical and accounting separation are the best demonstration of cost causation. To the extent Cal Water chooses not to separate its affiliate activities from its regulated assets and employees, maintaining our commitment to ensure that ratepayers do not subsidize affiliate activities will require detailed, verifiable accounting records, subject to thorough scrutiny and auditing by ORA. Office and facility inspections should also be used as needed.

To the extent separation and direct billing are not accomplished, we order Cal Water to develop an allocation methodology that convincingly demonstrates that ratepayers are not subsidizing affiliate operations. All doubts or uncertainties should be resolved in favor of the ratepayers. In preparing its allocation methodology for affiliates and other non-regulated operations, Cal Water shall comply with our recent decision setting out the standards for allocating costs to affiliate operations.

In Roseville Telephone Company, 2001 Cal PUC LEXIS 604 (D.01-06-077), we rejected Roseville's three-factor allocation methodology for common general and administrative costs. The three factors used in Roseville were gross plant, expenses, and employee headcount. We found that this formula "over-allocates costs" to the regulated utility. In reaching this determination, we found that "the use of accumulated assets as a significant factor in allocating common costs . . . does not provide a reasonable approximation of the extent to which affiliates caused common costs to be incurred." D.01-06-077, mimeo. at 57-8. We concluded that "use of an allocator-such as [the] three-factor formula – that emphasizes past asset accumulation would 'consistently understate' usage by unregulated affiliates." Id. at 60. Instead of the three-factor formula, we adopted an allocation factor based only on expenses.

In developing an allocation methodology, we direct Cal Water, where feasible, to rely on a cost-causation based factor to allocate common expenses, costs, or plant.[9] For example, for billing services, it would be

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[9] In contrast to its nonutility affiliate operations, Cal Water's utility operations in Washington and New Mexico may be sufficiently similar to its California utility operations to apply the four-factor allocation.

meaningful to allocate expenses by the number of bills sent out or by the hours the employees and equipment were used for regulated and non-regulated services. Another example, if regulated and non-regulated activities are conducted in the same building, the rent, utilities, and repairs, may be allocated by the space occupied by the different groups of employees, or if the same employees worked on both, then by their work hours on the different activities, or if that is not available, by the revenues generated, or a combination of the three. We expect Cal Water to develop and supply supporting rationale for a comprehensive cost allocation methodology.

Under the Joint Recommendation, Cal Water will conduct a six-month timekeeping study "to evaluate the proper allocation of management time to non-regulated CPUC activities which are not subject to D.00-07-018."[10] This component of the Joint Recommendation is a solid beginning but does not go far enough to the address the serious cost allocation issues raised by ORA.

Fundamentally, Cal Water management and employees should directly bill all non-utility work to affiliates. Direct billing, with thorough accounting records, is the best means of demonstrating that ratepayers are not subsidizing non-utility operations. We expect direct billing to include management time.

The Joint Recommendation also excludes management time spent on projects subject to D.00-07-018. Management time spent on utility non-tariffed products and services is an incremental cost of the non-tariffed product

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[10] In D.00-07-018, the Commission adopted rules covering non-tariffed services provided by water utilities.

or service. As we stated in D.00-07-018: "This mechanism allows new non-tariffed products and services, with shareholders absorbing all incremental costs and taxes, and shareholders and ratepayers sharing in any revenues." Consequently, all utility management and employee time and expenses for projects pursuant to D.00-07-018 must be carefully accounted for and allocated solely to shareholders. We, therefore, reject the component of the Joint Recommendation exempting Cal Water's utility projects subject to D.00-07-018 from direct billing and the timekeeping study.

8.2 Allocation of Capital Costs to Unregulated Operations

Notably missing from the discussion of general office capital costs is any discussion of allocating a portion of these costs to non-regulated operations. However, the rate base tables in Cal Water's testimony show an adjustment of 4.595% for "Nonregulated plant adjustment." ORA's testimony shows a similar adjustment but for 7%. In the Joint Recommendation, a line item for "non-regulated plant adjustment" is shown which reflects a 7% disallowance.

In a supplement to the Joint Recommendation, the parties noted, first, that Cal Water's work papers included a 4.595% allocation of General Office rate base to unregulated operations. Cal Water provided no data, calculations, or explanation for this allocation percentage. Cal Water stated that the purpose was "to give credit to ratepayers for general office service contracts made prior to D.00-07-018." Cal Water also stated that contracts made under the rules of D.00-07-018 will not lead to such an adjustment. Second, ORA determined that Cal Water had not allocated any general office rate base to its out-of-state operations. ORA's preliminary calculations showed that the allocation should be about 3%. In the Joint Recommendation, ORA and Cal Water apparently intended to add the two components but inexplicably came up with 7%.[11] Both parties recognized that this was an interim amount that will be scrutinized in the next rate case.

Properly calculating a rate base adjustment for non-regulated operations is vital because Cal Water and its corporate affiliates engage in significant non-regulated operations that may rely on regulated assets. Ratepayers should not be allocated 100% of the capital costs for any regulated asset also used for non-regulated purposes.

ORA expressed continued concerns about the impact on ratepayers of Cal Water's contract to provide billing services to the City of Stockton. Information provided by Cal Water to the Director of the Water Division, and copied to all parties to this case, shows that, in addition to the City of Stockton contract, Cal Water has existing billing service contracts with other entities. Cal Water's annual report to shareholders confirms that Cal Water has significant non-regulated operations, with 106,100 unregulated customers and 430,600 regulated California customers.[12] The annual report also identifies six billing contracts in California, as well as four operations and maintenance contracts, one meter reading contract, and two operating or service contracts.

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[11] Neither party presented any justification for "rounding down" 7.595% to 7%, which benefits shareholders not ratepayers. Consistent with our policy of resolving cost allocation issues in favor of ratepayers and, in this case, consistent with mathematical rounding principles, we will round the total to the closest whole number, 8%.

[12] Pursuant to Rule 73 and Evidence Code § 452, we take official notice of California Water Services Group's 2001 Annual Report to Shareholders.

As a matter of general ratemaking requirements, all costs, including indirect common costs, must be allocated between regulated and non-regulated operations. See, e.g., Roseville Telephone Company, D.01-06-077, 2001 Cal. PUC LEXIS 604, *55-*64. Non-regulated operations undertaken by affiliates should also be accounted for in the test years to the extent regulated assets or employees are used.

The record shows that Cal Water's general office expenses have increased substantially, with the greatest increases in the area of customer billing and information services. For general office capital costs, a similar result has occurred. The Joint Recommendation provides for $516,000 of capital additions related to billing and customer information in 2002 and $630,400 in 2003.

For water companies, such as Cal Water, that sell non-tariffed services, the Commission established a sharing mechanism for gross revenues in D.00-07-018. Shareholders receive the bulk of the revenue, either 90% or 70% depending on the type of project, but must also bear all costs. The Commission required that the shareholders absorb all incremental costs of the non-tariffed offering, and left to "future rate cases to consider the issue of whether or to what extent rates should reflect investments made and costs incurred for labor and capital jointly used for tariffed and nontariffed products and services." D.00-07-018 *mimeo* at p.16. The Commission also required an annual report for each utility[13] engaging in non-tariffed endeavors. Id.

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[13] We note that the record contains no evidence that Cal Water has complied with the report requirement. To the extent Cal Water has not submitted the required reports, Cal Water should remedy this oversight as soon as possible. Such reports should include detailed accounting for all costs and revenue.

To the extent a water utility has known contracts for the test year period to sell non-tariffed services that rely on assets included in the utility's revenue requirement, those contracts must be included in all cost allocations related to those assets. Failure to do so would result in ratepayers subsidizing non-tariffed endeavors.

A slightly different result will occur for non-tariffed services sold to a utility's corporate affiliate. In that instance, the corporate affiliate must contract for services from the utility. As set out in Cal Water's holding company decision, the utility must be compensated at the higher of actual cost or fair market value for these services. This revenue is a credit to the utility's revenue requirement, but the plant costs are included in rate base. In this way, ratepayers are compensated for services provided to the affiliate, and the affiliate retains all revenue fro

The Commission must undertake a thorough review of all capital costs and expenses in areas where substantial non-tariffed revenue is being generated from non-regulated utility customers as well intercompany sales to affiliates. For this reason, it is essential that water utilities present a compelling case for capital costs and expenses associated with operational areas with significant non-tariffed operations.

For purposes of today's decision, we will modify and accept as modified the Joint Recommendation to reduce rate base by 8% to account for non-regulated use of these assets. As with the allocation of indirect general office expenses, we accept this interim factor due, in part, to the substantial disallowances for specific costs that we adopt elsewhere in today's decision.

8.3 Payroll

General office payroll consists of both A&G payroll and operations and maintenance (O&M) payroll. Total payroll and associated general office pensions and benefits comprise about 2/3 of all general office costs. To arrive at its forecast for payroll, Cal Water began with recorded 2000 data, and then added new employees hired in 2001 and a 3% inflation factor to arrive at an estimate for 2001. Building off the 2001 estimate, Cal Water added new hires during 2001 and a 3% inflation factor to get a forecast for 2002. Similarly, the 2002 forecast is escalated for new hires and a 3% inflation factor, resulting in the 2003 forecast. ORA explained in its report that Cal Water then distributes the total general office payroll among A&G, operations, and maintenance accounts based on the historic ratio of each account's payroll to total payroll.

According to ORA's report, Cal Water included hiring 40 new employees over the three-year period from 2001 to 2003. Neither Cal Water's report on General Office nor any other record document offered by Cal Water identified these positions or the year of hiring, much less presented any justification for adding them. Apparently through the discovery process or review of Cal Water's work papers, which are not included in the record, ORA came to understand that 15 of these positions had already been filled or related to capital projects ORA supported. In its report, ORA also supported four additional positions for a total of 19 new positions over the course of 2001 to 2003.

The Joint Recommendation allowed for 23 new positions and three upgrades. The Joint Recommendation started with the 19 positions that ORA supported and added four additional positions and upgraded three positions. Cal Water stated that three of the four new positions are engineering related – an electrical engineer and technician in 2002, and a production engineer in 2003 – and that the majority of the costs of the positions will be related to capital projects and thus included in the districts' capital budgets. The fourth position is for a senior web developer to upgrade Cal Water's web site, which is addressed below, but we note here that this portion of the Joint Recommendation is not approved. Cal Water stated that the Joint Recommendation would result in a payroll increase of approximately 10% from authorized 2000 levels to test year 2002.

Aglet challenged Cal Water's overall payroll increase. Aglet criticizes Cal Water's 3% inflation factor as unreasonable because (1) Cal Water's union contract does not currently provide for such an increase in 2003, and (2) this factor far exceeds the rate of new customers, .9%, or inflation, 1.5%. Aglet recommended that the Commission use an average, judgment, or some other reasonable estimation method.

We agree with Aglet that Cal Water's case for the proposed 10% increase in payroll expenses is vaguely supported at best. Cal Water has not presented any record rationale to support the new employees. The Joint Recommendation also supported using a 3% factor for overall cost of living increases for all personnel for 2001, 2002, and 2003. This amount is based on the increase provided for in Cal Water's contract with its union for 2001 and 2002. As Aglet pointed out, the increase, if any, for 2003 has not yet been set.

We note that ORA's labor inflation factors were 5.9% for 2001[14], 3.4% for 2002, and 3.6% for 2003. The Joint Recommendation payroll increase is less than the increase ORA's labor inflation factors would indicate; we will therefore find it reasonable.

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[14] Although 2001 is not a test year in this proceeding, expense items, such as payroll, that are affected by annual escalations must be set for 2001 to provide a basis from which to calculate Test Years 2002 and 2003. The 2001 amounts do not change rates charged in 2001.

Included in the Joint Recommendation is one rate analyst position. Cal Water continued to request an additional rate analyst because Commission filing requirements have increased substantially. ORA disagreed. In agreeing to add one rates analyst, the Joint Recommendation allows for a 33% increase in the number of analysts. A second analyst would increase the staff by 50%. While Cal Water has not made a persuasive showing that its Commission-imposed workload has increased by 50%, the numerous deficiencies in the filing and litigation of these consolidated GRC's persuasively demonstrate that Cal Water's regulatory operations require additional attention. We will, therefore, grant Cal Water's request for a second rate analyst.

Cal Water also sought to add an electro-mechanical technician to the general office payroll. ORA objected because the technician will provide service only for the proposed Bakersfield treatment plant, and the Bakersfield district is not part of this proceeding. Cal Water agreed to remove these costs if they can be included in the labor component of advice letters submitted pursuant to D.01-08-039. We agree with ORA and will exclude the costs of this position from this proceeding. Cal Water may seek recovery of these costs in any otherwise appropriate proceeding it chooses.

8.4 Office Expenses

The Joint Recommendation supports a forecast $ 3,054,300 for Test Year 2002 and $ 3,360,600 for Test Year 2003 for office expenses. Cal Water stated that these amounts reflect a 30% (or $ 700,000) increase over Test Year 2000 assumptions and that the increase is due to expenses "of new hardware and software to manage customer information, bill customers, and provide accounting and human resources services." The 2002 Joint Recommendation amount is $50,000 more than ORA's estimate and $130,600 less than Cal Water's.

Aglet criticized this recommendation, as based solely on extrapolation from Cal Water's historic costs. Aglet characterizes such forecasting as an "an observation, not an explanation," and concludes that Cal Water's showing lacks sufficient evidence to support the reasonableness of the Joint Recommendation on this point. Aglet recommended using inflation plus customer growth of .9% to escalate office expenses.

We find on this record that a 30% increase in office expenses over two years is unreasonable. ORA's non-labor inflation rates are: .1% for 2001, a decrease of .2% for 2002, and 1.2% for 2003. Cal Water's non-labor inflation rates are .6% for 2001, .9% for 2002, and 1.2% for 2003. In the context of these low inflation rates, Cal Water's forecasted 30% increase in office expenses over two years requires far more explanation than Cal Water has provided.

Cal Water's explanation is that $700,000 is needed for software and hardware to manage customer information and billing, and accounting and human resource information. This explanation is at odds with basis upon which Cal Water determined its forecast – a linear trend of historic expenditures. Missing is any evidence to suggest that the inflation rate for office supplies has been about 15% per year for the last two years. A specific contemplated expenditure for the test year does little to support the escalation rate Cal Water and ORA advocate. Nor does Cal Water's statement in its data response to Aglet that it "believe[s] there is an upward trend in this category of expense" do much to explain why ratepayers should see office expenses increase by more than an order of magnitude higher than what would be suggested by ORA's or Cal Water's non-labor inflation factors or even Aglet's more generous factor comprised of customer growth plus inflation.

We note also that at the time this general rate case was pending, Cal Water entered into a contract with the City of Stockton to provide billing for the City's wastewater, stormwater, garden refuse, and garbage services. ORA discussed this contract in its testimony. In that same testimony, ORA also pointed out that Cal Water's allocation methodology for its non-utility operations failed to properly allocate a share of general office costs to non-utility operations. In the context of increasing costs for non-utility customer billing and a flawed cost allocation methodology for non-utility operations, the extreme office expense increase Cal Water sought requires particularly careful studies showing which costs are incurred for which activities. Cal Water has not provided such studies.

According to ORA, Cal Water agreed to use ORA's inflation factors because ORA's factors represented more recent estimates. For this reason, we will rely on ORA's non-labor annual inflation rates to escalate office expenses. We will also follow Aglet's suggestion and add on an annual factor reflecting Cal Water's historic customer growth of .9%. The sum of these two rates results in office expense increases of 1.0% for 2001, .7% for 2002, and 2.1% for 2003.

8.5 Outside Services

Cal Water forecasts $2,171,100 in outside services for Test Year 2002 and $2,223,200 in Test Year 2003.[15] Cal Water arrived at this forecast by averaging its recorded expenses for 1998, 1999, and 2000. ORA took issue with certain of the costs included in the average, mostly due to the Dominguez

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[15] Aglet points out, however, that the amounts in Cal Water's work papers are different and unexplained by Cal Water.

merger. ORA's forecast is $1,853,600 in Test Year 2002 and $1,877,800 in Test Year 2003. According to Cal Water, the Joint Recommendation includes general office outside services expense of $1,934,000 in Test Year 2002 and $1,959,900 in Test Year 2003.[16]

Aglet opposed the Joint Recommendation on outside services expenses, and Aglet recommends using a five-year historic average, as in Cal Water's previous general rate case. Aglet asserts that Cal Water has previously justified increases in this account by the need to use information services consultants, but at the same time and thus reduce the need for outside consultant services. Aglet alleges that using historic consultant costs to forecast future costs while simultaneously replacing some of those consultants with employees leads to double counting of these expenses.

In response to this allegation, Cal Water stated that the combined revenue requirement for the four employees that will be replacing consultants is approximately $500,000, and that this amount is more than offset by the $900,000 difference between recorded 2000 total outside services and forecasted Test Year 2002 expenses.

Cal Water's Exhibit 80 shows Cal Water's recorded outside services expenses disaggregated into legal expenses, auditing fees, information services consultants, and other consultants for 1998, 1999, and 2000. The information services and other consultant categories are combined for years 1996 and 1997.

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[16] In the Joint Recommendation, however, Cal Water and ORA stated that they arrived at the agreed-upon forecast by correcting ORA's forecast for a $75,000 per year error. The tables in Cal Water's August 26, 2002, supplemental information, however, show an increase in ORA's forecast for this account of $80,400 for 2002 and $82,100 2003. This difference is not explained.

Exhibit 80 shows that legal expenses alternated from increasing to decreasing on an annual basis. Overall, the amount increased but irregularly. Auditing fees, with a minor exception, increased each year, as did other consultants. Information services consultants, on the other hand, were $195,200 in 1998, decreased slightly to $129,800, and then leapt to $1,327,300 in 2000, an increase of over an order of magnitude. No other outside services cost increased nearly so dramatically. Consequently, this single increase will substantially affect the average cost increase for this account during 1998-2000, which Cal Water used to forecast test year 2002 expenses.

