

Decision 11-12-034 December 15, 2011

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Application of the GOLDEN STATE WATER COMPANY (U133W) for an order authorizing it to increase rates for water service by \$2,911,400 or 29.9% in 2011 and by \$321,200 or 2.5% in 2012 in its Arden Cordova Service Area; to increase rates for water service by \$1,782,400 or 33.2% in 2011 and by -\$66,200 or -0.9% in 2012 in its Bay Point Service Area; to increase rates for water service by \$409,100 or 22.6% in 2011 and by \$23,300 or 1.0% in 2012 in its Clearlake Service Area; to increase rates for water service by \$1,467,000 or 48.5% in 2011 and by \$50,100 or 1.1% in 2012 in its Los Osos Service Area; to increase rates for water service by \$1,647,900 or 38.8% in 2011 and by \$343,200 or 5.9% in 2012 in its Ojai Service Area; to increase rates for water service by \$2,350,700 or 25.2% in 2011 and by \$363,200 or 3.1% in 2012 in its Santa Maria Service Area and; to increase rates for water service by \$799,500 or 6.5% in 2011 and by \$213,000 or 1.6% in 2012 in its Simi Valley Service Area.

Application 10-01-009
(Filed January 13, 2010)

DECISION ADOPTING A SETTLEMENT WHICH REQUIRES GOLDEN STATE WATER COMPANY TO MAKE REFUNDS TO CUSTOMERS, PERMANENTLY REDUCE RATE BASE, REDUCE THE ARDEN-CORDOVA MEMORANDUM ACCOUNT, PAY A FINE, ENGAGE AN INDEPENDENT AUDITOR FOR THREE SPECIFIC AUDITS OF INTERNAL CONTROL FOR PROCUREMENT, AND, IN ADDITION TO THE TERMS OF THE

**SETTLEMENT, REQUIRES SPECIFIC EVIDENCE AND TESTIMONY
IN THE NEXT TWO GENERAL RATE CASES**

1. Summary

This decision adopts a settlement,¹ between Golden State Water Company (Golden State) and the Commission's Division of Water and Audits (Water & Audits), and imposes one further requirement. The settlement resolves an allegation that Golden State did not exercise reasonable management oversight, and failed to apply adequate internal control of the costs of specific projects and related contracts primarily in Region 1. Because of these failures ratepayers may have paid too much for water service in authorized rates.

As a result of the settlement Golden State will refund \$9.5 million to the customers of Region 1 (with a small portion going to customers in Regions 2 and 3) and will permanently reduce rate base by \$2.5 million which results in lower rates in the future. Golden State will reduce the balance in its existing Arden-Cordova Memorandum Account by \$500,000, and proportionately reduce the surcharge used to collect the account's remaining balance. The settlement requires three subsequent independent audits and reporting to both Water & Audits and the Division of Ratepayer Advocates. Finally, Golden State will pay a fine of \$1 million to the State of California's general fund for not informing the Commission of internal control failures. In addition to the terms of the settlement, we order Golden State to address its ongoing compliance with internal control in its next two general rate cases, the first of which is anticipated to be filed for test year 2016.

¹ The settlement is available at: <http://docs.cpuc.ca.gov/efile/MOTION/138677.pdf>.

This proceeding is closed.

2. Background

On January 13, 2010, Golden State Water Company (Golden State) filed its general rate case for Region 1.² A new issue arose in this proceeding when the Commission's Division of Water and Audits (Water & Audits) filed a motion for party status to present a proposed settlement between Golden State and Water & Audits which is before us here. In a Modified Scoping Memo dated April 22, 2011, Water & Audits was granted party status. Golden State was ordered to notify Region 1 customers of the proposed settlement and settlement conference, and to notify by electronic service and hardcopy letter every county, city attorney, and city manager in Region 1 of the proposed settlement and the settlement conference. Golden State did so. Customers, the counties, and cities were allowed 14 days to file a motion to request party status. Golden State properly noticed and conducted a settlement conference. No other parties attended. Golden State and Water & Audits then filed the proposed settlement on June 29, 2011.

