ALJ/KJB/sbf/acr **Date of Issuance 7/18/2012**

Decision 12-07-009 July 12, 2012

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California Water Service Company (U60W) for Authority to Establish its Authorized Cost of Capital for the period from January 1, 2012 through December 31, 2014.	Application 11-05-001 (Filed May 2, 2011)
And Related Matters.	Application 11-05-002 Application 11-05-003 Application 11-05-004

DECISION APPROVING SETTLEMENT AGREEMENT

1. Summary

We approve the settlement agreement (Agreement) between the four Class A water companies doing business in California (Applicants) and the Commission's Division of Ratepayer Advocates (DRA). A copy of the Agreement is attached as Appendix A to this decision. The Applicants are California Water Service Company (Cal Water or CWS), San Jose Water Company (San Jose or SJW), California-American Water Company (California-American Water or CAW) and Golden State Water Company (Golden State or GSW) (collectively, together with DRA, Parties). As shown in Table I, the approved Agreement establishes costs of capital (debt and equity), capital structures and rates of return for the Applicants for the period 2011-2014. It also eliminates Temporary Interest Rate Balancing Accounts (TIRBAs)

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previously authorized for Applicants other than SJW with the results shown in Table II.

Table I
Financial Terms of Approved Settlement Agreement

Company	Cost of Equity	Cost of Debt	Capital Structure	Rate of Return
CWS	9.99 percent	6.24 percent	46.6 percent debt, 53.4 percent equity	8.24 percent
CAW	9.99 percent	6.63 percent	47.0 percent debt, 53.0 percent equity	8.41 percent
GSW	9.99 percent	6.99 percent	45.0 percent debt, 55.0 percent equity	8.64 percent
SJW	9.99 percent	6.68 percent	48.65 percent debt, 51.35 percent equity	8.38 percent

Table II
Disposition of TIRBA Balances

Company	Disposition
CWS	TIRBA balance of $1,141,919 will be amortized over twelve months via a customer surcredit. Within five days of the effective date of this decision, Cal Water shall file a Tier 1 advice letter to implement the surcredit.
CAW	TIRBA balance of negative $2,081,865 will be recovered over 12 months based on the number of 5/8” meter equivalents (with flat-rate and wastewater services considered as 5/8” customers). The current estimated surcharge is $0.66 per 5/8” meter equivalent. Within five days of the effective date of this decision, California-American Water shall file a Tier 1 advice letter to implement the surcharges.
GSW	TIRBA balance of $407,797 will be returned to customers in the form of a one-time surcredit in accordance with Decision 03-06-072. Within five days of the effective date of this decision, Golden State shall file a Tier 1 advice letter to implement the surcredit.

2. Background

On May 2, 2011, the Applicants filed simultaneous applications for approval of their respective proposed costs of capital for the three-year period beginning January 1, 2012. On May 31, 2011, Division of Ratepayers Advocate

(DRA) filed a protest to the applications. Pursuant to the Scoping Memo of the assigned Commissioner issued September 13, 2011 the Applicants and DRA prepared and submitted extensive direct and rebuttal testimony addressing the methodology for determining costs of capital and their contrasting recommendations regarding those costs.

Evidentiary hearings were scheduled for the week of October 17, 2011. At the opening of the evidentiary hearings, the Parties informed the assigned Administrative Law Judge (ALJ) that they had reached a tentative settlement. On November 3, 2011, the Parties filed a joint motion for acceptance of the Agreement (Joint Motion).

After an initial review of the agreement, on November 28, 2011, the ALJ issued a ruling (Ruling) indicating his concern that the return on equity of 9.99 percent agreed to by the Parties might be excessive in light of current market conditions (and by extension, not in the public interest). The Ruling directed the Parties to supplement the record with additional testimony. In response, the Parties submitted joint testimony in support of the Agreement (Joint Testimony), specifically including testimony in support of the agreed-upon return on equity. At an evidentiary hearing on January 23, 2012, witnesses for the Parties testified in support of the settlement and the agreed-on return on equity. At the conclusion of the hearing, the ALJ issued an additional ruling directing the Parties to further supplement the record with written answers to a series of questions propounded by the assigned Commissioner. The Parties' filings in response to this ruling were received on February 27, 2012. This proceeding was submitted on January 23, 2012.