The record shows the following forecasts for outside services expense:

	Cal Water	ORA	Jt. Recomm.	Aglet
Test Year 2002	2,159,500	1,853,600	1,934,000	1,707,000
Test Year 2003	2,211,400	1,877,800	1,959,900	1,748,000

In Southern California Gas Co., 35 CPUC 2d 80, 125-8 (D.90-01-016), we expressed our frustration with the "seemingly endless increases requested by the utilities for A&G expenses." For want of a better guide to evaluating the reasonableness of A&G escalation, we adopted the rate of customer growth, not as an absolute cap but as a level above which the utility must overcome a heavy burden to demonstrate reasonableness. Id. at 126. We found this standard especially apt for accounts, such as outside services, that are catch-all accounts for expenses that have no specific identification. Id.

In D.01-08-039 for Cal Water and D.00-10-027 for Dominguez, the Commission adopted a combined estimate for outside services of $1,422, 100 for 2000. Comparing that number to the Joint Recommendation reveals a 36%

increase over two years. To support this steep increase, Cal Water and ORA relied on a three-year average derived from Cal Water's recorded expense levels for this account. As discussed above, the data upon which the average is calculated are substantially affected by a single year increase. In addition, new employees will perform some undetermined portion of the work formerly performed by outside service providers. These facts call into question the reliability of a simple average.

Given the steep increase in this account and the new employees, a budget-based methodology for forecasting outside services could have better supported Cal Water's request. A budget-based methodology would use a recorded year as a base for test year expenses and then would adjust the amount to remove non-recurring expenses as well as expected new expenses.[17] In this way, the utility can show what Aglet terms "real world expectations"[18] and provide the Commission some information with which to evaluate the reasonableness of the forecasted expense level.

A budget-based methodology for outside services is also particularly appropriate due to Cal Water's and its affiliates' non-regulated sales of billing services. Because most outside expenses are for information service consultants related to customer billing and accounting, a budget-based approach to forecasting outside services expense would allow Cal Water to demonstrate that all costs directly associated with non-regulated services and a share of joint costs are being properly charged to non-regulated operations.

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[17] See, e.g., Southern California Edison, 64 CPUC 2d 241, 316 (D.96-01-011).

[18] Transcript, page 214, line 4.

Cal Water bears the burden of justifying its request for this steep increase in outside services costs. A simple average with no analysis of the underlying data to remove nonrecurring costs, particularly in the context of additional employees and closely related non-regulated operations, is insufficient to meet this burden. The ORA and Aglet recommendations, however, are also based on averages and thus susceptible to the same criticisms.

For office expenses, Aglet suggested that the non-labor inflation rate plus customer growth could provide a reasonable escalation. As noted above, we have previously used customer growth as a means to guide cost increases. Given the lack of any justification for a higher rate of cost increases, we will rely on ORA's non-labor annual inflation rates plus customer growth of .9% to escalate adopted 2000 outside services expenses to Test Year 2002 and 2003. Therefore, we reject the Joint Recommendation on outside services, and adopt increases of 1.0%,.7%, and 2.1% for 2001, 2002, and 2003, respectively.

8.6 Expenses for the Board of Directors of the California Water Service Group

ORA recommended disallowing all expenses allocated to Cal Water from its holding company, California Water Services Group. ORA contends that the Board of Directors oversee company operations on behalf of shareholders and that there is no evidence that the Board of Directors considers the interest of ratepayers.

Cal Water countered that a Board of Directors is essential to every public corporation, and that public corporations have access to competitive capital markets that non-public corporations do not. Boards also perform vital management oversight, and review and monitor company programs and policies. Moreover, Cal Water stated that Commission precedent allows reasonable board of director costs.

We are not persuaded that the Board of Directors provide no benefits to ratepayers, and for that reason we deny ORA's request to disallow all Board costs. Consistent with our discussion throughout today's decision, we encourage ORA in Cal Water's next General Office rate case to conduct a thorough review of the allocation methodology for these and other holding company costs.

8.7 General Office Capital Items

In its General Report on Results of Operations, Cal Water proposed to incorporate in general office rate base gross additions of $3,935,000 in 2001, $6,696,000 in 2002, and $3,377,300 in 2003. These additions, less retirements and adjustments, would result in weighted average rate base increasing from $30,967,800 in 2001 to $40,319,900 in 2003, or a 30% increase in general office rate base in two years. Cal Water developed these proposed additions based on a construction budget, which was reviewed and approved by management. To the extent specific projects were not identifiable, Cal Water used blanket estimates based upon past experience to arrive at an estimate for nonspecific capital items.

ORA recommended smaller additions, as follows: $3,388,500 in 2001, $2,981,800 in 2002, and $3,239,800 in 2003. ORA arrived at these estimates by deferring some Cal Water proposed projects and rejecting others.

In the Joint Recommendation, the parties agree to additions of $3,813,00 in 2002 and $3,940,200 in 2003. The Joint Recommendation reflects may deferrals of projects from one year to the next. As Aglet explained in its brief, the rate base additions adopted for Test Years 2002 and 2003 are also used as a proxy for rate base additions in the Attrition Years, 2004 and 2005. Because these estimates are used twice, Aglet recommends that the Commission carefully review these estimates. The Joint Recommendation provides for general office rate base to increase by 7.5% in Attrition Year 2004, by 7% in Attrition Year 2005, and cumulatively by 30% over the four-year test/attrition period.

Aglet objects to the magnitude of the requested plant additions. Aglet calculated that from 1996 to 2000 Cal Water's average annual general office net plant additions were $1,484,700; in comparison, the average of Cal Water's proposed additions for 2001 to 2003 is $4,015,200. Aglet supports all of ORA's initial project rejections.

We find this level of general office rate base increases is cause for concern. Aglet, however, has not provided us with a detailed analysis identifying unneeded projects. The Joint Recommendation includes general office rate base additions that are substantially less than sought by Cal Water. The Joint Recommendation contains recommendations on a project-specific basis, from which we infer that ORA reviewed each project.

For example, ORA rejected the costs of upgrading to PeopleSoft Version 8, which is a computer program for maintaining financial, accounting, human resources, and billing records. Cal Water currently uses an older version. ORA noted that the version used by Cal Water was installed in 1999 and was not known to have problems. ORA also reviewed the limited cost estimates presented by Cal Water and found charges for "high cost consultants." ORA objected to the proposed $648,000 upgrade because Cal Water had supplied incomplete cost data and had been unable to present convincing evidence of need.

In the Joint Recommendation, the parties stated that Cal Water had provided ORA with additional information on the project, and had reduced the amount of outside consulting services. Cal Water also agreed to spread the project over three years. As a result, the Joint Recommendation provides for $192,000 in 2002 and $272,000 in 2003, a total of $464,000.

We remain concerned, however, with the proposed level of general office rate base additions. These capital addition budget forecasts are doubly important as they are used as a proxy for capital additions in the attrition years. As noted throughout today's decision, general office costs are rising at rates that greatly exceed inflation, and Cal Water has significant non-regulated operations in the general office.

Thus, we must make all reasonable corrections to obtain the best available forecast. Cal Water presented testimony (Exh. 90) showing that over the ten-year period 1991 to 2001, its budgeted capital expenditures exceeded actual expenditures by an average of 3.1%. This testimony demonstrates that Cal Water's capital budgets, which are the basis for additions level provided in the Joint Recommendation, tend to be overstated by 3.1%. Therefore, we will reduce the general office capital additions for each test and attrition year by 3.1%. With this minor modification, we find the Joint Recommendation on general office rate base is reasonable and should be approved.

8.8 Cal Water Web Site

ORA rejected Cal Water's proposal to add an internet server for its website at a cost of $54,000 in addition to spending $216,000 (for a total of $270,000) to redesign the website to meet Commission requirements. ORA particularly objected to a consultant fee of $175,000. ORA stated Cal Water's website required only minor modifications to implement new Commission tariff publication requirements, work that could easily be performed by Cal Water's employees.

ORA did not, however, offer any explicit testimony regarding what portion of the costs of the current Cal Water Group web site has been allocated to the non-regulated affiliates. In reviewing the web site,[19] we note that the home page is for Cal Water's holding company, California Water Services Group (Cal Water Group). The home page lists all four affiliated companies, along with their business offerings and links to a more detailed page for each. The logos of all the affiliated companies appear and disappear in turn in the upper left-hand corner. Of the six substantive links also found under the changing logos, only one presents any information remotely helpful to California utility customers. The first listed line is "Investor Relations and News," where extensive financial and investor information is available with provision for email alerts, live broadcasts of earnings information, current stock price look-ups, frequently asked questions, and an interactive investment calculator.

The second link is for "Customer Information." In contrast to the audio, interactive, and up-to-date investor portion of the website, the "customer information" link takes one to a simple text page that describes all three regulated operations of the Cal Water Group. In addition to California, the Cal Water Group has regulated utility operations in Washington state and New Mexico. All are listed in the customer information page. Clicking on the California Water link brings one to a page that lists all the districts and provides

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[19] Pursuant to Rule 73 and Evidence Code § 452, we take official notice of www.calwater.com.

links to pages with additional information about some districts. Tariff information is also available.

The third listed line is "How We Help Cities and other Companies." Clicking on that link brings one to a page that describes Cal Water's affiliate CWS and states:

CWS Utility Services offers agencies, municipalities and water companies a complete range of utility services, including:

- Meter Reading
- Billing
- Leak Detection
- Engineering Services
- Water Treatment
- Water Testing
- Recycled Water Operations and Design
- Wastewater Operations

Staffed and managed by the same talented and skilled personnel who work for Cal Water, CWS provides services which are exempt from utility commission oversight. Clients receive the same high-quality services which they've come to expect from Cal Water. However, CWS delivers them in ways that can better meet clients' needs in today's increasingly demanding regulatory environment.

Clearly, this portion of the Cal Water Group web site provides no benefits to regulated California customers. Moreover, as discussed above, all forecasted expenses and capital costs associated with providing these unregulated services must be allocated to unregulated operations. To do otherwise would require that ratepayers subsidize Cal Water's affiliate operations, in violation of long-standing Commission requirements and the Public Utilities Code. The record in this proceeding contains no evidence that such allocations have been performed.

In addition, the tone and representations contained in this portion of the Cal Water Group's web page are deeply troubling. Services provided by Cal Water employees with Cal Water assets are not "exempt" from Commission oversight. Cal Water acknowledged the Commission's continuing authority in the holding company settlement agreement which we approved in California Water Service Company, 77 CPUC 2d 53, 59 (D.97-12-011). For example, the Commission retains access to all records and books of account of the holding company and all affiliates (see settlement agreement at section III); the Commission also has continuing authority to review cost allocation methodologies to ensure compliance with Commission requirements (settlement agreement at section XI).

We are particularly concerned about the obvious attempts to link services provided by the affiliate with that of utility. The "same talented and skilled personnel who work for Cal Water" provide "[c]lients . . . the same high-quality services which they've come to expect from Cal Water." As an initial matter, utility employees providing services to affiliate customers is at odds with Cal Water's holding company decision, 77 CPUC2d 53, 59, where Cal Water agreed to transfer unregulated operations and employees to perform those services to the affiliates. More significantly, these statements attempt to link the affiliates' services with those provided by the utility in such a way as to capitalize on the reputation and goodwill associated with the utility. These statements could even be read to suggest that the affiliate has the authority to control and direct employees of the utility. In sum, these portions of the Cal Water Group web page provide no benefits to Cal Water's customers and contain representations that are at odds with statutes and the Commission precedent.

The remaining portions of the Cal Water Group Web site list employment opportunities, benefits information for employees, and telephone numbers and addresses for all Cal Water districts, New Mexico and Washington offices.

In addition to excluding the web site costs associated with non-regulated affiliate operations, we must also scrutinize the contents of the Cal Water Group web site that relate to Cal Water's California regulated operations to determine whether those components represent institutional or goodwill advertising. The cost of such advertising is not recoverable from ratepayers. In Roseville Telephone Company, 70 CPUC 2d 88, 135-6 (D.96-12-074), we determined that the defining feature of ratepayer funded advertising is benefit to the ratepayers. Here, the Cal Water Group web site contains very little information that benefits ratepayers. The tariffs and district offices' addresses and telephone numbers are the only pieces of information that might assist ratepayers. These components form a small portion of the Cal Water Group web site related to Cal Water's California operations. Moreover, each of the pages displaying this customer information also displays the logos of all Cal Water Groups affiliates. We have previously held that displaying affiliate logos renders the entire advertising to be institutional or goodwill advertising. Roseville Telephone Company, D.01-06-077, 2001 Cal. PUC LEXIS 604, *44-*45.

In the Joint Recommendation, the parties support $170,000 in general office plant for software, hardware, and site development to enable the website www.calwater.com to meet Commission requirements and provide greater customer benefits. In testimony, witnesses for Cal Water and ORA stated that in addition to these capital expenditures, one of the new employees funded in the general office would perform some tasks otherwise performed by outside consultants.

The record shows no allocation of the costs of the Cal Water Group web site among the regulated and non-regulated affiliates, and we infer that no such allocation has taken place. Similarly, the record shows no disallowance for institutional or goodwill advertising. Consequently, we are unable to approve the portion of the Joint Recommendation that includes web site costs. In addition to those costs explicitly addressed in the Joint Recommendation, we infer that other costs of the Cal Water Group web site may be reflected in current expenses as well as in capital plant accounts. These costs must be excluded from Cal Water's revenue requirement as well.

Our resolution of this issue should not be misinterpreted as being anti-web site. We remain fully committed to using new technology and services to better inform ratepayers. We see substantial value in providing customers useful information and services via the World Wide Web, and we have devoted substantial resources to designing and continuously improving our own web site. We will not, however, allow our commitment to this medium to alter or diminish our commitment to Commission policies and precedents regarding ratepayer protection and oversight of transactions involving a utility and its affiliates.

We direct Cal Water to revise its entire presence on the web to clearly separate regulated operations from non-regulated, and to provide useful information and services to ratepayers. As one step, we require Cal Water to change the page associated with www.calwater.com to that of the regulated

California Water, not the holding company, California Water Services Group. A link to the holding company page would be acceptable. This revised web site should present useful information and interactive features for customers regarding service, rates, and other customer oriented information. No information regarding service offerings by non-regulated affiliates should be present. The only logo should be that of the regulated company. Of course, only costs associated the regulated web site will be included in revenue requirement.

Therefore, we reject all components of the Joint Recommendation allocating to ratepayers any capital costs or expenses of the web site www.calwater.com. Pending the web site revisions outlined above, we direct that all capital costs and expenses associated with the web site be excluded from revenue requirement.

8.9 Small Mains

ORA contested Cal Water's proposed small main replacement program. ORA's study of Cal Water's past main replacement budgets and actual installations in each district showed that Cal Water actually completed only about 11% of budgeted main replacements in 2001 for certain districts. From this evidence, ORA concluded that Cal Water could not keep up with its replacement budgets, so ORA advocated deferring small main replacement projects to later years, with the result that about 37% of Cal Water 's requested small main replacements would be deferred outside the test period.

In rebuttal, Cal Water claimed that ORA's analysis did not properly reflect capital projects that were budgeted in one year but completed in another year. Cal Water explained that deferred projects retain their original budget year for accounting purposes and are not included in another year. In this way, the projects are accomplished in order, but not necessarily in the original budget year. Moreover, Cal Water explained that to the extent the actual expenditures are less than budgeted the Commission's step and attrition year formulae rely on actual plant balances, not forecasts.

Cal Water's Vice President – Engineering and Water Quality, testified that Cal Water manages its capital expenditures by budgeting to the Commission-approved total amount for the year. Cal Water management then uses engineering and financial judgment to determine which specific projects to fund. Should an unanticipated project arise that has immediate urgency, typically due to water quality or the likelihood of a very severe short-term impact on customers, then the urgent project will be funded and another less urgent capital project deferred. Consequently, capital budgets are not necessarily directly translated into capital expenditures.

On its small main replacement program in each district, Cal Water stated that the goal is to replace all undersized and bare steel mains in the next 50 years. As some of these mains currently have been in service for 50 years, the mains may be up to 100 years old when replaced. Undersized mains are those that have a diameter of less than six inches; replacing these small mains with mains that are a minimum of six inches in diameter enhances flows and water pressure, which also improves fire protection. Many of these smaller mains also suffer from internal corrosion that can obstruct water flow in the main, in some cases by half. These obstructions can also cause water quality problems by becoming sites for bacteria colonies.

In addition to the undersized mains, Cal Water is also replacing steel mains six inches and larger. These mains are being replaced to reduce leaks. Cal Water's engineer testified that many of the steel mains are over 40 years old and are apt to randomly develop leaks. Cal Water tracks the leak repair records and uses this information to select mains for replacement. Cal Water also compiles all leak information. Cal Water's witness presented charts showing that Cal Water's total system leaks as well as leaks per 100 miles of pipe are increasing over time. From these data, the witness concluded that Cal Water's replacement program should be increasing, not decreasing.

Cal Water also explained that currently it has 4.5 million feet of pipe that meet the criteria for replacement. To accomplish this task in the next 50 years will require Cal Water to install 90,000 feet of mains per year, as is proposed in the application. Cal Water also noted that at a rate 90,000 feet per year of mains, it would take Cal Water 307 years to replace all 27.6 million feet of mains in its system. Cal Water concluded that a 300-year replacement schedule was not aggressive and that as the system continues to age, leaks and catastrophic failures will increase. Cal Water's witness also presented a table showing that Cal Water's budgeted capital projects exceed actual expenditures by about 3.1% on average over a 10-year period.

Aglet supported ORA's recommendations. Aglet observed that the magnitude of Cal Water's overall plant additions is "unprecedented." In looking at Cal Water's main replacement program, Aglet noted that Cal Water is seeking a 60% increase in replacement footage from 50,000 in 2001 (actual) to 82,000 (requested) in 2002, and even more in 2003. Aglet also explained that these high levels of plant additions could subject ratepayers to "bloated" attrition increases two years later.