3. Standards of Review

Applicant bears the burden of proof to show that the regulatory relief it requests is just and reasonable. In order for the Commission to consider the

² There was a prehearing conference on March 3, 2010 (Rule 7.2), and an Assigned Commissioner's Scoping Memo and Ruling (Rule 7.3) was issued on March 11, 2010, which adopted a schedule and defined the scope of the proceeding. Public Participation Hearings were held in various locations. Decision (D.) 10-12-059 was issued on December 16, 2010 adopting a settlement on most of the issues for the test year revenue requirement. The decision resolved all litigated or otherwise contested issues, except it deferred to a separate decision the ratemaking treatment for the abandonment of Hill Street and the replacement water agreement with the Contra Costa Water District. D.11-09-017 resolved that issue.

proposed settlement in this proceeding as being in the public interest, the Commission must be convinced that the parties had a sound and thorough understanding of the underlying issues.

4. Proposed Settlement Is In the Public Interest

Based on our review of all filed information and a careful review of the proposed settlement between Golden State and Water & Audits, as discussed below, we find the proposed settlement was offered by competent and adequately prepared parties able to make informed choices in the settlement process. We can find, as required by Rule 12.1 of the Commission's Rules of Practice and Procedure (Rules),³ the proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest. No item settled in this proceeding is dispositive of the appropriate rate treatment in subsequent proceedings. (Rule 12.5). We therefore adopt the settlement.

5. Why There Was a Settlement – Factual Record

This settlement comes before the Commission with no prior formal assertion of the alleged transgressions by Golden State. Therefore we must rely on the settlement's factual recital by Golden State and Water & Audits of the circumstances which lead us to today's decision. Based on this recital, which forms our factual record, we find the settlement is consistent with the facts as summarized below. (Rule 12. 1(d).)

Richardson Engineering Company was the subject of an internal investigation by Golden State. (Settlement § 2.)

³ http://docs.cpuc.ca.gov/WORD_PDF/AGENDA_DECISION/143256.PDF.

In early 2003, [Golden State's] senior management became aware of allegations of violations of the company's internal procurement policies in Region 1. Specifically, two officers from Region 1 were alleged to have awarded construction contracts to Richardson Engineering Company in violation of [Golden State's] written procurement policy's requirement for competitive bidding. Nearly all of the contracts awarded to [Richardson Engineering Company] were for work in Region 1. (Settlement § 2.2.)

After concluding its in-house review Golden State determined that, in its opinion, it did not need to report the problems with Richardson Engineering Company to the Commission. (Settlement § 2.7.) However, in February 2007, a former senior officer, no longer with Golden State, informed the Commission's General Counsel at the time that Golden State had investigated its transactions with Richardson Engineering Company but had never informed the Commission. (Settlement § 2.8.) Shortly thereafter Water & Audits, with staff counsel, began an informal investigation. Among the steps taken:

From 2007 through 2010, [Water & Audits] engaged in extensive discovery, including issuing numerous data requests, which resulted in the production of more than 20,000 documents, took several examinations under oath of [Golden State's] senior officers, including [its] former President and Chief Executive Officer, its current Senior Vice President of Regulated Utilities, and its current Vice President of Regulatory Affairs, and [a] limited procurement examination of [Richardson Engineering Company] contracts from 1989 through 2003 primarily in Region 1. (Settlement § 2.10.)

Section 3 of the Proposed Settlement contains a description of Water & Audits (identified therein as "Commission Staff") findings and recommendations. In §§ 3.1 – 3.9 there is a description of those various findings and recommendations. Following those findings and recommendations Golden

State provides a response in §§ 4.1 – 4.5 which culminated in the agreed terms of settlement in § 6. The entire settlement and motion are available at:

<http://docs.cpuc.ca.gov/efile/MOTION/138677.pdf>.

We accept the narrative of the parties as the factual record of this phase of the proceeding. After reviewing the record we find the terms of settlement to be reasonable and consistent with the record.