3. Summary of the Settlement Agreement Agreements with Individual Companies

The Parties assume that all four Class A water companies face identical costs of equity, and agree that this cost is 9.99 percent. This number is a compromise between the Applicants' proposed costs of equity which range from 11.25 percent to 11.50 percent and DRA's proposed costs of equity which range from 8.75 percent to 9.00 percent for individual companies. Since we approve the same cost of equity for all four companies, the differences in the overall rates of return among the companies reflect two other factors: capital structure and embedded cost of debt. We discuss the derivation of an overall rate of return for each individual company below.

California Water Services Company

In Application (A.) 11-05-001, direct testimony, and rebuttal testimony, California Water Service Company (Cal Water or CWS) sought Commission approval of the following:

- Capitalization of 46.10 percent long-tem debt and 53.90 percent equity;[1] a cost of debt of 6.24 percent (modified from 6.16 percent);[2]
- A return on equity of 11.25 percent;[3]
- A rate of return of 8.86 percent (as modified);[4]

1 Cal Water's original capitalization request was based on its actual estimated capital structure. Cal Water proposed to correct its application to reflect a debt-to-equity capitalization of 47 percent/53 percent. CWS Exhibit 1 (CWS Corrected Application) at 2.

2 CWS Exhibit 13 (CWS/Kropelnicki Rebuttal) at 4-9.

3 CWS Exhibit 1 (CWS Corrected Application) at 2.

4 The 8.86 percent rate of return is based upon Cal Water's actual estimated debt-equity capital structure of 46.10 percent/53.90 percent and Cal Water's actual cost of debt (with transaction costs) of 6.24 percent.

- Discontinuation of the Temporary Interest Rate Balancing Accounts (TIRBA),[5] and TIRBA balance of $1,149,919[6] (modified from an estimated $658,000)[7] to be returned to ratepayers over twelve months; and
- Continuation of the Water Cost of Capital Mechanism (WCCM), with a base year of 2012.[8]

DRA does not oppose Cal Water's proposal to discontinue the TIRBA. DRA accepts Cal Water's calculation of the TIRBA balance as $1,141,919, and Cal Water agrees to amortize that balance over twelve months via a customer surcredit. DRA does not oppose continuation of the WCCM.

Cal Water and DRA agree that the settlement terms in Table I and Table II will provide ratepayers with reasonable rates sufficient to maintain the financial soundness and stability of Cal Water.

San Jose Water Company

In A.11-05-002, direct testimony, and rebuttal testimony, San Jose Water Company (San Jose or SJW) sought Commission approval of the following:

- Capitalization of 48.83 percent long-term debt and 51.17 percent common equity for the year 2012, and 48.48 percent long-term debt and 51.52 percent common equity for years 2013 and 2014;[9]
- A cost of debt of 6.68 percent;[10]

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[5] CWS Exhibit 7 (CWS/Kropelnicki Direct) at 31 (lines 8-9).

[6] CWS Exhibit 14 (CWS/Smegal Rebuttal) at 20 (lines 3-6).

[7] CWS Exhibit 7 (CWS/Kropelnicki Direct) at 31 (lines 11-16).

[8] *Ibid*. at 30 (lines 10-12).

[9] A.11-05-002 at 7; SJW Exhibit 1 (SJW/Lynch) at 6 and Schedule 3.

[10] A.11-05-002 at 7; SJW Exhibit 1 (SJW/Lynch) at 6 and Schedule 4.

- A return on common equity of 11.50 percent[11] for years 2012-2014;
- An overall rate of return of 9.14 percent for 2012 and 9.17 percent for 2013 and 2014;[12] and
- Continuation of the WCCM, with a base year of 2012.[13]

DRA's testimony advocated the following recommendations with respect to San Jose's application:

- Capitalization of 50 percent long-term debt and 50 percent equity for 2012-2014;[14]
- A cost of debt of 6.68 percent;
- A return on equity of 8.75 percent for 2012-2014;[15]and
- Continuation of the WCCM, but with a deadband zone of plus or minus 100 basis points and a benchmark period of October 2010 through September 2011.[16]

San Jose accepts DRA's offer of a capital structure comprising 48.65 percent/51.35 percent as the average of the debt and equity ratios San Jose proposed for year 2012 and later years. DRA accepts San Jose's cost of debt of 6.68 percent, which reflects San Jose's actual cost of borrowing (including transactional costs). The Parties agree on a return on equity of 9.99 percent for each Applicant as part of the comprehensive settlement. For San Jose, this results in a rate of return of 8.38 percent, to which San Jose and DRA agree.