Cal Water has met its burden (albeit through rebuttal testimony rather than its direct) of demonstrating that its proposed main replacement program is necessary to provide adequate service to its customers. In fact, Cal Water's rebuttal testimony showed that prudent long-term planning could support an even higher level of main replacement. Cal Water plans to replace its mains over a 300-year period. Commission Standard Practice U-4, Determination of Straight-line Remaining Life Depreciation Accruals, Revised January 3, 1961, states that the longest projected actual service life for any type of main is 100 years. These facts would suggest that Cal Water should be replacing more small mains, not less.

ORA's and Aglet's testimony, however, do not directly challenge the program itself but rather Cal Water's implementation history. The testimony showed that Cal Water used its Commission-approved capital budget as the starting point for considering actual capital expenditures; however, should a more "pressing" project arise, Cal Water will instead spend the capital on the more pressing project. As a consequence, capital budgets may not be implemented exactly as planned. Overall, actual capital expenditures lag budgets by about three percent. Therefore, as discussed in relation to general office capital budgets, to the extent Cal Water has relied on budgets to support its request for capital projects, those budgets should be decreased by three percent.

Having determined that Cal Water's small main replacement program is necessary, ORA's analysis and Cal Water's admitted process for modifying capital budgets cause us concern. This necessary program should not be systematically slighted in implementation. Capital budgets where only 11% of budgeted costs actually occur in the budget year strongly suggest, at the very least, that the budgeting process fails to represent "real world expectations." We will, therefore, require that Cal Water submit a report in each of its future district general rate case filings showing budgeted capital projects and actual expenditures. We expect these reports to compare the budgeted capital projects to actual expenditures, and to explain each deviation and deferral, with revised in-service dates for the deferrals. We will use this historic analysis to guide our evaluation of any proposed capital projects. Overall, we suggest that Cal Water direct more of its corporate attention to similar long-term infrastructure issues. These facilities are vital for continued service to ratepayers. Relying on infrastructure to provide service two and three times longer than its projected service life could be a plan for catastrophic failures, emergency repairs, and resulting sharp rate increases. Such an outcome is not in the best interests of the ratepayers.

8.10 Postage

The Joint Recommendation provided that ORA's estimates for postage should be increased to reflect the postal rate increase of 2.3 cents per bill, which became effective on July 1, 2002. Aglet opposed this component of the Joint Recommendation.

Aglet noted that Cal Water did not include in its application or updated tables the costs of the postage rate increase. Aglet also pointed out that Cal Water's work papers do not list an amount for postage, but Aglet estimated it to be about $840,000. Because the postage rate escalation will occur mid-way through the test year, Aglet opposed reflecting it in Cal Water's expenses. Aglet points out that all other costs are evaluated on a full year basis, not in half-year increments. Aglet also noted that this component of the Joint Recommendation violates the rate case plan.

To evaluate this issue, we turn to the Rate Case Plan, which resolves the issue of updates in the future test year ratemaking process. Updates to future projections used in a rate case are potentially endless. To enable the orderly processing of rate case applications, the Commission has determined that the utility may file one update to its application 30 days after filing. The utility may also request permission from the ALJ to file an update. Re Schedule for Processing Rate Case Applications by Water Utilities, 37 CPUC 2d 175, 191 (D.90-08-045).

Here, Cal Water requested no such permission, and it had plenty of notice that postal rates were likely to increase. We note that the United States Postal Service web site (www.usps.com) shows press releases indicating that the July 8, 2002, rate increase was the result of the R2001-1 Rate Case filed by the Postal Service before the Unites States Postal Rates Commission (PRC) in September 2001. The PRC recommended the July increases to the Governors of the Postal Service in March 2002, and the Governors approved the increase in April 2002.

We are also concerned that the Joint Recommendation provided for updating postage costs but does not undertake a comprehensive update to account for other cost changes. Other cost estimates may well have declined in such a way as to offset, in whole or in part, the increase in postal costs. These types of concerns form the basis for the rule strictly limiting updates cited above. Because the postage rate update provided in the Joint Recommendation is not consistent with our rules for updates, we do not approve this component of the Joint Recommendation.

8.11 ¾" Meters

ORA notes that Cal Water does not offer all its customers the option of having a ¾ inch meter. This size meter is in between the two meter sizes offered by Cal Water - 5/8 inch meter or 1 inch meter. ORA stated that the standard flow rate for 5/8 inch meter is 20 gallons/minute, but that current meters typically provide actual flow rates of about 25 gallons/minute. In comparison, the standard flow rate for a ¾ inch meter is 30 gallons/minute, and current meters typically provide actual flows of about 35 gallons/minute. ORA recommended that Cal Water provide its customers with the option of a ¾ inch meter, as do other California water companies.

Cal Water opposed ORA's request and provided a witness to testify that the customers are unlikely to be interested in the slightly higher flow rates available with a ¾ inch meter due to the higher monthly service charge. The service charge for the larger meter is 50% higher than that for the 5/8 inch meter. Cal Water also notes that the larger meters cost it $45.10, while the 5/8 inch meters cost only $24.08.

This issue is about offering customers choices. Some customers may choose to pay the 50% increase in service charge to obtain the 10 gallon/hour difference between the flow rate offered by the 5/8 inch meter and the ¾ inch meter (a 40% increase in flow). Cal Water has not presented any valid reason why customers, fully informed of their options, who desire and are willing to pay for this increase in flow rate should be denied the opportunity to take service through a ¾ inch meter. We, therefore, order Cal Water to begin offering ¾ inch meter service in all its districts.

8.12 Low-Income Rate Assistance Program

In each of its 15 applications, Cal Water requested Commission authorization to institute a low-income rate assistance program that would be available to all Cal Water customers who meet the requirements for energy utility rate assistance programs. Eligible customers would receive a discount of $5 per month on their bill. The discount would be funded by a surcharge of $0.25 per month on bills for all customers not eligible for the program. Cal Water provided no testimony on this topic.

ORA agreed that a low-income rate assistance program should be available for eligible customers. However, due to the lack of experience with funding this program, ORA suggested that the surcharge revenues and discounts be recorded in a balancing account for true-up in next general rate case for each specific district. The Joint Recommendation adopted ORA's position.

Aglet supports low-income assistance in general but considers this proposal "half-baked at best" because it lacks any analysis of the likely customer use rate, program budget, or staffing estimate. Aglet also recommends that the balancing account be replaced with a memorandum account.

We find that Aglet's characterization of Cal Water's proposal is overly generous; this proposal is not half-baked, the ingredients are not even identified. Cal Water offered no testimony on this issue, no draft tariff language, no draft customer information, and no evidentiary support whatsoever for the rate design. Cal Water's entire presentation is eight lines in its applications. This meager showing fails to demonstrate that the proposal meets our standards for low-income programs.

We have a long history of supporting programs that result in reduced rates for low-income customers of California's public utilities. *See, e.g.,* Re Universal Service and Compliance with the Mandates of Assembly Bill 3643, 68 CPUC 2d 524 (D.96-10-066). Such support, however, is tempered by requirements that the programs be carefully constructed to meet clearly identified needs in an efficient and equitable manner. We find, based on the record in this proceeding, that Cal Water has failed to demonstrate that this low-income discount program would be compatible with our conservation goals, and that the discount would fairly reach all low-income persons in Cal Water's 15 districts.

As noted above, Cal Water presented no testimony on this issue. Cal Water did not articulate the objective of the proposal or state a rationale for selecting the proposed rate design over alternatives. The Legislature has directed us to "consider . . . programs to provide rate relief to low-income ratepayers." (§ 739.8.) Therefore, despite the meager record, we will consider Cal Water's proposal.

In D.02-01-034, we approved a lifeline rate proposal by Southern California Water Company that provided for a 15% reduction in all components of each eligible customer's water bill. We approved this proposal rather than ORA's alternative rate design that waived the entire monthly service charge. ORA contended that the overall 15% rate reduction was contrary to our conservation goals. ORA pointed to our decision for California-American Water Company's Monterey District,[20] as supporting the concept of reducing monthly service charges rather than discounts on all components of service. We rejected this comparison, noting that the Monterey District had a "carefully developed, inverted block rate structure that ties higher consumption levels to higher rates. All residential customers, not merely the low-income subset, pay higher rates for higher usage." D.02-01-034, 2002 Cal. PUC LEXIS 35, at page *16. Although approving the Southern California Water Company's lifeline rate, we noted that we did not adopt it as a model for low-income rate relief in all Commission-regulated water companies.

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[20] California-American Water Company, 69 CPUC 2d 398, 404 (D.96-12-005), revised by D.00-03-053.

Also in D.02-01-034, we addressed the issue of mobile home parks that provide master-metered water service to their tenants. We concluded that otherwise eligible mobile home park residents should not be excluded from the benefits of the proposed low-income program.

Turning now to Cal Water's proposal, we find several components to be at odds with D.02-01-034 and our standards for low-income programs. First, Cal Water chose a rate design that focuses on reducing the overall bill, which is similar to the design approved in D.02-01-034, but rather than a percentage, Cal Water uses a set amount, $5. Cal Water did not explain its rationale for selecting a set amount rather than a percentage or for setting the amount at $5.

Second, Cal Water has not explained how low-income residents who are not direct water customers, e.g., apartment dwellers or submetered mobile home park residents, would be able to receive the proposed discount. Absent such an explanation, we are unable to conclude that the proposed program would be equitably offered to low-income persons.

In sum, we agree with and fully support the concept of rate relief for low-income customers. Such rate relief, however, must be accomplished through a well-thought-out and even-handed program with specific identification of need, consideration of alternative means to address that need, justification for the selected components of the program, and a plan to assess, evaluate, and modify the program as necessary. At this point, Cal Water's proposal does not meet these standards. Until these standards are met, we are constrained to reject Cal Water's proposal. We will, however, order Cal Water to file a revised low-income rate proposal.

8.13 Rate of Return

The capital structure, cost of debt and equity, and rate of return on rate base as set in the Joint Recommendation:

Cost of Capital

	Test Years 2002, 2003, Attrition Years 2004, 2005		
	Capital Structure	Cost	Weighted Cost
Debt	48.0 %	8.09%	3.88%
Preferred Stock	.5%	4.19%	.02%
Common Equity	51.5	9.7%	5.0%
Total	**100.00 %**		**8.9%**

ORA recommended a rate of return for Cal Water of 8.56%, 8.55%, 8.57%, and 8.57% for the years 2002-2005. Cal Water requested 9.59%, 9.66%, 9.72%, and 9.78% for the same years. ORA recommended 9.10% for return on equity and Cal Water requested 11.5%. For debt, ORA recommended 8.14%, 8.09%, 8.09%, and 8.05%, while Cal Water requested 8.06% for 2002, 8.04% for 2003, and 8.04% for the remaining years.

The Joint Recommendation provided for a rate of return and return on equity that represent a compromise of the parties' positions. Aglet here supports the Joint Recommendation:

> [T]he recommended overall rate of return of 8.9% is lower than the present weighted average rate of return of 9.21% for all 15 districts. The joint recommendation is a reasonable compromise of the positions of the parties and will result in lower costs for the majority of Cal Water customers.

We agree with Aglet and approve the Joint Recommendation on rate of return.

9. District-Specific Issues

9.1 District Overview

The increases in general office expenses and capital costs discussed above are allocated to each of the districts. Expenses and capital costs for each particular district are also part of the revenue requirement for the district.

The time since the last general rate case varies for the 15 districts from a relatively short two years for Bear Gulch and others to nine years for King City. The time period since the last rate case should be considered when expressing the revenue increase as a percentage. For example, a 10% increase in two years for Bear Gulch is very different from a 10% increase for King City.

Bearing in mind this variation, the record shows that purchased power and general office allocations are the primary factors behind this revenue requirement increases. While the percentage increases vary, both these expense items top the list of cost increases for most districts.

The issues remaining in dispute between ORA and Cal Water regarding each of the districts are: general office allocation of one regulatory analyst and the Board of Directors costs and small main replacements. These issues have been addressed above. In addition, three districts have painting issues, which are discussed immediately below, and several districts have unique issues, which are addressed in turn below.

9.2 Painting Tanks and Reservoirs

In its rebuttal testimony, after ORA had filed its testimony, Cal Water presented its Tank Maintenance Supervisor, a National Association of Corrosion Engineers certified coating inspector, who described Cal Water's inspection and re-painting program. The goal of the program is to proactively maintain these tanks to reduce costs over the life of the tank or reservoir. The

Supervisor presented specific analysis of each tank or reservoir and explained in detail the need for prompt re-painting.[21]

9.3 Bear Gulch

Cal Water sought a 15.13% increase for Test Year 2002 in revenue requirement in the Bear Gulch District. ORA recommended a 5.28% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 3.74% increase, and Cal Water's resolution yields a 4.29% increase for Test Year 2002.

Cal Water explained that the primary reasons for the increase in this district are purchased power expenses (56% increase), general office expense allocation (32% increase), and rate base amortization (7% increase). However, a 7% increase in water sales as well as other rate increases since the last general rate case test year of 2000 avoid an even greater increase at this time.

In this district, the Joint Recommendation provides for an advice letter for a capital project to deactivate cryptosporidium. The ORA testimony states that Cal Water intends to select the specific project through a study in 2002 to investigate different methods of treatment and that due to the "uncertainties, size, and cost" the project should be reviewed through the advice letter process. Cal Water estimates $648,000 for this project in Test Year 2003. The Joint

[21] We draw Cal Water's attention to the project justification sheets and photographs attached to the rebuttal testimony included in the record as Exhibit 55. These sheets present project-specific analysis and explanation for painting each tank or reservoir, along with photographs that show the corrosion. These are excellent examples of the quality of evidence necessary to support a rate increase request. Such evidence, however, should be included in the direct case, not as rebuttal testimony.

Recommendation caps the amount at $648,000 and requires that the equipment be installed no later than January 1, 2005. Subject to these two requirements, the parties expect the advice letter to be accepted.

We are not eager to approve this part of the Joint Recommendation due to the "uncertainties, size, and cost" of the proposed treatment project. The Joint Recommendation provides that Cal Water will resolve these issues in a study yet to be completed. Under typical conditions, a promise for a post-decision study would not be a sufficient basis upon which to authorize so large an expenditure. Here, however, the health implications of failing to promptly deactivate cryptosporidium require that Cal Water proceed immediately. When completed, the study should include the specific information needed for this Commission to conduct a reasonableness review for this project.

The issue remaining in dispute between ORA and Cal Water regarding the Bear Gulch District is customer service center rent. The Bear Gulch Office is located on El Camino Real in Atherton in a rented building where it has been located since 1989. The rent for this building was $3.75 per square foot as of September 2001, based on a 10-year lease in September 1999. ORA stated that since Cal Water entered into this lease there is a "glut" of office space in the area with comparable space as low as $2 per square foot. ORA also testified that Cal Water should attempt to re-negotiate its lease or move to a less expensive location. ORA recommended reducing the amount allowed for office rent to $2.25 per square foot.

Cal Water responded by presenting current rental rates for commercial property in the area, which ranged from $1.50 per square foot to $12. Cal Water stated that the Bear Gulch District serves high cost areas with rapidly appreciating real estate prices. While that market has "softened" since Cal Water last negotiated the lease, Cal Water continues to believe that the current rental rate is reasonable in light of rents for other properties.

Aggressive cost containment by utility management is our goal. Here, both ORA and Cal Water agree that the market for commercial real estate has changed since Cal Water signed the lease, and there is no evidence that Cal Water has attempted to re-negotiate the lease. Cal Water's evidence of other office space available at much higher rates is predominantly composed of Class A office space with amenities such as a "fully equipped health club." Cal Water's own testimony shows that rental rates vary from $1.50 to $12 per square foot, with three properties having rates at or below ORA's recommended rate. Cal Water, like ORA, made no attempt to identify specifically comparable rental properties.

Cal Water's witness testified that he had spoken with the person within the company responsible for "dealing with rental property throughout the company," Richard Schuppe. The witness stated that Schuppe informed him: "this is not a lease that we would be likely to be able to renegotiate." The rate case witness did not know whether Schuppe had spoken directly to the landlord on this topic or had simply formed an "impression" from earlier conversations. This testimony fails to demonstrate that Cal Water has taken all reasonable steps to ensure that the costs it incurs are as low as possible. Cal Water admits that commercial real estate market was "very tight" at the time it signed the 10-year lease and that the market has since "softened quite a bit." Given this change in market circumstances, prudent business practices dictate that Cal Water at least attempt to modify the terms of the lease. However, not even ORA's proposed disallowance of this rent payment sparked Cal Water to action with the landlord, even for the purpose of gathering evidence to support its assertion that the landlord was unwilling to consider modifying the lease.

The burden of proof is on Cal Water to show that the Bear Gulch office rent is reasonable. Here, ORA presented evidence that the rent was too high. Cal Water's rebuttal evidence consisted of a wide range of prices for office space, which included both ORA's and Cal Water's, with no analysis of the data to demonstrate which sites were comparable to the existing office, as well as vague assertions of the landlord's unwillingness to re-negotiate. Cal Water's evidence is insufficient to meet its burden.

We do not substitute ORA's rental rate, however, because ORA did not account for moving expenses or site modifications. We will select the point mid-way between the two amounts, $3.00 per square foot, as reasonable.

9.4 Chico District

Cal Water sought a 21.11% increase for Test Year 2002 in revenue requirement for its Chico District. ORA recommended a 3.19% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 15.84% increase, and Cal Water's resolution yields a 16.95% increase for Test Year 2002.

Cal Water explained that, as with most other districts, the primary reasons for the rate increase are purchased power expenses (28% increase), general office expense allocation (74% increase), and the revenue requirement of rate base (45% increase). The Chico District's last general rate case was for test year 1995.

The issue remaining in dispute between ORA and Cal Water regarding the Chico District is replacement of the customer service and operations center (customer center). This issue includes disputes regarding the cost of the new customer center and the treatment of the proceeds from the sale of the old center.