6. Summary of Settlement Terms

Under the terms of the proposed settlement Golden State will apportion \$9.5 million in refunds⁴ an amortization period of between 12 and 36 months, depending on the ratemaking area to the seven Region 1 ratemaking areas, and to Regions 2 and 3, as follows:

Golden State Ratemaking Service Areas Refunds over 12 - 36 Months	
1. Arden-Cordova	\$ 3,578,522
2. Bay Point	\$ 1,556,435
3. Clearlake	\$ 1,437,211
4. Los Osos	\$ 33,983
5. Ojai	\$ 986,463
6. Santa Maria	\$ 192,566
7. Simi Valley	\$ 993,167
8. Region 2	\$322,325
9. Region 3	\$ 399,328
Total	\$9,500,000

Additionally, Golden State will reduce the rate base by \$2.5 million, which will result in lower rates.⁵ Golden State will reduce rate base in its ratemaking areas as follows:

⁴ Settlement § 6.1.A.

⁵ Settlement § 6.2.

Golden State Ratemaking Service Areas Rate Base Reductions	
1. Arden-Cordova	\$ 1,241,460
2. Bay Point	\$ 299,587
3. Clearlake	\$ 266,684
4. Los Osos	\$ 17,841
5. Ojai	\$ 250,651
6. Santa Maria	\$ 98,265
7. Simi Valley	\$ 267,457
8. Region 3	\$ 58,055
Total	\$2,500,000

Finally, Golden State will reduce the balance in its existing Arden-Cordova Memorandum Account by \$500,000, and proportionately reduce the surcharge used to collect the account's remaining balance.⁶ The effect of these three adjustments is that the ratepayers see a permanent reduction in the total revenue requirement collected by Golden State.

The proposed settlement agreement also provides that Golden State will pay the State of California a penalty of \$1,000,000 to the State's general fund, consistent with the requirements for any other fine or penalty imposed by the Commission on a regulated public utility.⁷

In addition to the revenue requirement and rate base reductions, and the fine, the settlement provides that Water & Audits will engage an independent auditor to examine the operations of the company.⁸ Section 7.5 of the Settlement

⁶ Settlement § 6.3.

⁷ Settlement § 6.4.

⁸ See Settlement § 7.3.

provides that, for each separate and independent audit, Golden State agrees to pay all costs of the independent auditor and not seek recovery of this expense from its customers at any time. Golden State will be subject to three separate independent audits over a ten-year period from the date of approval of the proposed settlement of its procurement practices for engineering or construction for any and all capital projects starting in 1994.⁹ These audits will examine Golden State's compliance with Commission and in-house Golden State policies and procedures for the procurement of outside engineering or construction contracts for capital projects in Golden State's Region 1, Region 2, Region 3, and General Office.

Golden State also agrees that it will not include any legal, investigation costs, or other expenses incurred in connection with its Richardson Engineering Company investigation and with Water & Audits' investigation, in any historical expense figures used to forecast Golden State's expenses for any future rates. It also agrees to identify separately any and all litigation costs, investigation costs, and other expenses incurred in connection with any civil litigation arising out of or related to the Richardson Engineering Company investigation prior to the date of the settlement that are included in any historical expenses used to determine expenses in any future filings, including, but not limited to, general rate cases, including General Office costs, and advice letter filings.

(Settlement § 6.5.)

⁹ There are various other exclusions and descriptions of these audits included in the settlement: this is only a summary and not all-inclusive.

We find the terms of the settlement to be in the public interest because they result in substantial refunds, a fine, and resolve serious allegations of wrong-doing by Golden State. (Rule 12. 1(d).)

7. Consistent With the Law

With the exception of the release related to the Richardson Engineering Company matter contained in § 9 of the settlement, there are no terms in the settlement which limit this Commission's future discretion and none of the outcomes are inconsistent with the law. By refunding the overcharges and reducing rate base for the improper Richardson Engineering Company related activities, we satisfy our obligation to set just and reasonable rates with respect to the work performed by Richardson Engineering Company. With the exception of the release related to the Richardson Engineering Company matter contained in § 9 of the settlement, nothing in this settlement precludes or in any way limits the Commission or its staff to continue to examine Golden State's ongoing exercise of internal control over current and future business activities. Nothing in the settlement precludes or limits in any way the Commission's ability to make further refunds or other regulatory adjustments for any other past or future failures by Golden State to exercise reasonable internal control which have resulted or may result in unjust or unreasonable costs being collected from ratepayers.