Cost of the New Customer Center

Cal Water had originally estimated that the new Chico Customer and Operations Center would be a $2,800,000 capital project in 2001, intended to provide greater efficiency and accessibility. ORA recommended that the unspent budgeted portion of the project, $1,391,000, be eligible for inclusion in rate base via an advice letter filing. ORA based its recommendation on the uncertainties, size and cost of the project. ORA also emphasized that Cal Water had not provided sufficient detail on the proceeds it expected to realize from any sale of the old operations center. ORA urged the Cal Water be required to track such proceeds as is required by § 790.

Cal Water, in rebuttal, said that it was scheduled to occupy the new facilities in May 2002. As of the date of serving the testimony, Cal Water had spent $339,600 and projected that the "total cost for the new facilities would be $1,391,000."[22] Cal Water stated that it was able to estimate these costs with a high level of certainty, and that the costs should be included in rate base for test year 2002 rather than through an advice letter.

We note that ORA puts the total cost of this project at $2,800,000, while Cal Water claims the total will be $1,391,000. This is a huge discrepancy. Given this discrepancy, we cannot authorize this substantial increase in rate base without a further showing by Cal Water as to the amount actually spent. Moreover, as discussed below, given Cal Water's proposed treatment of the net proceeds from the sale of the replaced Chico operations center, we must carefully

[22] This is not consistent with ORA's description of this amount as being the unspent remainder of the $2,800,000 total project cost.

review the customer center replacement decision and impose any safeguards needed to ensure that ratepayers benefit from the incentives created by § 790. Consequently, we agree with ORA that the Chico customer center issue should be fully reviewed.

Rate Treatment of Sale Proceeds

Cal Water contended that any amount that may be realized from the sale of the old service center would "not likely impact Cal Water rates." In its brief, Cal Water explained that "[u]nder Cal. Pub. Util. Code § 790, if Cal Water invests at least the amount of its gain from the sale [of the old center] in new water facilities within eight years of the sale, it is permitted to earn a reasonable return on its investments instead of allocating the gain to ratepayers." Cal Water projected that the gain from the sale would be $455,000.

The issue is highly controversial due to the potential ratemaking ramifications of § 790. Cal Water takes the position that § 790, in effect, allocates any and all gain on the sale of the old customer center (or any other real property) to shareholders, provided that the "net proceeds" are reinvested in facilities needed for the utility's water system. To meet the reinvestment requirement of § 790, Cal Water contends that reinvestment of the actual sale proceeds is not necessary so long as the utility invests at least that amount in needed facilities during the same year. Under this reasoning, Cal Water concludes that the actual sale proceeds should be available for immediate distribution to shareholders.[23] Cal Water's statutory interpretation allowing this

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[23] Cal Water reads § 790 to require only that the utility invest in a given year, from any source, at least as much as the amount realized from the sale of real property in that year. If the utility does so, then Cal Water believes it has fulfilled the reinvestment

Footnote continued on next page

substitution process results in real property sales proceeds, such as the sale of the old Chico customer center, being allocated exclusively and immediately to shareholders.

In contrast, under ORA's reading of the statute and its preceding statement of legislative intent, Commission must track the sale proceeds to ensure reinvestment of those proceeds in utility infrastructure within eight years.

We have not previously had occasion to review the Water Utility Infrastructure Improvement Act of 1995 (Infrastructure Act), codified at §§ 789 to 790.1.[24] We begin our review by referring to the established principles of statutory interpretation. We summarized these principles quite recently:

> We look to the well-recognized principles of statutory construction. The California Supreme Court has stated: "To interpret statutory language, the courts must ascertain the intent of the legislature so as to effectuate the purpose of the law." (California Teachers Assn. v. Governing Bd. of Rialto United School Dist. (1997) 14 Cal.4th 627, 632.) In determining the Legislature's intent, they are to "scrutinize the actual words of the statute giving them a plain and commonsense meaning." (People v. Vallodoli (1996) 13 Cal.4th 590, 597.) "In construing a statute, a court may consider the consequences that would follow from a particular construction and will not readily imply an unreasonable legislative purpose. Therefore, a practical construction is preferred." (California Correctional Peace Officers Assn. v. State Personnel Bd. (1995) 10 Cal.4th 1133, 1147.) "In analyzing statutory language, we seek to give meaning to every word and phrase in the statute to accomplish

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requirement of the statute and may retain the proceeds from the real property sale or distribute the proceeds to shareholders.

[24] The operative sections are reproduced in Attachment D.

> a result consistent with the legislative purpose . . . ." (Harris v. Capital Growth Investors XIV (1991) 52 Cal.3d 1142, 1159.)

D.02-06-007 citing D.01-11-031.

We must therefore review §§ 789.1 and 790 and determine the Legislature's intent from the plain words of the sections. We are to seek a reasonable and practical interpretation that accomplishes the Legislature's goals.

The Legislature made specific findings and declarations of intent in § 789.1. Subsections (a) through (c) concern the need for new or improved water infrastructure. In subsection (a), the Legislature finds that water corporations are subject to increasing demands for new infrastructure to comply with increasingly strict safe drinking water laws and regulations. Subsection (b) concludes that maintaining and improving the state supply will require investment by water corporations in infrastructure, and subsection (c) finds similar needs for improving fire flow standards for public fire protection purposes. In sum, subsections (a) through (c) describe the infrastructure investment needs of water companies.

Subsections (d) and (e) concern the disposition, in certain circumstances, of water utilities' real property. Specifically, subsection (d) notes that water corporations may own real property that is no longer necessary to provide water service, and that now may be sold. The subsection then announces the policy that water corporations should be encouraged to dispose of such real property and to invest the net proceeds in needed utility infrastructure. Subsection (e) states that the investment of all net proceeds should be included among the water corporation's other utility property, upon which it earns a reasonable rate of return.

Thus, the first portion of the Infrastructure Act states that water utilities are confronted with increasing needs for investment in infrastructure. These utilities also may have no longer needed real property that can and should be sold to fund the needed infrastructure investments. Finally, the investments should be included among other utility property.

The second portion of the Infrastructure Act, codified at § 790, contains the operative portions of the Act. Subsection (a) directs that whenever a water corporation sells any no longer needed real property, the water corporation shall invest any net proceeds in needed water system infrastructure. The water corporation must also maintain records necessary to document the investment of the net proceeds. Subsection (a) further provides that any net proceeds from the sale of no longer needed property will be the water corporation's "primary source of capital" for investment in needed infrastructure.

Subsection (b) states that infrastructure funded by reinvestment of net proceeds should be included among the utility's other property, upon which it earns a reasonable rate of return. Subsection (c) imposes an eight-year limit on the utility's reinvestment period. Any net proceeds remaining after eight years must be allocated to the ratepayers.

Subsection (d) allows a small water corporation to apply to the Commission for an exemption from the requirements of the Infrastructure Act. Subsection (e) states that the "commission retains continuing authority to determine the used, useful, or necessary status of any and all infrastructure improvements and investments." This subsection, and § 851, provide the Commission complete authority to determine whether an asset is "necessary and useful" for a water utility.

In summary, § 790 requires water utilities to sell no longer needed property and to invest the net proceeds in needed infrastructure. These net proceeds are to be the utility's primary source of capital for infrastructure, and the utility must track the investment of the proceeds. The utility has eight years to re-invest the funds, and must include the property among its other utility property.

The directives of § 790 must also be considered in the context of extant Commission authority over water utilities. The Commission maintains complete authority over water utility rates, see, e.g., § 454, and the sale or encumbrance of utility property, § 851. The Legislature has granted the Commission far-reaching authority to "supervise and regulate" utilities in this state as set out in § 701. In adopting § 790(e), the Legislature explicitly recognized the Commission's on-going authority "to determine the used, useful, or necessary status of any and all infrastructure improvements and investments." This authority takes on enhanced importance in the case of rate base assets that the water utility proposes to transfer pursuant to § 790 due to the financial incentives Cal Water believes § 790 creates. Thus, we conclude that the Legislature expected the Commission to continue to exercise its authority over water utilities and to scrutinize sales and purchases proposed by water utilities pursuant to § 790.

Such scrutiny is critical to enable the Commission to meet its statutory obligations. Real property that is "necessary or useful in the performance of a water corporation's duties to the public" would have been included in a water utility's rate base upon which it earned a return. By authorizing the utility to earn a return in its rates on the value of the property, the Commission expects the property to be used to serve the public. The contrary determination, namely, that the property is "no longer necessary or useful" and consequently should not earn a return for the utility, requires that the Commission review how the property was employed in service to the public and how the need will be filled absent the property. The Commission must also determine the ratemaking treatment for assets and expenses associated with the sale of unneeded real property and reinvestment of the net proceeds from the sale.

Cal Water's Chico customer center replacement project does not comport with the statutory provisions, described above, for regulatory scrutiny and ratemaking treatment. First, the project is remarkably vague and the need for the project has not been demonstrated. Cal Water has not presented any objective fact, such as customer growth rates, that would justify this project. Second, the lack of regulatory scrutiny of this project to date cause us even greater concern in light of the ratemaking consequences were we to follow Cal Water's interpretation of the Infrastructure Act. While we need not, for reasons discussed later, decide on the merits of that interpretation, we note that the result of allocating all net proceeds to shareholders creates a powerful financial incentive for water utilities to sell real property. Our research indicates that this purported statutory right to allocate all gain on sale to shareholders is unprecedented in all regulatory jurisdictions in this country. Such a right could encourage water utilities to sell real property without regard to long-term customer service needs, and may even lead to real property speculation by water utilities, relying on rate base treatment to protect shareholders from losses but using § 790 to reap all gains. In short, the interpretation of this statute, and the potential consequences, will need to be fully analyzed and briefed when we address the ratemaking and rate base issues raised by the Infrastructure Act.

For now, however, we note that the Infrastructure Act creates new incentives and that those incentives require even greater regulatory scrutiny of real estate transactions to ensure that the intended benefits to ratepayers materialize. Accordingly, the Commission must carefully review the details of each real property parcel that a water utility proposes to sell pursuant to § 790. The Commission must consider both the history of the property proposed to be sold, its use to provide service to customers, its historic ratemaking treatment, as well as any potential future use to serve customers, whether any replacement property is needed, and such issues as may be specific to each proposed transaction.

Such scrutiny would be most conveniently accomplished in a general rate case, although the application process could also be used. There, the water utility could explicitly identify the properties it considered to be no longer necessary in the performance of its duties to the public, provide a detailed explanation with applicable historical, ratemaking, and future use analysis, and request authorization to treat the properties as being subject to § 790. The Commission would then review the proposals for compliance with applicable law and policy and issue a decision.

The Infrastructure Act requires water utilities to sell unneeded property that "was at any time" included in rate base, and to reinvest the net proceeds in water utility infrastructure. The utility must carefully track all such revenue to ensure that it is so invested. We have previously determined that net gain proceeds over original cost should go into a memorandum account with interest to be accrued for use as a capital fund for infrastructure additions and repairs. Tahoe Park Water Company, 73 CPUC 2d 715, 719 (D.97-08-021).

Therefore, in addition to the requirements set out above, we find that the Infrastructure Act requires that water utilities do the following:

1. Track all utility property that was at any time included in rate base and maintain sales records for each property that was at any time in rate base but which was subsequently sold to any party, including a corporate affiliate.

2. Obtain Commission authorization to establish a memorandum account in which to record the net proceeds from all sales of no longer needed utility property.

3. Use the memorandum account fund as the utility's primary source of capital for investment in utility infrastructure.

4. Invest all amounts recorded in the memorandum account within eight years of the calendar year in which the net proceeds were realized.

Conclusions Regarding Cal Water's Real Estate Issues

In reviewing the issues surrounding the replacement of the Chico customer center, we find that additional review of the facts as well as further evaluation of Cal Water's proposal is required. We observe that, as a threshold matter, § 790 may not even apply to this transaction. Here, Cal Water proposes to charge customers at least $1.4 million[25] to build a new customer center, declare the old one "no longer necessary or useful in the performance of [its] duties to the public," and give shareholders all the proceeds from the sale of the old center. Cal Water's proposal fails to recognize that but for the construction of the new center, the old center would be needed to serve customers. Thus, in looking at the entire project, the amount Cal Water expects to realize from the sale of the

[25] Or possibly $2.8 million, the record is unclear on this point.

old center, $455,000, is more than offset by the cost of the new center.[26] Consequently, after detailed review of the facts, the Commission could conclude that there are no net proceeds from this transaction to consider allocating to shareholders. Thus, to enable the Commission to scrutinize the replacement of the Chico customer center, Cal Water must file an application with the information discussed above.

We are also concerned that the types of problems we have encountered here maybe recur with other Cal Water properties. In Cal Water's 2001 Annual Report, of which we took official notice elsewhere in today's decision, Cal Water states that it has embarked on a multi-year process to liquidate over $10 million in property:

> Real Estate Program. The Company's subsidiaries own more than 900 real estate parcels. Certain parcels are not necessary for or used in water utility operations. Most surplus properties have a low cost basis. A program has been developed to realize the value of certain surplus properties through sale or lease of those properties. The program will be ongoing for a period of several years. During the next four years, the Company estimates that gross property transactions totaling over $10 million could be completed. In 2001, $3.9 million in pretax sales were completed. No transactions were completed during 2000. During 2002, the Company expects to complete sales in excess of $3 million.

Cal Water has not included any details of this program in its showing in this proceeding. We are, therefore, unable to conclusively determine that the properties included in the real estate program are not also subject to

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[26] This is consistent with the accounting treatment of "trade-ins," where any revenue from sale of the old asset offsets the cost of acquiring the replacement asset.

§ 851[27], or to determine the proper ratemaking treatment of the amounts realized from the transactions.

We, therefore, order Cal Water to submit an application fully explaining in detail its real estate program from its beginning to current plans. All properties included in the program shall be specifically identified and the use and regulatory history of each property set out. Cal Water shall state its rationale for removing any property from rate base and provide supporting documentation. Cal Water shall include the accounting history of each property, including original cost and amount realized, for each property as well as the disposition of all proceeds. The Commission staff, after careful review of the proposed transactions for compliance with all applicable statutes and rules, will file and serve a detailed report on its review. The Commission will then issue an order with any further actions as may be necessary. Because all California water utilities may have an interest in our interpretation of § 790, we will also order Cal Water to serve its first § 790 application on all other California water utilities regulated by this Commission.

9.5 Dixon

Cal Water sought a 14.8% increase for Test Year 2002 in revenue requirement in the Dixon District. ORA recommended a .72% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues

[27] Section 851 provides that every subject transaction "made other than in accordance with the order of the commission authorizing it is void."

results in a 7.82% increase, and Cal Water's resolution yields an 8.09% increase for Test Year 2002.

Cal Water explained that, as with the other districts, the primary reasons for the rate increase are purchased power expenses (15% increase), general office expense allocation (66% increase), and the revenue requirement of rate base (8% increase). Cal Water also sees a large increase in payroll (33% increase). Customer growth of 6% and attrition and other non-general rate case rate increases have kept this increase lower than it otherwise would have been. The Dixon District's last general rate case was for test year 1996.

Issues remaining in dispute between ORA and Cal Water regarding the Dixon District have been addressed above.

9.6 East Los Angeles

Cal Water sought a 9.89% increase for Test Year 2002 in revenue requirement for its customers in the East Los Angeles District. ORA recommended a 4.79% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 7.04% increase, and Cal Water's resolution yields a 7.30% increase for Test Year 2002.

Cal Water explained that the primary reasons for the rate increase are purchased power expenses (54% increase), general office expense allocation (30% increase), payroll (15% increase) and rate base amortization (10% increase). An 8 % increase in water production and attrition and other non-general rate case rate increases keep down today's increase. This district's last general rate case was for test year 2000. The issues remaining in dispute between ORA and Cal Water regarding this district are: general office allocation of one regulatory analyst and the Board of Directors costs, and small main replacements and all have been addressed above.

9.7 Hermosa-Redondo

Cal Water sought a 16.12% increase for Test Year 2002 in revenue requirement for the Hermosa-Redondo District. ORA recommended a 5.4% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 12.61% increase, and Cal Water's resolution yields a 12.84% increase for Test Year 2002.

Cal Water explained that the primary reasons for the rate increase are purchased power expenses (23% increase), payroll (13% increase), general office expense allocation (29% increase), and rate base amortization (14% increase). The Hermosa-Redondo District's last general rate case was for test year 2000.

The issues remaining in dispute between ORA and Cal Water regarding this district are: general office allocation of one regulatory analyst and the Board of Directors costs, small main replacements, and painting of tanks 5B and C and reservoirs 3B and 8A – D. The general office and small main replacement issues have been addressed above.

ORA would reject various painting projects that totalled $42,300 in Test Year 2002, and for Test Year 2003, total $83,600. ORA stated that it had inspected the tanks and determined that coatings "were still OK."

Cal Water's initial testimony did not describe or provide a supporting rationale for this or any specific capital addition project. As discussed above, Cal Water has met its burden of demonstrating that it has a sound inspection program and that these tanks and reservoirs require painting. We will deny ORA's requested removal of these projects.

9.8 King City

Cal Water sought a 26.35% increase for Test Year 2002 in revenue requirement for the King City District. ORA recommended a 1.82% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 15.41% increase, and Cal Water's resolution yields a 15.68% increase for Test Year 2002.

Cal Water explained that the primary reasons for the rate increase are purchased power expenses (20% increase), general office expense allocation (118% increase), and rate base amortization (58% increase). The King City District payroll increase is also notable (52%). Customer growth, a 20% increase in water production and attrition and other non-general rate case rate increases keep today's increase below what it would have been otherwise. The King City District's last general rate case was for test year 1993. The issues remaining in dispute between ORA and Cal Water regarding the King City District are the general office issues, which have been addressed above.

9.9 Livermore

Cal Water sought a 5.7% increase for Test Year 2002 in revenue requirement for the Livermore District. ORA recommended a 5.7% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 1.4% increase, and Cal Water's resolution yields a 1.7% increase for Test Year 2002.

Cal Water explained that the primary reasons for the rate increase are purchased power expenses (134% increase), general office expense allocation

(73% increase), and rate base amortization (22% increase). This district's last general rate case was for test year 1998.

The issues remaining in dispute between ORA and Cal Water regarding the Livermore District are: general office allocation of one regulatory analyst and the Board of Directors costs, small main replacements, and painting of station 23 tanks. The general office and small main replacement issues have been addressed above.

In its report, ORA did not object to the painting but rather alleged that Cal Water had revised the amount several times prior to hearing such that ORA could not verify the amount. Cal Water's original 2001 budget for this project was $99,800, but Cal Water later revised the amount to $84,400. Cal Water later reported the project complete in 2001, so ORA included it in its report in the amount of $84,400. Since then, ORA contends that Cal Water has identified the final amount as $100,006.09 and $105,500, and that these latest figures came too late in the process for ORA to confirm.

Cal Water testified that the accepted bid price was $73,900 but that the actual cost was $105,500 due to unexpected costs for inspector time. Cal Water asked the Commission to include the full amount of the project.

We note that this project experienced a 43% cost overrun – bid of $73,900 to $105,500 actual. We understand that even the best-managed bidding processes cannot be expected to foresee each and every cost component in every single bid. At the same time, however, we are concerned that this bid may appear to have been non-binding or "cost-plus." Cal Water provided no testimony on any change order or what explanation it required of its vendor to increase the bid price for the project. Most significantly, because Cal Water provided ORA the actual cost information so late in the process, ORA was unable to evaluate it.

We will include this project at the amount last timely reported to ORA, $84,400. This amount is over the bid price but not the alleged total actual price. We are unable to consider the higher amount advocated by Cal Water due to the lack of timely evidence.

9.10 Los Altos

Cal Water sought a 14.54% increase for Test Year 2002 in revenue requirement for the Los Altos District. ORA recommended a .13% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 6.96% increase, and Cal Water's resolution yields a 7.4% increase for Test Year 2002.

Cal Water explained that the primary reasons for the increase include the usual ones such as are purchased water expenses (48% increase since 1996) and general office expense allocation (58% increase), with the cost increases partially offset by a 10% increase in water production as well as other rate increases since the last general rate case for test year 1996.

The issues remaining in dispute between ORA and Cal Water regarding this district include the general office and small main replacements issues discussed above. ORA and Cal Water are also at odds with regard to the forecast for contracted maintenance.

In addition to maintenance performed by its own employees, Cal Water contracts with outside vendors for some maintenance services. To forecast this expense for this proceeding, Cal Water averaged the expenses for five years of recorded inflation-adjusted data, from 1996 to 2000. ORA did the same with four years' data, disregarding 2000, because that year was 80% over the 1999 amount.

In its brief, ORA pointed out that Cal Water proposes to add three new employees for the Los Altos District – one Foreman, one Inspector, and one Operations Maintenance Worker. Cal Water justified these new positions based on improved maintenance, among other things. Cal Water did not, however, adjust its forecast for maintenance expenses to reflect these three new employees.

The impact of the difference between the two forecasts is not large, about $29,000 in revenue requirement for each of the two test years. The Los Altos District's revenue requirement for Test Year 2002 is over $12 million. Cal Water bears the burden of demonstrating that its forecast of contracted maintenance costs is reasonable. ORA persuasively argues that the new employees should reduce such costs and that Cal Water has not accounted for this reduction. We will adopt ORA's requested forecast as a conservative reflection of cost reductions expected from the additional three new employees.

9.11 Marysville

Cal Water sought a 28.06% increase for Test Year 2002 in revenue requirement for its Marysville District. ORA recommended a 9.13% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 19.78% increase, and Cal Water's resolution yields a 20.05% increase for Test Year 2002.

Cal Water explained that the primary reasons for the increase are purchased power expenses (43% increase), general office expense allocation (43% increase), payroll (19% increase) and rate base amortization(20% increase). These increases are also necessary to reflect a 4% decrease in water sales. This district's last general rate case was for test year 1999. The issues remaining in dispute between ORA and Cal Water regarding the Marysville District are the general office allocation and small main replacement issues that have been addressed above.

9.12 Mid-Peninsula District

Cal Water sought a 12.5% increase for Test Year 2002 in revenue requirement for the Mid-Peninsula District. ORA recommended a .51% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 5.2% increase, and Cal Water's resolution yields a 5.61% increase for Test Year 2002. The Joint Recommendation also provides that Cal Water will file an advice letter when it completes its new customer operations center.

Cal Water explained that the primary reasons for the increase are purchased power expenses (67% increase since 1994), general office expense allocation (66% increase), payroll (34%), and rate base amortization (22% increase). A 13% increase in water production as well as other rate increases since the last general rate case for test year 1994 keep down today's increase.

The issues remaining in dispute between ORA and Cal Water regarding the Mid-Peninsula District include the general office allocation and small main replacement issues addressed above. In addition, ORA and Cal Water base their respective forecasts of contracted maintenance on different periods.

As in the Los Altos District, Cal Water forecast contracted maintenance by averaging the expenses for five years of recorded inflation-adjusted data, from 1996 to 2000. ORA did the same but with a different five-year period – 1995 to 1999. ORA's witness testified that he disregarded 2000 data for his average because the amount was 100% over the 1999 amount, which is the basis on which ORA disregarded the 2000 amount in the Los Altos District as well.

The contract maintenance issue in this district and the Los Altos District raise the same question: When using historical averages to forecast future expenses, how should data that significantly deviates from the average be treated? Neither Cal Water nor ORA explicitly address this question. Cal Water would include the 2000 data, and ORA exclude it. Cal Water bears the burden of demonstrating that its forecast of contracted maintenance costs is reasonable, and it has not articulated a rationale to support including the 2000 data. Cal Water presented testimony detailing each contracted maintenance project for 2000 in the Mid-Peninsula district, and stated that the amount of contracted maintenance expenses vary due to "the number of main and service leaks, hydrant replacements, and valve replacements," and that the costs for leaks can vary significantly depending on location, time of day or day of week, and amount of excavation required. What Cal Water's rebuttal testimony does not do is provide sufficient evidence that the average of the five-year period 1996 to 2000 is a better predictor of Test Year contract maintenance than the five-year period 1995 to 1999. Cal Water bears the burden of proof and it has not met it. We will therefore adopt ORA's forecast for contracted maintenance.

The Joint Recommendation provides for Cal Water to file an advice letter for recovery of capital costs of a new Mid-Peninsula customer operations center, provided that the amount does not exceed $1,000,000 and that it goes into service prior to January 1, 2005. Cal Water provided no testimony on this capital project. According to ORA's Mid-Peninsula District report, Cal Water determined that its current customer operations center in this district is inadequate for current staff configuration. ORA investigated the proposed new operations center and discovered that there were no definitive plans for the location, size, or cost of the new center, or for the disposition of the current operations center. ORA, therefore, recommended an advice letter filing when the project is completed, due to these uncertainties. ORA's report did not contain any evaluation of the reasonableness of replacing the operations center, or of the alternatives.

The record on this issue is extremely limited, far too limited to support assigning this issue to the advice letter process. The record shows that Cal Water has not made any final plans for replacing the operations center. In fact, Cal Water has presented no justification of any kind in the record for this million-dollar project. The advice letter process is not well suited for the broad review necessary to evaluate the need for this project and the reasonableness of Cal Water's yet-to-be selected components of the project. For this reason, we will reject this portion of the Joint Recommendation.

9.13 Stockton

Cal Water sought an 11.28% increase for Test Year 2002 in revenue requirement for the Stockton District. ORA recommended a .46% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 7.94% increase, and Cal Water's resolution yields an 8.23% increase for Test Year 2002.

Cal Water explained that the primary reasons for the increase are purchased power expenses (39% increase), payroll (18% increase), general office expense allocation (57% increase), and rate base amortization (12% increase). This district's last general rate case was in 1997.

The issues remaining in dispute between ORA and Cal Water regarding the Stockton District are: general office allocation of one regulatory analyst and the Board of Directors costs, small main replacements, and painting of tank 3 and reservoirs 10 A and B. The general office and small main replacement issues have been addressed above.

In its report, ORA recommended that the Commission reduce Cal Water's capital budget by $88,300 in Test Year 2002 for painting reservoirs 10 A and B. For Test Year 2003, ORA similarly excluded the costs of painting tank 3 ($96,300). ORA stated that it had inspected the tank and reservoirs and that Cal Water had decided to postpone painting tank 3 until the next rate case. For reservoirs 10 A and B, ORA stated that its inspection showed that the tank was in "fairly good condition" and that only the legs showed "minor deterioration."

As discussed above, Cal Water's Tank Maintenance Supervisor presented specific analysis of tank 3 and reservoirs 10 A and B. Cal Water has met its burden of demonstrating that it has a sound inspection program and that this tank and these reservoirs require painting.

9.14 Visalia

Cal Water sought an 11.70% increase for Test Year 2002 in revenue requirement for the Visalia District. ORA recommended a 4.96% decrease for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in a 5.25% increase, and Cal Water's resolution yields a 5.85% increase for Test Year 2002.

Cal Water explained that the primary reasons for the increase are purchased power expenses (47% increase) and general office expense allocation (28% increase). A 4% increase in customers, a 5% increase in water production, and attrition and other non-general rate case rate increases keep today's increase below what it would have otherwise been. This district's last general rate case was for test year 2000. The issues remaining in dispute between ORA and Cal Water regarding the Visalia District are the general office allocation and small main replacements issues that have been addressed above.

9.15 Westlake

Cal Water sought a 14.86% increase for Test Year 2002 in revenue requirement for the Westlake District. ORA recommended a 2.89% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in an 8.76% increase, and Cal Water's resolution yields an 8.95% increase for Test Year 2002.

Cal Water explained that, as with the other districts, the primary reasons for the rate increase are purchased power expenses (26% increase), general office expense allocation (64% increase), and payroll (19% increase). A 22% increase in water sales and attrition and other non-general rate case rate increases keep down the size of today's increase. This district's last general rate case was in 1996. The issues remaining in dispute between ORA and Cal Water regarding this district are the general office issues and small main replacement issues that have been addressed above.

Also, Cal Water, ORA, Aglet, and North Ranch reached a Joint Recommendation on Reclaimed Water Rates. The Reclaimed Water Joint Recommendation is Attachment C.

The testimony showed that North Ranch purchases approximately 90% of the reclaimed water sold by the Westlake District. Cal Water sells reclaimed water only in one other district, Hermosa-Redondo, where it obtains reclaimed water from a different source, with different prices and facilities. In Westlake, Cal Water purchases the reclaimed water at wholesale from Calleguas Municipal Water District. Cal Water has invested approximately $14,480, less depreciation, for facilities to serve North Ranch. Cal Water incurs virtually no operating costs to deliver the reclaimed water to North Ranch. Cal Water's existing rates, however, provide for a 33% mark up over wholesale costs. Proposed rates would increase the amount North Ranch pays. In its prepared written testimony, North Ranch's expert witness contended that this mark up was excessive.

In the Joint Recommendation, the parties agreed to reduce the reclaimed water rate (both the service charge and volumetric components) proposed by Cal Water in this proceeding by 20%, but only so far as the resulting rate would not be lower than the previously applicable rate. If the rate resulting from applying the discount is lower than the previously applicable rate, then the previously applicable rate shall remain in effect. The Joint Recommendation includes sample calculations.

All active parties have agreed to the Reclaimed Water Joint Recommendation, after having reviewed all direct and rebuttal testimony. The recommendations are the result of significant negotiation and compromise of the parties thereto on issues substantially affecting them, and the parties agree that this is a fair resolution of their differences. The proposed resolution will substantially reduce Cal Water's effective mark up over its wholesale costs as sought by North Ranch, but such a reduction is limited by previously applicable rates, which will provide other Cal Water ratepayers with a contribution to overall operating costs. The Reclaimed Water Joint Recommendation is not procedurally flawed and is not contrary to law or Commission policy.

In sum, the Reclaimed Water Joint Recommendation is a reasonable compromise of this issue. We find, therefore, that it is reasonable in light of the whole record, consistent with the law, and in the public interest.

9.16 Willows

Cal Water sought a 17.10% increase for Test Year 2002 in revenue requirement for the Willows District. ORA recommended a 5.43% increase for the same period. ORA and Cal Water reached a Joint Recommendation on most, but not all, issues affecting this district. ORA's resolution of the disputed issues results in an 11.48% increase, and Cal Water's resolution yields an 11.77% increase for Test Year 2002.

Cal Water explained that, as with the other districts, the primary reasons for the increase are purchased power expenses (28% increase), payroll (40% increase), and general office expense allocation (61% increase). An 8.31% increase in water production plus attrition and other non-general rate case increases since the Willows District's last general rate case for test year 1996 keep down today's increase.

The issues remaining in dispute between ORA and Cal Water regarding the Willows District are: general office allocation of one regulatory analyst and the Board of Directors costs, small main replacements, and painting of tank 1. The general office and small main replacement issues have been addressed above.

ORA would defer $44,600 in capital costs from Test Year 2003 to 2004 but ORA did not identify the project or state a supporting rationale for this deferral in its report. Cal Water's initial testimony did not describe or provide a rationale for this or any specific capital project. As discussed above, Cal Water's rebuttal testimony explained all painting projects, and specifically points out that tank 1 has been in service since 1921 and that primer and rust are exposed in 10-15% of the roof area. Because the dollar amount identified by Cal Water corresponds to that of ORA's deferral, we conclude that the parties are referring to the same project. Cal Water has met its burden of demonstrating that it has a sound inspection program and that this tank requires painting.

Comments on Proposed Decision

The proposed decision of the assigned 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. Comments were filed on __________, and reply comments were filed on__________.

Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Findings of Fact

1. Cal Water must improve its initial showing in future rate cases.

2. Cal Water and ORA reached a joint recommendation to resolve most, but not all, outstanding issues in this proceeding.

3. Comments from members of the public opposed Cal Water's initial proposed rate increase.

4. The Joint Recommendation sets forth a rate increase that is substantially less than Cal Water's initial proposal and was the result of negotiation and compromise between the parties after all testimony had been filed.

5. ORA, Cal Water, Aglet, and North Ranch agreed on a proposal for reclaimed water rates in the Westlake District that reduces the proposed reclaimed water rate increase by 20% but only insofar as the resulting rate would not be less than the current rate.

6. All costs attributable to non-utility functions must be directly allocated to non-utility accounts. To the extent such allocation is not feasible, a cost allocation methodology must be used that fairly assesses indirect costs.

7. The record does not contain an allocation methodology for in-state affiliate operations.

8. We have previously rejected cost allocation methodologies for affiliates that use accumulated assets as a significant factor.

9. Management and employee time spent on a non-utility project is an incremental cost of the project.

10. Cal Water general office and its corporate affiliates share office space, receptionist, telephone system, and web site.

11. Cal Water has not demonstrated management policies and accounting safeguards to ensure that ratepayers are not subsidizing its affiliate operations.

12. Cal Water did not provide data, calculations, or an explanation for its determination that 4.595% of the general office rate base should be allocated to unregulated in-state operations.

13. ORA used the four-factor analysis to determine that Cal Water's out-of-state utility operations should be allocated 3% of the general office rate base.

14. ORA and Cal Water added 4.595% and 3% and arrived at the sum of 7%; this sum is mathematically incorrect and unreasonable. The correct whole number sum, reflecting accurate rounding, is 8%.

15. Cal Water proposed substantial increases in general office expenses and rate base.

16. ORA's testimony stated that Cal Water sought 40 new employees from 2001 to 2003, and the Joint Recommendation provided for 23 new positions and three upgrades.

17. The 3% labor inflation factor for 2001 and Test Years 2002 and 2003 in the Joint Recommendation is less than ORA's labor inflation increase.

18. Cal Water did not provide a sufficient justification for a 30% increase in the office expense category for the general office, a rate which substantially exceeds ORA's and Cal Water's inflation forecasts.

19. The ORA non-labor inflation rate plus customer growth (.9% per year) is a reasonable escalation factor for office expenses.

20. The Joint Recommendation provided for general office outside service expense to increase by 36% from 2000 to 2002.

21. Cal Water used an average of historic increases in office expenses to justify its requested increase; historic averages are not adequate justification where there is no attempt to remove nonrecurring costs, additional employees have been hired to perform a portion of the tasks previously performed by outside consults, and the utility is engaged in closely related non-regulated operations.

22. The California Water Service Group board of directors provides benefits to ratepayers.

23. The Joint Recommendation provides for general office rate base additions that are substantially less than that sought by Cal Water and that reflect a project-by-project review by ORA.

24. Over the ten-year period 1991-2000, Cal Water's budgeted capital expenditures exceeded actual expenditures by an average of 3.1%.

25. The web site www.calwater.com leads to the home page of Cal Water's holding company, California Water Services Group, which contains substantial information for investors and prospective customers of utility affiliates. Almost all the content of the web site is institutional or good will advertising. Information and services for Cal Water's California customers form a small portion of information on the web site. The logos of all the affiliates are present on all pages of the web site.

26. The record shows neither an allocation of web site capital costs and expenses to affiliates nor a disallowance for institutional or goodwill advertising.

27. Cal Water historically has not implemented its capital projects as planned if a more pressing project arises.

28. Cal Water's goal for its small main replacement program is to replace all undersized and bare steel mains in the next 50 years.

29. Cal Water's overall main replacement program projects replacement of all mains in the system in 307 years.

30. ORA's study showed that Cal Water actually installed only 11% of budgeted main replacements in 2001.

31. Cal Water is seeking a 60% increase in its main replacement budgets, an unprecedented increase.

32. Commission Standard Practice U-4, Determination of Straight-line Remaining Life Depreciation Accruals, Revised January 3, 1961, states that the longest projected actual service life for any type of main is about 100 years.

33. The commercial real estate market where the Bear Gulch customer service center is located was very tight when Cal Water signed the current lease. That the market has subsequently softened quite a bit but Cal Water has made little effort to modify the lease although rental office space is available in the Bear Gulch district at rates substantially less than the rate provided in Cal Water's lease.

34. Cal Water reported the Livermore station 23 tank painting capital project for to ORA as $84,400.

35. Cal Water's tank and reservoir inspection and re-painting program endeavors to proactively maintain the tanks and reservoirs to reduce costs over the life of the tank or reservoir.