8. The Fine is Reasonable

Golden State unreasonably withheld information from the Commission when it failed to inform the Commission of the internal control failures and the resultant problems with Richardson Engineering Company. The settling parties agreed on a fine of \$1,000,000. At the maximum rate of \$20,000 per occurrence, this equates to a minimum 50 serious violations, and as many as 2,000 more

minor violations at the minimum fine of \$500 per occurrence, as permitted by Pub. Util. Code § 2111.

Every corporation or person, other than a public utility and its officers, agents, or employees, which or who knowingly violates or fails to comply with, or procures, aids or abets any violation of any provision of the Constitution of this state relating to public utilities or of this part, or fails to comply with any part of any order, decision, rule, direction, demand, or requirement of the commission, or who procures, aids, or abets any public utility in such violation or noncompliance, in a case in which a penalty has not otherwise been provided for such corporation or person, is subject to a penalty of not less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense.

The violations here would be Water & Audits' assertions of Golden State's failure to disclose the problems with Richardson Engineering Company and would include the continued inclusion of unreasonable costs in rates when Golden State knew these costs to be problematic. In § 6.4 of the proposed settlement Golden State and Water & Audits agree that the \$1,000,000 fine resolves the question of a duty to inform the Commission. In joint comments on the proposed decision, the settling parties point out that "Section 5 of the Settlement makes clear that Golden State only agreed that, for purposes of this Settlement, as a consequence of its failure to disclose the Richardson Engineering Company matter to the Commission, ratepayers were exposed to unjust and unreasonable costs in the their water rates." (Joint Comments at 5 – 6.) Pursuant to the settlement the fine will be paid to the general fund of the State of California.

This is a substantial fine in both absolute terms and in relation to the refunds and other rate adjustments included in the settlement. We find that it is in the public interest to accept the settlement's proposed fine.

9. Subsequent General Rate Cases

We are very concerned that Golden State not consider the settlement as “putting the problem behind them” but should instead view the settlement as a fresh start to vigorously enforce strong and effective internal controls. Golden State needs to clearly and explicitly demonstrate, going forward, that effective internal control is now a corporate core value and not a short-term penance after the Richardson Engineering Company problem.

We therefore direct Golden State to present direct testimony and provide detailed factual support in the next two general rate cases in the form of a thorough and comprehensive presentation on the scope and operation of its internal control system, and the day to day exercise of those internal controls, applicable to all of its California operations. In both general rate case proceedings Golden State must include in its testimony, as a part of the offered evidence on internal control, the most recent audit as required by § 7 in the settlement. The testimony in support of its internal control process must be sponsored by the corporate officer with direct authority and responsibility for internal control. This testimony may be filed under seal based on the confidentiality provision of § 8.4 in the settlement. The purpose of this requirement to serve this testimony and factual support is to emphasize that Golden State, like all regulated utilities, has an affirmative duty to disclose and redress lapses in management oversight, as occurred with Richardson Engineering Company, where the utility failed to exercise adequate internal control. Absent this settlement, ratepayers would still be exposed to paying unreasonable rates which would still contain the unreasonable costs from Richardson Engineering Company.

10. Need For Hearing and Categorization

This application was previously categorized as ratesetting and hearings were held on two earlier phases, however there was no need for hearings on this unopposed settlement.

11. Comments

The proposed decision of the assigned Administrative Law Judge (Judge) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Joint comments were timely filed by Golden State and Water & Audits. Minor corrections and clarification have been made based on these comments without altering the final outcome of the decision.

12. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Douglas M. Long is the assigned Judge in this proceeding.

Findings of Fact

1. There is an adequate record composed of all filed and served documents.
2. Golden State failed to exercise reasonable internal control over its procurement process with Richardson Engineering Company.
3. There is evidence that Golden State overpaid for services received from Richardson Engineering Company.
4. Golden State withheld material information from the Commission, thereby violating its duty to inform the Commission.
5. The proposed settlement redresses the continued exposure to over-charging of customers.
6. The three audits over the next ten years will redress Golden State's failure to exercise adequate internal control.