36. Cal Water's contracted maintenance forecast for its Los Altos district uses an average of five years of historical expenditures, without accounting for new maintenance employees authorized, and ORA's forecast is based on four years' data. Tank 1 in the Willows district has been in service since 1921 and has rust and primer exposed in 10-15% of the roof area.

37. Cal Water's forecast for contracted maintenance in its Mid-Peninsula district is based on historic expenditures from 1996 to 2000; ORA did the same but used the years 1995 to 1999.

38. Several unpredictable factors affect contract maintenance expense.

39. Cal Water has not presented definitive plans for the location, size, and cost of its new operations center in the Mid-Peninsula district.

40. Cal Water did not include the July 1, 2002, postage increase in its application or in its updated tables; Cal Water did not obtain permission to update postage expense.

41. Cal Water does not provide customers the option of taking service through a ¾ inch meter.

42. The standard flow rate for 5/8 inch meter is 20 gallons/minute, but that current meters typically provide about 25 gallons/minute. The standard flow rate for a ¾ inch meter is 30 gallons/minute, and current meters typically provide about 35 gallons/minute. The service charge for a ¾ inch meter is 50% greater than a 5/8 inch meter.

43. Cal Water did not present sufficient evidence to support its proposed low-income tariff.

44. Attachment E shows summaries of earnings for all districts, and attachment F show tariff sheets. Attachments G through W show adopted quantities and attachment X is a bill comparison for each district.

Conclusions of Law

1. The Salinas application, A.01-09-071, should be removed from this consolidated proceeding.

2. As set out above, the rate increases included in this consolidated proceeding should be approved.

3. Cal Water bears the burden of proof in this proceeding; Cal Water must present a prima facie showing that justifies its proposed rate increase.

4. All public utility rates must be just and reasonable.

5. All general office costs must be allocated to those operations subject to Commission rate regulation and those that are not.

6. Where a regulated public utility with a Commission-approved holding company structure nevertheless chooses to co-locate facilities with its affiliates, the utility must maintain scrupulous records and cost accounting to demonstrate convincingly that ratepayers are not subsidizing affiliate operations.

7. In D.97-12-011, the Commission approved a settlement agreement, the purpose of which was to establish procedures for prompt and fair compensation or reimbursement for all assets, goods, and services transferred between Cal Water and its affiliates.

8. All management and employee time spent on non-utility projects must be carefully accounted for and allocated only to shareholders.

9. D.00-07-018 established rules and procedures for water utilities to offer non-tariffed services that use excess capacity of regulated assets and employees. That decision applies to utility non-tariffed projects only and has no applicability to affiliate projects; it also directs that shareholders absorb all incremental costs of non-tariffed projects. D.00-07-018 left to future rate cases, such as this one, to consider the issue of whether or to what extent rates should reflect investments made and costs incurred for labor and capital jointly used for tariffed and non-tariffed products and services.

10. All known test year contracts for non-tariffed products or services that rely on assets included in a utility's revenue requirement should be allocated a share of the capital costs of the asset.

11. Cal Water's general office rate base should be reduced by 1% to correct a mathematical error in the determination of the unregulated operations adjustment.

12. D.97-12-011 requires that Cal Water's corporate affiliates compensate it for utility services at the higher of cost or market.

13. Pursuant to Rule 73, we may take official notice of the California Water Service Group's 2001 Annual Report to Shareholders and the internet web site www.calwater.com.

14. The fact that the Joint Recommendation's general office payroll increases are less than ORA's labor inflation rates is sufficient evidence that the majority of the new employees and position upgrades provided for in the Joint Recommendation are reasonable.

15. Cal Water has demonstrated that it needs a second additional rate analyst, and its request should be granted.

16. The costs of an electro-mechanical technician position should be excluded from this proceeding.

17. The Joint Recommendation's for office expenses in the general office is excessive and unreasonable, and should be rejected.

18. Aglet's proposal to escalate office expenses in the general office by ORA's inflation rates plus customer growth of .9% per year is reasonable and should be adopted.

19. The Joint Recommendation's for outside services in the general office is not reasonable and should be rejected.

20. Outside services expense should be escalated from 2000 adopted levels by ORA's inflation rates plus customer growth of .9% per year.

21. ORA's request to disallow the costs of the California Water Services Group board of directors should be denied.

22. The general office capital additions amount in the Joint Recommendation should be reduced by 3.1%; with that reduction, the amount is reasonable and should be approved.

23. All capital costs and expenses for the current web site www.calwater.com should be disallowed for ratemaking purposes.

24. Cal Water should revise its advertising for its affiliates to comply with the letter and spirit of Commission policies.

25. Cal Water should revise is entire presence on the internet to clearly separate regulated operations from non-regulated and to provide useful information and services to customers.

26. Cal Water has met its burden of demonstrating that its proposed main replacement program is necessary to provide just and reasonable service to its customers.

27. Cal Water should submit a report in its general rate case showing its budgeted capital projects and actual expenditures.

28. Cal Water has failed to meet its burden of showing that its Bear Gulch office rent is reasonable.

29. A reasonable rent for office space in the Bear Gulch district is $3.00 per square foot.

30. Cal Water should file an application detailing its proposed replacement of the Chico Operations Center.

31. The Infrastructure Act requires water utilities to sell unneeded real property that was at any time included in rate base and to re-invest the net proceeds in water utility infrastructure. All such revenue must be tracked and included in a memorandum account.

32. The Commission has exclusive authority to determine the used, useful, or necessary status of any and all infrastructure improvements and investments.

33. The Infrastructure Act requires that water utilities:

a. Track all utility property that was at any time included in rate base.

b. Maintain sales records for each property that was at any time in rate base but which was subsequently sold to any party, including a corporate affiliate.

c. Obtain Commission authorization to establish a memorandum account in which to record the net proceeds from all sales of no longer needed utility property.

d. Use the memorandum account fund as the utility's primary source of capital for investment in utility infrastructure.

e. Use the memorandum account fund as the utility's primary source of capital for investment in utility infrastructure.

f. Invest all amounts recorded in the memorandum account within eight years of the calendar year in which the net proceeds were realized.

34. Cal Water should file an application setting up an Infrastructure Act memorandum account with an up-to-date accounting of all real property that was at any time in rate base and that Cal Water has sold since the effective date of the Infrastructure Act. Such application shall also include all details on Cal Water's real estate program. The transactions should be recorded on a district-by-district basis.

35. The Livermore station 23 tank-painting project should be included at $84,400.

36. Cal Water has met its burden of demonstrating that it has a sound tank and reservoir inspection program, and that (1) Hermosa-Redondo tank 5B and C and reservoirs 3B and 8A-D, (2) tank 3 and reservoirs 10 A and B in the Stockton district, and (3) tank 1 in the Willows district all require painting.

37. ORA's forecast of Los Altos contracted maintenance is reasonable and should be adopted.

38. Cal Water has not met its burden of demonstrating that its forecast of Mid-Peninsula contracted maintenance expense is superior to ORA's; we should adopt ORA's forecast.

39. Cal Water has not its burden of showing that the new Mid-Peninsula district operations center is needed and components of the project are reasonable; therefore, this part of the Joint Recommendation should not be approved.

40. The Rate Case Plan allows for updates 30 days after filing and/or with the permission of the ALJ.

41. The Joint Recommendation would allow for updating postage expense, but no other expenses, in violation of the Rate Case Plan; consequently, this portion of the Joint Recommendation cannot be approved.

42. Customers should have the option of selecting service from a ¾ inch meter.

43. With the exceptions noted above, the Joint Recommendation is reasonable in light of the record, consistent with the law, and in the public interest.

44. The revenue increases reflected in the Joint Recommendation, as modified by this decision, will result in just and reasonable rates for Cal Water's Districts in this proceeding.

45. The reclaimed water rate recommended by the parties is reasonable in light of the record, consistent with the law, and in the public interest.

46. The rates reflected in the Reclaimed Water Joint Recommendation will result in just and reasonable reclaimed water rates.

47. The revenue increases reflected in the Joint Recommendation, as modified by this decision, should be approved for Cal Water's Districts in this proceeding.

48. Cal Water's proposed low-income tariff should not be approved.

49. This decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The Salinas Application 01-09-071 is removed from this proceeding.

2. As modified by this decision, the Joint Recommendation between California Water Services Company (Cal Water) and the Office of Ratepayer Advocates is adopted.

3. In all future general rate case applications, Cal Water shall present an initial showing with the major changes that led to the requested change identified and quantified. Each issue should include detailed explanations and justifications for the requested change, with cross-references to evidentiary support. All tables of data should be explained and analyzed. All necessary evidence should be included in the record.

4. Cal Water shall keep its personnel and assets physically separate from its corporate affiliates to the maximum feasible extent. Where such physical separation is not feasible, Cal Water shall develop and implement management and accounting policies and procedures to ensure that ratepayers are not subsidizing unregulated operations.

5. Cal Water shall carefully account for and directly charge to the applicable affiliate at the higher of market price or fully allocated cost all management and employee time spent on affiliate endeavors. Such charges shall be paid within 45 days.

6. Cal Water shall carefully account for and directly charge non-utility accounts for the fully allocated cost of all utility management and employee time,

as well as any incremental cost of facilities or equipment, used for utility non-tariffed endeavors. Such charges shall be paid within 45 days.

7. Cal Water shall comply with the annual report requirement of Decision 00-07-018, and shall remedy any past non-compliance as soon as possible. Such reports shall include detailed accounting for all costs and revenue.

8. In its future general rate case filings, Cal Water shall include an allocation of any regulated asset's capital costs to all known test year contracts for non-tariffed products or services that rely on that asset.

9. Cal Water shall revise its entire presence on the web to clearly separate regulated operations from non-regulated and to provide useful information and services to regulated utility customers.

10. In all future general rate cases, Cal Water shall include a report showing its budgeted capital projects and actual expenditures.

11. Cal Water shall file an application for authority to replace its Chico Operations Center.

12. In compliance with the Water Utility Infrastructure Act, Cal Water shall:

a. Track all utility property that was at any time included in rate base.

b. Maintain sales records for each property that was at any time in rate base but which was subsequently sold to any party, including a corporate affiliate.

c. Obtain Commission authorization to establish a memorandum account in which to record the net proceeds from all sales of no longer needed utility property.

d. Use the memorandum account fund as the utility's primary source of capital for investment in utility infrastructure.

e. Invest all amounts recorded in the memorandum account within eight years of the calendar year in which the net proceeds were realized.

13. Within 90 days after the effective date of this order, Cal Water shall file an application setting up an Infrastructure Act memorandum account with an up-to-date accounting of all real property that was at any time in rate base and that Cal Water has sold since the effective date of the Infrastructure Act. The application shall also include all required information on Cal Water's real estate program on a district-by-district basis. In each district with a net proceed balance, the next general rate case for that district must show that the net proceeds are being used as the district's first source of capital to fund any needed infrastructure additions.

14. Within 180 days of the effective date of this order, Cal Water shall offer all customers the option of selecting service from a ¾ inch meter.

15. Cal Water is authorized to file in accordance with General Order (GO) 96-A, and to make effective on not less than five days' notice, tariffs containing the test year 2003 increases for its districts as provided in attachments to this decision. The revised rates shall apply to service rendered on and after the tariffs' effective date.

16. Advice letters for authorized rate increases for 2004 and, unless the Commission changes the schedule, 2005, may be filed in accordance with GO 96-A no earlier than November 1st of the preceding year. The filing shall include appropriate work papers. The increase shall be the amount authorized herein, or a proportionate lesser increase if Cal Water's rate of return on rate base, adjusted to reflect rates then in effect, normal ratemaking adjustments, and the adopted change to this pro forma test, for the 12 months ending September 30th of the preceding year, exceeds 8.9%. The advice letters shall be

reviewed by the Commission's WD for conformity with this decision, and shall go into effect upon WD's determination of compliance, not earlier than January 1st of the year for which the increase is authorized, or 30 days after filing, whichever is later. The tariffs shall be applicable to service rendered on or after the effective date. WD shall inform the Commission if it finds the proposed increase does not comply with this decision or other Commission requirements.

17. Cal Water's proposed low-income tariff is rejected. Within 180 days of the effective date of this order and in consultation with the Commission's Water Division, Cal Water shall file an application with a low-income water rate proposal that fully and completely addresses the matters discussed in this Order and contained in Pub. Util. Code § 739.8 including but not limited to: availability of the program to all low income families served with water directly or indirectly by Cal Water; costs of the program; conservation effects of the program; and ratemaking treatment of program costs.

This order is effective today.

Dated ______________________, at San Francisco, California.

Attachment A
(Page 1)

Comparison of Rate Changes Provided In Cal Water's Applications, ORA's Report, and the Joint Recommendation

			Joint Recommendation	
District	**CW Proposed**	**ORA Report**	**CW**	**ORA**
Bear Gulch				
2002	15.13%	-5.28	4.29%	3.74%
2003	3.11%	1.03%	3.18%	2.9%
2004	3.5%	NA	3.0%	2.8%
2005	3.4%	NA	3.0	2.7
Chico				
2002	21.11	3.19	16.95	15.84
2003	5.11	1.99	2.67	1.65
2004	5.2	NA	2.1	2.1
2005	4.9	NA	2.0	1.1
Dixon				
2002	14.08	-.72	8.09	7.82
2003	4.04	1.29	2.48	2.11
2004	3.7	NA	2.3	2.0
2005	3.7	NA	2.3	1.9
East Los Angeles				
2002	9.89	4.79	7.30	7.04
2003	1.95	1.72	1.63	1.36
2004	1.9	NA	1.6	1.3
2005	1.9	NA	1.5	1.3

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Hermosa/Redondo				
2002	16.12	5.4	12.84	12.61
2003	3.43	1.84	.9	.71
2004	3.1	NA	.7	.5
2005	3.0	NA	.7	.5
King City				
2002	26.35	1.82	15.68	15.41
2003	6.16	6.03	3.68	3.67
2004	5.6	NA	3.5	3.5
2005	5.4	NA	3.4	3.4
Livermore				
2002	5.7	- 5.7	.02	1.4
2003	2.5	1.37	2.1	2.0
2004	.8	NA	2.1	2.0
2005	.8	NA	2.0	2.0
Los Altos				
2002	14.54	.13	7.4	6.96
2003	4.22	1.56	2.42	2.4
2004	.6	NA	2.3	2.3
2005	.6	NA	2.3	2.3
Marysville				
2002	28.06	0.13	20.05	19.78
2003	16.47	7.54	8.32	8.33
2004	18.5	NA	7.6	7.6
2005	16	NA	7.1	7.1
Mid-Peninsula				
2002	12.5	.51	5.61	5.2
2003	4.52	.68	.91	.86
2004	6.5	NA	1.3	1.3
2005	6.2	NA	1.3	1.2

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Stockton				
2002	11.28	- .46	8.23	7.94
2003	2.54	1.23	1.47	1.34
2004	1.47	NA	1.6	1.5
2005	1.47	NA	1.6	1.4
Visalia				
2002	11.07	-4.96	5.85	5.25
2003	1.27	2.11	1.34	.81
2004	1.2	NA	1.3	.8
2005	1.2	NA	1.3	.8
Westlake				
2002	14.86	2.89	8.95	8.76
2003	2.74	1.84	.9	.82
2004	2.6	NA	.6	.6
2005	2.5	NA	.6	.6
Willows				
2002	17.1	5.43	11.77	11.48
2003	6.1	3.65	3.42	3.09
2004	7.6	NA	2.6	2.3
2005	7.1	NA	2.5	2.3

(End of Attachment A)

Attachment B

JOINT RECOMMENDATIONS OF THE

OFFICE OF RATEPAYER ADVOCATES AND

CALIFORNIA WATER SERVICE COMPANY

IN APPLICATION 01-09-062 et al

JOINT RECOMMENDATIONS OF THE OFFICE OF RATEPAYER ADVOCATES AND CALIFORNIA WATER SERVICE COMPANY IN APPLICATION 01-09-062 et al

1.00 General Office Expenses

Complement

1.01 ORA's General Office report stated that ORA's general office payroll expenses included 19 new employee positions for 2001 (page 2-5). Included were a CIS Functional Team Member, a CIS Functional Help Desk Member, and a CIS project leader; however, ORA's revenue requirement inadvertently did not include the salaries for the three positions and included the salary for an environmental assistant twice. ORA agrees that its general office payroll expenses should be increased by $182,479 in 2002 and $187,953 in 2003 to reflect these positions.

1.02 After further discussions concerning the responsibilities and comparable compensation for three existing positions (Database Administrator, Network Manager, Network Administrator) that were upgraded in 2001, the parties agree that it is reasonable to add to ORA's estimates $89,000 in 2002 and $91,670 in 2003 to reflect the new assignment of duties and responsibilities.

1.03 During discussions with ORA, Cal Water provided additional detail concerning the duties and responsibilities for three new engineering positions: an electrical engineer in 2002, an electrical technician in 2002, and a production engineer in 2003. Since the majority of salaries for these positions is capitalized (87%) and reflected in the district capital project estimates, ORA accepts and the parties agree that $14,033 in 2002 and $22,011 in 2003 or 13% of the salaries for these positions should be added to ORA's estimates of payroll expenses for in-house expertise in these areas.

1.04 After Cal Water provided additional justification concerning the need to upgrade its web site to meet the Commission's requirements for posting tariffs and filings with the Commission and the customer benefits of accessing customer specific information, ORA accepts and the parties agree that $80,000 in 2002 and $82,400 in 2003 for one senior web developer should be added to ORA's payroll estimates.

Other Operating Expenses

1.05 Cal Water clarified that $43,000 in its capital costs included the annual maintenance expenses for the LIMS system. ORA properly removed this expense as a capital cost, but did not include the estimate in ORA's annual expense estimates. ORA and Cal Water agree that the annual maintenance contract expense should be added to ORA's expense estimates for 2002 and 2003 in account 742.

1.06 Cal Water's representatives from its Informations Systems (IS) department detailed the need for additional data storage and demonstrated that a centralized storage system was the most cost effective alternative. Additionally, the IS representatives provided additional information concerning a Citrix system, which will allow Cal Water to upgrade its windows operating system that will no longer be supported by Microsoft. These projects are more fully discussed under General Office Plant Improvements; however, ORA and Cal Water agree that these capital improvements would save administrative costs of $50,000 in 2002 and 2003. ORA's estimate for Account 792 should be reduced accordingly.

1.07 Cal Water provided additional justification showing that $1 million of the $1.2 million in credit associated with the curtailment of the Dominguez Water Corporation pension plan in 2000 was a one-time saving due to the Cal Water/Dominguez merger and not an ongoing benefit to Cal Water's pension plan. Accordingly, ORA and Cal Water agree that this one-time merger related cost savings should be treated in the same manner as one-time merger related costs and that only $200,000 of the Dominguez pension credit should be reflected in ORA's estimates of account 795. Additionally, ORA and Cal Water agree that a $200,000 adjustment should be spread over three years, the rate case cycle. ORA had reflected its original $1.2 million credit over two years, however, after further analysis and discussion concerning the impact on attrition rates ORA agrees that this adjustment should be evenly spread over the three year rate case cycle. Thus, ORA agrees that its estimate of account 795 should be increased by $533,333 per year.

1.08 As with the pension adjustment above ORA and Cal Water agree that the adjustment to the injuries and damages account should be amortized over three years instead of two as shown in ORA's report. This increases ORA's estimates for account 794 by $67,000 per year.

1.09 ORA and Cal Water corrected calculation errors in account 798 and 799, increasing ORA's estimates in those categories by approximately $75,000 annually and $40,000 annually, respectively.

1.10 ORA and Cal Water clarified that pensions and benefits calculations for general office should be based in part on total company changes to complement. Therefore, ORA and Cal Water agree that $155,600 in 2002 and $272,100 in 2003 Pensions and Benefits should be added to ORA's original position.

Synergies

1.11 In its General Office report ORA removed Cal Water's proposed adjustment for synergies/savings related to the combining of Dominguez Water Corporation's general office functions with Cal Water's general office functions. On March 8, 2002, Cal Water filed a Petition to Modify Decision 00-05-047, the Commission's decision in the Dominguez/Cal Water merger Application 99-02-004, requesting authority to file the first combined rate application for Cal Water's Hermosa-Redondo and Palos Verdes districts and Dominguez' South Bay district in July of 2002. As stated in the petition ORA does not intend to oppose Cal Water's request.

After further discussion concerning Cal Water's first combined application ORA and Cal Water agree that the issue of general office merger related synergies will be addressed in that proceeding. Moreover, since that proceeding will also address synergies related to the combining of Dominguez' South Bay district with the two Cal Water districts, ORA and Cal Water agree to defer the issue of synergies in the instant proceeding pending the outcome of the combined application proceeding. Accordingly, ORA and Cal Water agree that the Commission should authorize Cal Water to establish a memorandum account that will track the revenue requirement associated with Cal Water's proposed synergies adjustment for subsequent recovery, if found reasonable. Furthermore, Cal Water agrees to accept ORA's proposed treatment of general office synergies in the instant proceeding.

2.00 General Office Plant Improvements

2.01 ORA and Cal Water agree that Cal Water should be allowed $170,000 in 2002 for software, hardware, and site development so that the website calwater.com will meet all the Commission's requirements under General Order 96-B and provide greater customer benefits.

2.02 After Cal Water clarified the calculations shown in its workpapers, ORA and Cal Water agree that $199,400 expended on capital projects in 2001 but omitted from ORA's report should be added to ORA's 2001 plant estimate.

2.03 Cal Water provided additional justification for a new plan to implement PeopleSoft version 8.0 and provided a reduced cost estimate. Peoplesoft version 8.0 is a software package that will be used for maintaining Cal Water's financial, accounting, human resources, and billing records. Currently, Cal Water uses an older Peoplesoft version that will no longer be supported by Peoplesoft. The new plan reduces outside consulting services and spreads the cost of the implementation over 2002, 2003, and 2004. ORA and Cal Water agree that the new plan responds to ORA's initial concerns with the project and that $192,000 in 2002 and $272,000 in 2003 should be added to ORA's estimates of capital improvements.

2.04 As discussed above, in response to ORA's concerns, Cal Water and ORA quantified the operating savings from implementing the Citrix and centralized storage system projects. Cal Water and ORA agree that $324,000 for the centralized storage system in 2002 and

$250,400 for the Citrix system in 2003 should be included in ORA estimates of capital improvements

2.05 Cal Water presented additional justification that the project to replace its aging payment processing machines with more efficient machines should be allowed in 2003 and 2004. Based on this additional information ORA agrees that $108,000, one half of the project cost, should be included in its 2003 test year estimate. Additionally, Cal Water and ORA agree that $150,000 should be removed from plant and $125,000 from depreciation reserve in 2003 to reflect the retirement of two existing payment processing machines.

2.06 Cal Water provided additional justification for six vehicles purchased by the company in 2002, but disallowed in ORA's estimate of capital improvements. Based on the discussions that addressed employee compensation and the business use of these vehicles ORA and Cal Water agree that three of these vehicles totaling $75,000 should be included in ORA's 2002 capital improvements estimate.

2.07 After Cal Water showed additional detail reflecting lower costs for the source water assessment program (SWAP), ORA agrees that $70,000 in plant additions for each test year should be included in its estimates and to withdraw its recommendation of an advice letter filing capped at $387,000.

3.00 District Expenses

3.01 Cal Water and ORA agree to use the depreciation rates previously adopted by the Commission and currently in effect for each district rather than the proposed rates of either party.

3.02 ORA agrees that its estimate of franchise fees for Test Year 2002 in the Westlake district should be corrected to include local franchise fees based on test year revenues.

3.03 ORA agrees that Cal Water's deferred income taxes and depreciation expenses based on the adopted depreciation rates and rate base should be used to calculate income taxes in accordance with the Commission's rate setting policy.

3.04 ORA and Cal Water agree that the Department of Health Services (DHS) fees should be added to ORA expense estimates. The five-year average (1996-2000) of the DHS fees contained in Cal Water's workpapers should be used to estimate the appropriate level of these fees in each district. Attached as Appendix A is a list of fees by district.

3.05 ORA and Cal Water agree that ORA's estimates for postage should be increased to reflect the postal rate increase, effective July 1, 2002, of 2.3 cents per bill or 9.02%.

4.00 District Plant & Rate Base

General

4.01 ORA and CWS agree to use a ten-year average adjusted for inflation for estimating non-specific capital expenditures. This consistent method for all districts was used in ORA's reports for Cal Water's southern districts.

4.02 Cal Water provided additional information clarifying that the 20% factor for employee time to convert its district water system paper maps to digital maps was not Cal Water's standard overhead factor. Based on Cal Water's additional information ORA agrees that the 20% factor should replace its use of Cal Water's standard overhead factor for this project.

4.03 ORA and Cal Water have revised the lag days for computing the impact of federal and state income taxes on working cash allowance based on actual taxes paid and agree that 93 lag days fairly represents the timing and amount of taxes paid. Accordingly, Cal Water and ORA recommend that 93 lag days be used for the Commission adopted tax expense in determining the appropriate level of working cash allowance.

Advice Letters

4.04 Bear Gulch

ORA and Cal Water agree that the advice letter for the cryptosporidium deactivation project recommended in ORA's report may be filed as long as the equipment is in service prior to January 1, 2005 and capped at $648,000 for capital costs.

4.05 King City

ORA and Cal Water agree that Cal Water should be allowed to file an advice letter for a 2003 well project as long as the well is in service prior to January 1, 2005 and capped at $500,000 for capital costs and an additional $100,000 for permitting.

4.06 Marysville

ORA and Cal Water agree that Cal Water should be allowed to file advice letters for the 2003 greensand purification project capped at $734,000 and the 2003 MTBE purification project capped at $864,000 if they are in service prior to January 1, 2005. ORA also agrees that should Cal Water demonstrate in its advice letter that one or more alternative capital improvement projects is equally cost effective that Cal Water should be authorized to replace the greensand and/or MTBE projects with one or more projects that are equally cost effective.

4.07 Mid-Peninsula

ORA and Cal Water agree that Cal Water should be allowed to file an advice letter covering the capital cost of a new operation center capped at $1 million as long as the facilities are in service prior to January 1, 2005.

4.08 Salinas

ORA and Cal Water agree that the north Salinas reservoir project should be deferred until the next general rate case for the Salinas District. Accordingly, ORA and Cal Water agree that the Commission should not adopt ORA's recommended advice letter treatment for this project.

4.09 Visalia

After additional discussions concerning Cal Water's request for two new wells, ORA and Cal Water agree that both wells should be excluded from ORA's estimate of the capital budget and that Cal Water should be authorized to file an advice letter capped at $600,000 for each well if in service prior to January 1, 2005.

4.10 Westlake

Cal Water and ORA agree that Cal Water should be allowed to file an advice letter capped at $250,000 to recover the capital costs of the Notter reservoir turnover project as long as it is in service prior to January 1, 2005.

5.00 Other Joint Recommendations

5.01 ORA and Cal Water agree that this proceeding should remain open to address the disposition of under-collections in Cal Water's offset expense balancing and memorandum accounts pending the outcome of R.01-12-009.

5.02 After discussions with the Director of the Commission's Water Division, Cal Water and ORA agree that Cal Water should be authorized to recover Commission ordered intervenor funding in step and/or attrition advice letter filings.

5.03 Cal Water agrees with ORA's recommendation that the Commission should establish a temporary balancing account to track revenues and expenses of the low-income rate assistance program. In its district reports ORA supports the proposed low-income rate assistance program as shown in Cal Water's application for each district.

5.04 ORA and Cal Water agree that Cal Water should conduct a six month time keeping study to evaluate the proper allocation of management time to non-regulated CPUC activities which are not subject to Decision 00-07-018. ORA agrees that this study addresses the recommendation in its General Office report.

5.05 Following considerable discussion concerning the cost of capital ORA and Cal Water agree that the Commission should adopt an 8.90% overall return on rate base. This agreement takes into consideration several factors including correcting certain calculations in ORA's report and adjusting American Water Company's stock price to remove the impact of the announced sale of the company. Additionally, ORA and Cal Water agree that the Commission should use a weighted cost of debt of 8.09%, a cost of 4.19% for preferred stock, and a return on equity of 9.70%. Finally, ORA and Cal Water agree that the Commission should apply these costs to the following capital structure: equity 51.5%, preferred 0.5%, and debt 48.0%.

5.06 ORA in its district reports recommended that the Commission use recorded sales data unadjusted for weather in calculating proforma earnings for approving Cal Water's step and attrition filings for districts in this proceeding. This recommendation was made in response to Cal Water's proposed language affecting the application of the Commission's current earnings test. After considering the merits of each party's position ORA and Cal Water agree that the Commission should authorize step and attrition increases for Cal Water's districts in this proceeding based on recorded earnings for the latest 12 months ending September 30 each year. Additionally, the recorded earnings test should be adjusted to exclude expenses subject to balancing or memorandum account recovery. Moreover, the sales and sales related expenses in the recorded earnings test should be adjusted to reflect normalized weather and exclude revenues credited to balancing and memorandum accounts. While ORA and Cal Water are in agreement with the methodology to adjust recorded sales to reflect normalized weather, additional time is necessary to develop a table of weather coefficients by district for each affected class of customers. ORA and Cal Water will jointly submit the table of coefficients within 30 days of the filing of this Joint Agreement. In accordance with the Commission's policy for approving step and attrition increases, should Cal Water's earnings, based on the recorded test above, exceed its authorized return, the requested step or attrition increase should be reduced to offset the earnings in excess of its authorized return in this proceeding or in any other future Cal Water proceeding, whichever is lower. Furthermore, Cal Water and ORA agree that any earnings adjustment to the step and attrition increases for the districts in this proceeding should not double count any portion of an earnings adjustment in another Cal Water proceeding or filing with the Commission. This Joint Recommendation is intended to resolve the issue of the appropriate earnings test for approving step and attrition increases and should not be considered binding in other proceedings, including R.01-12-009.

5.07 After further discussions and a review of recent recorded sales data ORA and Cal Water agree that the midpoint between ORA's and Cal Water's original sales forecasts for the residential and business classes should be used to estimate sales for 2002 and 2003. The agreed upon estimates are shown on the attached tables.

Additionally, ORA and Cal Water agree that, after reviewing recent recorded sales data, 17,000 KCcf, should be used for 2002 and 2003 as the total estimated sales in all districts for the multifamily, industrial, public authority, other, irrigation, and reclaimed water classes. This agreement represents the midpoint between average recorded sales and ORA's sales forecast. The attached Appendices B and C detail the joint recommendation by customer class for each district.

Furthermore, Cal Water agrees to file future general rate applications using the regression analysis referred to in Standard Practice U-25 and the supplement to U-25 (U-25). As set forth in U-25 the regression analysis uses annual temperature and rainfall (limited to 4-inches per month) and time as variables. Up to 13 years of recorded sales data (additional years may be added to eliminate years of drought data) should be used in the modeling process. Regression output statistics such as the Inverse McSee (standard error divided by the mean) and statistics that measure the regression models success should be used to evaluate and select the most appropriate sales forecasting models. Additionally, Cal Water may use other appropriate commercially available regression analysis programs.

5.08 After several meetings between ORA and Cal Water which included presentations by Cal Water's engineering personnel and Basin Water, a company that provides water treatment services for nitrates and other contaminants, ORA and Cal Water agree that the Salinas District faces an immediate and critical need for treatment facilities at four well sites. Additional information concerning the need for water treatment facilities in the Salinas District was provided in oral testimony by ORA and Cal Water and is contained in Cal Water's motion to establish a memorandum account filed May 10, 2002. Accordingly, ORA and Cal Water agree that the Commission should authorize Cal Water to establish a well-head treatment memorandum account for the Salinas District that will track the revenue requirement associated with water treatment for four wells. Additionally, ORA and Cal Water recommend that:

1. The well-head treatment memorandum account track the revenue requirement associated with treatment costs until the Commission issues a decision in Cal Water's next general rate application (subsequent to A. 01-09-071) for the Salinas District, and

2. Cal Water file annually by advice letter or application for recovery of the revenue requirement tracked in the wellhead treatment memorandum account.

Finally, in reaching this joint recommendation ORA and Cal Water recognize that Cal Water has not demonstrated a critical need for a similar memorandum account in its other

14 districts in this proceeding. Therefore, ORA and Cal Water agree that the Commission should not authorize Cal Water to establish the water quality memorandum accounts requested in its applications for these districts.

5.09 As set forth in its Results of Operation reports for the Dixon, King City, Marysville, Salinas, and Willows Districts ORA is in agreement with Cal Water's proposed water supply special facilities fees. Moreover, ORA and Cal Water agree that these fees should apply prospectively to all qualifying developments for which water supply special facilities costs have not been previously paid.

6.00 VERIFICATION

The signatories to these joint recommendations personally and independently verify that all elements, including the attached tables are correct, complete, and internally consistent.

OFFICE OF RATEPAYER ADVOCATES	CALIFORNIA WATER SERVICE COMPANY
By: /s/ Sung B. Han	By: /s/ Francis S. Ferraro .
Sung B. Han Project Manager California Public Utilities Commission 505 Van Ness Avenue San Francisco, CA 94102	Francis S. Ferraro Vice President California Water Service Co. 1720 N. First Street San Jose, CA 95112
Dated: July 18, 2002	Dated: July 18, 2002 .