7. Detailed testimony on internal control in subsequent general rate cases will inform the Commission on the current status of Golden state's internal control system.

Conclusions of Law

1. Applicant bears the burden of proof to show that the proposed settlement is reasonable.

2. The proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest, therefore the Commission may adopt it.

3. The Commission has authority under Pub. Util. Code § 2111 to fine Golden State for withholding information.

4. The Commission has the discretion and authority to resolve issues which were not addressed in the settlement and order additional testimony in subsequent general rate cases.

5. This decision should be effective today.

6. This proceeding should be closed.

O R D E R

Therefore **IT IS ORDERED** that:

1. The settlement between Golden State Water Company (Golden State) and the Division of Water and Audits is adopted. The settlement is available at: <http://docs.cpuc.ca.gov/efile/MOTION/138677.pdf>. As a result of this settlement Golden State must file a tier 1 advice letter within 30 days of today's decision to implement the following refunds and reductions to rate base:

a. Begin the refunds in the table below.

Golden State Ratemaking Service Areas Refunds over 12 - 36 Months	
1. Arden-Cordova	\$ 3,578,522
2. Bay Point	\$ 1,556,435
3. Clearlake	\$ 1,437,211
4. Los Osos	\$ 33,983
5. Ojai	\$ 986,463
6. Santa Maria	\$ 192,566
7. Simi Valley:	\$ 993,167
8. Region 2	\$322,325
9. Region 3	\$ 399,328
Total	\$9,500,000

b. Reduce rate base as shown in the table below:

Golden State Ratemaking Service Areas Rate Base Reductions	
1. Arden-Cordova	\$ 1,241,460
2. Bay Point	\$ 299,587
3. Clearlake	\$ 266,684
4. Los Osos	\$ 17,841
5. Ojai	\$ 250,651
6. Santa Maria	\$ 98,265
7. Simi Valley	\$ 267,457
8. Region 3	\$ 58,055
Total	\$2,500,000

- c. Immediately reduce the balance of the existing Arden-Cordova Memorandum Account by \$500,000 and proportionately reduce the amortization rate for the account.

2. Golden State Water Company, pursuant to the settlement adopted in Ordering Paragraph 1, must pay a fine of \$1,000,000 by check or money order payable to the California Public Utilities Commission and mailed or delivered to the Commission's Fiscal Office at 505 Van Ness Avenue, Room 3000, San Francisco, CA 94102, within 30 days of the effective date of this order. Golden State must write on the face of the check or money order "For deposit to the General Fund per Decision 11-12-034."

3. Over a 10-year period Golden State Water Company (Golden State) must pay for all costs of three audits, pursuant to Section 7 of the settlement adopted in Ordering Paragraph 1. The Division of Water and Audits must engage an independent auditor to perform three audits of Golden State's procurement practices for engineering or construction for any and all capital projects begun in 1994 through 2021.

4. Golden State Water Company (Golden State) must serve testimony and introduce other evidence in its next two general rates that provides a thorough and comprehensive presentation on the scope and operation of its internal control system, and the day to day exercise of those internal controls, applicable to all of its California operations. In both general rate case proceedings Golden State must include in its testimony, as a part of the offered evidence on internal control, the most recent audit as required by Ordering Paragraph 3. The testimony in support of its internal control process must be sponsored by the corporate officer with direct authority and responsibility for internal control. This testimony and other evidence may be filed under seal pursuant to § 8.4 of

the settlement adopted in Ordering Paragraph 1 and must remain confidential unless otherwise ordered by the Commission.

5. There was no need for a hearing on the unopposed settlement adopted in Ordering Paragraph 1.

6. Application 10-01-009 is closed.

This order is effective today.

Dated December 15, 2011, at San Francisco, California.

MICHAEL R. PEEVEY

President

TIMOTHY ALAN SIMON

MICHEL PETER FLORIO

CATHERINE J.K. SANDOVAL

MARK J. FERRON

Commissioners