2002 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
Bear Gulch			
Residential	4,192.0	5,021.2	4,606.6
Business	644.5	656.8	650.7
Multi Family	110.0	113.9	111.3
Industrial	2.2	2.2	2.2
Public Authority	92.8	112.8	99.3
Other	4.6	5.5	4.9
Total	5,046.1	5,912.4	5,475.0
Chico			
Residential	2,256.4	2,450.9	2,353.7
Business	2,502.3	2,489.5	2,495.9
Multi Family	1,062.0	1,028.1	1,050.9
Industrial	140.5	142.5	141.2
Public Authority	469.7	556.6	498.0
Other	20.2	19.2	19.9
Total	6,451.1	6,686.8	6,559.6
Dixon			
Residential	571.1	603.5	587.3
Business	58.5	54.7	56.6
Multi Family	33.6	39.9	35.7
Industrial	0.3	0.3	0.3
Public Authority	15.2	18.2	16.2
Other	-	-	-
Total	678.7	716.6	696.1
East Los Angeles			
Residential	3,930.9	4,085.6	4,008.3
Business	2,526.1	2,519.4	2,522.8
Multi Family	188.3	192.1	189.5
Industrial	1,497.5	1,528.9	1,507.7
Public Authority	846.0	696.9	797.4
Other	5.9	4.1	5.3
Total	8,994.7	9,027.0	9,031.0

Hermosa-Redondo

Residential	3,292.8	3,576.3	3,434.6
Business	895.7	945.9	920.8
Multi Family	1,107.9	1,211.8	1,141.8
Industrial	245.2	245.2	245.2
Public Authority	271.9	279.2	274.3
Other	4.3	4.3	4.3
Reclaimed	88.0	89.7	88.6
Total	5,905.8	6,352.4	6,109.6

2002 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
King City			
Residential	393.2	399.2	396.2
Business	249.9	247.2	248.6
Multi Family	36.5	28.5	33.9
Industrial	63.3	74.2	66.9
Public Authority	30.9	38.4	33.3
Other	4.9	2.8	4.2
Irrigation	0.5	0.5	0.5
Total	779.2	790.8	783.6
Livermore			
Residential	3,094.3	3,454.5	3,274.4
Business	605.1	574.2	589.7
Multi Family	252.4	269.1	257.8
Industrial	1.8	1.8	1.8
Public Authority	359.9	489.5	402.1
Other	21.6	27.5	23.5
Total	4,335.1	4,816.6	4,549.3
Los Altos			
Residential	3,965.9	4,691.8	4,328.9
Business	1,125.9	1,120.5	1,123.2
Multi Family	294.1	317.7	301.8
Industrial	19.4	17.4	18.7
Public Authority	238.6	298.7	258.2
Other	3.7	3.1	3.5
Total	5,647.6	6,449.2	6,034.3

Marysville			
Residential	66.0	79.6	72.8
Business	308.0	324.5	316.3
Multi Family	145.1	141.1	143.8
Industrial	26.9	34.2	29.3
Public Authority	95.3	108.8	99.7
Other	0.3	0.4	0.3
Total	641.6	688.6	662.2
Mid Peninsula			
Residential	4,284.7	4,695.2	4,490.0
Business	1,429.2	1,478.4	1,453.8
Multi Family	1,034.8	1,055.5	1,041.5
Industrial	66.9	67.2	67.0
Public Authority	355.6	375.9	362.2
Other	26.1	36.3	29.4
Total	7,197.3	7,708.5	7,443.9

2002 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
Salinas			
Residential	3,860.1	4,241.6	4,050.9
Business	2,367.0	2,410.4	2,388.7
Multi Family	717.6	718.6	717.9
Industrial	477.0	474.6	476.2
Public Authority	342.1	328.1	337.5
Other	47.9	57.9	51.2
Total	7,811.7	8,231.2	8,022.4
Stockton			
Residential	6,728.9	7,260.8	6,994.9
Business	2,512.1	2,591.2	2,551.7
Multi Family	1,068.7	1,004.6	1,047.8
Industrial	1,954.4	2,091.3	1,999.5
Public Authority	1,175.4	1,133.4	1,161.7
Other	11.2	13.5	11.9
Total	13,450.7	14,094.8	13,767.5
Visalia			
Residential	2,477.1	2,855.5	2,666.3
Business	2,529.0	2,554.2	2,541.6
Multi Family	412.2	412.2	412.2
Industrial	235.7	245.6	238.9
Public Authority	414.6	382.2	404.0
Other	129.4	168.1	142.0
Total	6,198.0	6,617.8	6,405.0

Westlake			
Residential	2,212.3	2,523.0	2,367.7
Business	847.9	1,009.3	928.6
Multi Family	96.5	106.1	99.6
Industrial	30.9	31.6	31.1
Public Authority	136.2	152.2	141.4
Other	4.0	3.8	3.9
Reclaimed	187.8	230.2	201.6
Total	3,515.6	4,056.2	3,773.9
Willows			
Residential	229.5	229.0	229.3
Business	124.8	121.2	123.0
Multi Family	61.8	55.4	59.7
Industrial	-	-	-
Public Authority	51.6	42.2	48.5
Other	-	-	-
Total	467.7	447.8	460.5

2003 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
Bear Gulch			
Residential	4,201.7	5,032.9	4,617.3
Business	651.3	657.3	654.3
Multi Family	110.0	113.9	111.3
Industrial	2.2	2.2	2.2
Public Authority	90.5	112.8	97.8
Other	4.6	5.8	5.0
Total	5,060.3	5,924.9	5,487.9
Chico			
Residential	2,397.5	2,604.2	2,500.9
Business	2,543.5	2,502.2	2,522.9
Multi Family	1,062.0	1,028.1	1,050.9
Industrial	145.7	142.5	144.7
Public Authority	474.4	589.1	511.8
Other	20.2	19.8	20.1
Total	6,643.3	6,885.9	6,751.3
Dixon			
Residential	574.1	609.8	592.0
Business	57.9	54.7	56.3
Multi Family	32.6	39.9	35.0
Industrial	0.3	0.3	0.3
Public Authority	15.2	18.9	16.4
Other	-	-	-
Total	680.1	723.6	700.0
East Los Angeles			
Residential	3,937.9	4,092.9	4,015.4
Business	2,538.1	2,521.4	2,529.8
Multi Family	186.8	192.1	188.5
Industrial	1,497.5	1,540.2	1,511.4
Public Authority	846.0	696.9	797.4
Other	5.9	4.1	5.3

Total	9,012.2	9,047.6	9,047.8
Hermosa-Redondo			
Residential	3,323.9	3,610.0	3,467.0
Business	888.2	943.3	915.8
Multi Family	1,088.9	1,211.0	1,128.7
Industrial	245.2	245.2	245.2
Public Authority	265.8	279.2	270.2
Other	4.3	6.8	5.1
Reclaimed	99.1	99.1	99.1
Total	5,915.4	6,394.6	6,131.1

2003 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
King City			
Residential	398.4	404.5	401.5
Business	257.8	254.9	256.4
Multi Family	41.8	32.0	38.6
Industrial	63.3	78.3	68.2
Public Authority	31.3	40.5	34.3
Other	5.3	3.4	4.7
Irrigation	0.5	0.5	0.5
Total	798.4	814.1	804.2
Livermore			
Residential	3,130.5	3,495.0	3,312.8
Business	636.8	598.0	617.4
Multi Family	252.4	269.1	257.8
Industrial	1.8	1.8	1.8
Public Authority	359.9	525.9	414.0
Other	21.6	30.0	24.3
Total	4,403.0	4,919.8	4,628.1
Los Altos			
Residential	3,981.1	4,709.8	4,345.5
Business	1,138.5	1,125.8	1,132.2
Multi Family	294.8	320.4	303.1
Industrial	19.4	17.4	18.7
Public Authority	233.6	309.8	258.4
Other	3.7	2.9	3.4
Total	5,671.1	6,486.1	6,061.3
Marysville			
Residential	67.0	80.9	74.0
Business	308.6	324.0	316.3
Multi Family	147.7	143.2	146.2
Industrial	26.9	34.2	29.3
Public Authority	96.3	111.7	101.3
Other	0.3	0.4	0.3

Total	646.8	694.4	667.4
Mid Peninsula			
Residential	4,286.9	4,697.6	4,492.3
Business	1,431.4	1,480.6	1,456.0
Multi Family	1,044.2	1,068.0	1,052.0
Industrial	66.9	67.2	67.0
Public Authority	355.6	378.2	363.0
Other	26.1	39.8	30.6
Total	7,211.1	7,731.4	7,460.9

2003 TOTAL SALES (KCcf)

	ORIGINAL CWS	ORA	JOINT POSITION
Salinas			
Residential	3,934.9	4,347.7	4,141.3
Business	2,521.9	2,518.1	2,520.0
Multi Family	722.3	718.6	721.1
Industrial	477.0	474.6	476.2
Public Authority	342.1	326.3	336.9
Other	47.9	61.7	52.4
Total	8,046.1	8,447.0	8,247.9
Stockton			
Residential	6,760.5	7,294.8	7,027.7
Business	2,521.1	2,600.4	2,560.8
Multi Family	1,077.8	1,004.6	1,053.9
Industrial	1,974.7	2,091.3	2,012.7
Public Authority	1,175.4	1,140.8	1,164.1
Other	11.2	14.7	12.3
Total	13,520.7	14,146.6	13,831.5
Visalia			
Residential	2,589.2	3,022.9	2,806.1
Business	2,607.9	2,597.4	2,602.7
Multi Family	426.2	426.2	426.2
Industrial	246.3	253.1	248.5
Public Authority	427.6	391.3	415.8
Other	129.4	179.6	145.8
Total	6,426.6	6,870.5	6,645.1
Westlake			
Residential	2,205.7	2,536.6	2,371.2
Business	847.9	1,018.2	933.1
Multi Family	93.9	106.1	97.9
Industrial	30.9	31.6	31.1
Public Authority	136.2	155.5	142.5
Other	4.0	3.8	3.9
Reclaimed	187.8	244.6	206.3

Total	3,506.4	4,096.4	3,786.0
Willows			
Residential	235.2	232.4	233.8
Business	125.8	121.2	123.5
Multi Family	63.2	55.4	60.7
Industrial	-	-	-
Public Authority	52.0	42.2	48.8
Other	-	-	-
Total	476.2	451.2	466.8

Joint Recommendation Weather Adjustments

	Normal Weather Values		Coefficients	
	Temperature	Rainfall	Temperature	Rainfall
Bear Gulch	58.02	13.72		
Residential			5.300	-2.247
Business			5.984	-3.235
Multi Family			0.993	-4.133
Public Authority			43.728	-19.575
Chico	60.97	19.23		
Residential			3.503	-1.678
Business			16.250	-2.128
Multi Family			63.376	-3.630
Public Authority			14.290	-19.230
Dixon	60.51	15.12		
Residential			0.323	-1.245
Business			4.624	-3.906
Multi Family			3.546	-5.159
Public Authority			-	-3.287
East Los Angeles	66.53	11.91		
Residential			1.773	-0.781
Business			2.963	-1.463
Multi Family			2.215	-2.865

Public Authority			61.763	-29.980
Hermosa-Redondo	63.16	11.75		
Residential			3.090	-0.749
Business			9.509	-1.552
King City	59.24	11.09		
Residential			5.641	-1.362
Business			4.001	-6.442
Multi Family			4.011	-12.927
Public Authority			16.016	-10.825
Livermore	59.83	13.50		
Residential			5.175	-0.977
Business			7.811	-2.586
Multi Family			65.194	-0.417
Public Authority			118.829	-32.740

Joint Recommendation Weather Adjustments

	Normal Weather Values		Coefficients	
	Temperature	Rainfall	Temperature	Rainfall
Los Altos	60.50	13.39		
Residential			5.650	-2.017
Business			22.781	-6.759
Multi Family			56.774	11.930
Public Authority			76.988	-27.703
Marysville	62.89	17.43		
Residential			2.889	-1.633
Business			4.944	-1.111
Multi Family			48.769	-3.030
Public Authority			38.430	-15.793
Mid Peninsula	57.55	15.82		
Residential			2.631	-0.838

Business			7.309	-3.277
Multi Family			26.841	-2.845
Public Authority			31.955	-6.116
Salinas		58.10	13.42	
Residential			2.721	-1.266
Business				-1.803
Multi Family			28.087	-4.259
Public Authority			55.302	-23.679
Stockton	60.17	14.51		
Residential			0.164	-1.254
Business			4.770	-1.895
Multi Family				-3.435
Public Authority				-39.540
Visalia		63.10	10.65	
Residential			6.656	-3.066
Business			5.870	-2.920
Multi Family			40.078	-6.460
Public Authority			56.442	-8.721

Joint Recommendation Weather Adjustments

	Normal Weather Values		Coefficients	
	Temperature	Rainfall	Temperature	Rainfall
Westlake	64.30	12.62		
Residential			5.644	-3.661
Business				-40.934
Multi Family				-3.696
Public Authority			33.988	-27.895
Willows	60.21	15.25		
Residential				-1.098
Business				-1.004

Public Authority	-13.560

(End of Attachment B)

Attachment C

Joint Recommendation
for Calculation of Reclaimed Water Rates

Application 01-09-062 *et al*.

California Water Service Company

General Rate Case

April 23, 2002

1. Beginning with the revenue requirement adopted by the Commission in this proceeding, and 2002 tariff rates calculated using the method proposed by California Water Service Company (Cal Water), subtract 20% discounts to: (a) the tariff volumetric rate less the wholesale rate for reclaimed water paid by Cal Water, and (b) the tariff service charge.
2. The resulting 2002 volumetric rate shall not be lower than the current volumetric rate of $1.4512 per hundred cubic feet (ccf), and the resulting service charge shall not be lower than the current service charge of $251.00 per month.
3. When Cal Water receives a 2003 step increase, and 2004 and/or 2005 attrition increases, the reclaimed water rates shall be recalculated. The floor volumetric rate and service charge shall be the reclaimed water rates in effect prior to the step or attrition increases.
4. The volumetric rate, including the 20% discount, shall be recalculated if the Commission approves any change to the wholesale rate for reclaimed water paid by Cal Water.
5. Northern Ranch Country Club withdraws its recommendation that Cal Water be required to submit a comprehensive cost allocation study in its next rate proceeding.
6. The "Direct Testimony of John H. Mook on Behalf of North Ranch Country Club," including accompanying exhibits, and any related rebuttal testimony shall be received into evidence subject to future cross-examination if for any reason cross-examination becomes necessary.
7. This joint recommendation is supported by all parties to this proceeding: Cal Water, the Office of Ratepayer Advocates, North Ranch Country Club and Aglet Consumer Alliance.

Example Reclaimed Water Calculations

1. The reclaimed water discount will be calculated as follows, where:

(a) Wholesale reclaimed water rate paid by Cal Water to Calleguas = $402 per acre-foot / 435.6 ccf per acre-foot = $0.9229 per ccf;

(b) Present volumetric rate for reclaimed water = $1.4512 per ccf;

(c) Proposed volumetric rate for reclaimed water = $1.5953 per ccf;

(d) Present monthly service charge = $251.00; and

(e) Proposed monthly service charge = $349.35.

2. If the Commission adopts Cal Water's requested revenue requirement for 2002, the joint recommendation for the volumetric rate would be:

$1.5953 - 20% x ($1.5953 - $0.9229) = $1.4608 per ccf,

which is higher than the floor rate of $1.4512 per ccf.

The joint recommendation for the service charge for 2002 would be:

$349.35 x (1 - 20%) = $279.48 per month,

which is also higher that the floor rate of $251.00 per month.

3. Then if Cal Water is authorized a 3% step increase for 2003, the volumetric rate before the discount would be approximately:

$1.5953 + 3% x ($1.5953 - $0.9229) = $1.6155 per ccf.

The volumetric rate after the discount would be:

$1.6155 - 20% x ($1.6155 - $0.9229) = $1.4770 per ccf,

which is higher than the new floor rate of $1.4608 per ccf.

Expressed differently, the volumetric rate after the discount would be:

$1.4608 + (1- 20%) x ($1.6155 - $1.5953) = $1.4770 per ccf.

The result is the same.

The service charge before the discount would be approximately:

103% x $349.35 = $359.83 per month.

The service charge after the discount would be:

$359.83 x (1 - 20%) = $287.86 per month,

which is also higher than the new floor rate of $279.48 per month.

Calculations for subsequent attrition years would be similar.

4. If the Commission were to adopt 60% of Cal Water's requested relief for 2002, the volumetric rate before the discount would be approximately:

$1.4512 + 60% x ($1.5953 - $1.4512) = $1.5377 per ccf.

The volumetric rate after the discount would be:

$1.5377 - 20% x ($1.5377 - $0.9229) = $1.4147 per ccf,

which is lower than the floor rate of $1.4512 per ccf. Therefore the floor rate would prevail.

The service charge before the discount would be approximately:

$251.00 + 60% x ($349.35 - $251.00) = $310.01 per month.

The service charge after the discount would be:

$310.01 x (1 - 20%) = $248.01 per month,

which is also lower than the floor rate of $251.00 per month. Therefore, the floor rate would prevail.

* * *

Dollars at Stake

Potential 2002 discount for North Ranch Country Club =
203,225 ccf (2001 usage) x ($1.5953 - $1.4608) + 0.2 x $349.35 x 12 = $27,334 + $838 = $28,172

Compare to 2001 total annual bill = $390,831 or undiscounted revenue at present rates = 203,225 x $1.4512 + $251 x 12 = $297,932. The value of the discount will be less than 10% of annual bills for North Ranch Country Club.

(End of Attachment C)

Attachment D

§ 789.1. Legislative findings and declarations

The Legislature finds and declares all of the following:

(a) Water corporations currently are faced with, and will continue to be faced with, increasing demands for new infrastructure, plant, and facilities to comply with increasingly strict state and federal safe drinking water laws and regulations.

(b) The state's limited water supply will require investment by water corporations in infrastructure, plant, and facilities to develop new sources of supply, make existing sources of supply more reliable, and encourage and implement water conservation measures including water reclamation and reuse.

(c) Water corporations also are faced with the need to replace or upgrade water infrastructure, plant, and facilities and to design and construct all of those replacements and improvements to meet the governing fire flow standards for public fire protection purposes.

(d) Water corporations may, from time to time, own real property that once was, but is no longer, necessary or useful in the provision of water utility service and that now may be sold. It is the policy of the state that water corporations be encouraged to dispose of real property that once was, but is no longer, necessary or useful in the provision of water utility service and to invest the net proceeds therefrom in utility infrastructure, plant, facilities, and properties that are necessary or useful in the provision of water service to the public.

(e) It is the policy of the state that any net proceeds from the sale by a water corporation of real property that was at any time, but is no longer, necessary or useful in the provision of public utility service, shall be invested by a water corporation in infrastructure, plant, facilities, and properties that are necessary or useful in the performance of its duties to the public and that all of that investment in infrastructure, plant, facilities, and properties shall be included among the other utility property of the water corporation that is used and useful in providing water service and upon which the commission authorizes the water corporation the opportunity to earn a reasonable return.

§ 790. Investment in water system infrastructure

(a) Whenever a water corporation sells any real property that was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public, the water corporation shall invest the net proceeds, if any, including interest at the rate that the commission prescribes for memorandum accounts, from the sale in water system infrastructure, plant, facilities, and properties that are necessary or useful in the performance of its duties to the public. For purposes of tracking the net proceeds and their investment, the water corporation shall maintain records necessary to document the investment of the net proceeds pursuant to this article. The amount of the net proceeds shall be a water corporation's primary source of capital for investment in utility infrastructure, plant, facilities, and properties that are necessary or useful in the performance of the water corporation's duties in providing water utility service to the public.

(b) All water utility infrastructure, plant, facilities, and properties constructed or acquired by, and used and useful to, a water corporation by investment pursuant to subdivision (a) shall be included among the water corporation's other utility property upon which the commission authorizes the water corporation the opportunity to earn a reasonable return.

(c) This article shall apply to the investment of the net proceeds referred to in subdivision (a) for a period of 8 years from the end of the calendar year in which the water corporation receives the net proceeds. The balance of any net proceeds and interest thereon that is not invested after the eight-year period shall be allocated solely to ratepayers.

(d) Upon application by a water corporation with 10,000 or fewer service connections, the commission may, after a hearing, by rule or order, exempt the water corporation from the requirements of this article.

(e) The commission retains continuing authority to determine the used, useful, or necessary status of any and all infrastructure improvements and investments.

(End of Attachment D)

Attachments E thru X
Tables