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11 A.11-05-002 at 7; SJW Exhibit 2 (SJW/Ahern) at 2-3, 62; SJW Exhibit 3 (SJW/Ahern) at Schedule PMA-1.

12 A.11-05-002 at 7; SJW Exhibit 2 (SJW/Ahern) at 2-3, 62.

13 A.11-05-002 at 1-2, 12.

14 DRA Exhibit 1 (DRA/Woolridge) at 55 (lines 14-15).

15 *Id.* at 49 (lines 23-24).

San Jose and DRA agree to a continuation of the WCCM for San Jose on the same terms applicable to the other three Applicants. For San Jose, this requires a reduction of the deadband zone from one of plus or minus 200 basis points to one of plus or minus 100 basis points. The Parties agree that the benchmark period is the calendar year 2012. San Jose and DRA agree that the above settlement terms will provide ratepayers with reasonable rates sufficient to maintain San Jose's financial soundness and stability.

California-American Water Company

In A.11-05-003, direct testimony, and rebuttal testimony, California-American Water Company (California-American Water or CAW) sought Commission approval of the following:

- Capitalization of 50.31 percent long-term debt and 49.69 percent equity, if the Commission grants Special Request #4[17] and Special Request #33[18] as requested by California-American Water in its general rate case (GRC), A.10-07-007;[19]
- Capitalization of 37.84 percent long-term debt and 62.16 percent equity, if the Commission denies California-American Water's Special Request #4 and

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16 DRA Exhibit 3 (DRA/Kotyrlo) at 6 (lines 2-8).

17 Special Request #4: that the Commission allow it to earn at its return on equity or equivalent interest rate on all deferred items when it has balances in excess of its short-term debt limit. A.10-07-007 at 12.

18 Special Request #33: that the Commission allows it to earn its authorized rate of return or equivalent interest rate on all Advice Letter projects that are not included in the rate base, until such time as they are included in the rate base and the Commission has authorized the return on and recovery of the investment in rates. A.10-07-007 at 16.

19 A.11-05-003 at 3 and Attachment A, Chapter 3, Table 1B; CAW Exhibit 2 (CAW/Stephenson Direct) at 3 and § IV.

Special Request #33 in A.10-07-007;[20]

- A cost of debt of 6.70 percent,[21] a return on equity of 11.50 percent,[22] and a rate of return of 9.08 percent,[23] if the Commission grants California-American Water's Special Request #4 and Special Request #33 in A.10-07-007;
- A cost of debt of 6.70 percent,[24] a return on equity of 11.50 percent,[25] and a rate of return of 9.68 percent,[26] if the Commission denies California-American Water's Special Request #4 and Special Request #33 in A.10-07-007;
- Discontinuation of the TIRBA,[27] and authorization to recover the TIRBA balance of $2,081,865[28] as a surcharge on customer bills over a 12-month period; and
- Continuation of the WCCM.[29]

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[20] A.11-05-003 at 3-4 and Attachment A, Chapter 3, Table 1C; CAW Exhibit 2 (CAW/Stephenson Direct) at 4 and § IV.

[21] A.11-05-003 at 3 and Attachment A, Chapter 3, Table 3; CAW Exhibit 2 (CAW/Stephenson Direct) at 4 and § V.

[22] A.11-05-003 at 3 and Attachment A, Chapter 3, Table 1B; CAW Exhibit 3 (CAW/Villadsen Direct) at 2 (lines 2324).

[23] A.11-05-003 at 3 and Attachment A, Chapter 3, Table 1B; CAW Exhibit 2 (CAW/Stephenson Direct) at 4 and § VI.

[24] A.11-05-003 at 3-4 and Attachment A, Chapter 3, Table 3; CAW Exhibit 2 (CAW/Stephenson Direct) at 4 and § V.

[25] A.11-05-003 at 3-4 and Attachment A, Chapter 3, Table 1C; CAW Exhibit 3 (CAW/Villadsen Direct) at 2 (lines 23-24).

[26] A.11-05-003 at 3-4 and Attachment A, Chapter 3, Table 1C; CAW Exhibit 2 (CAW/Stephenson Direct) at 4 and § VI.

[27] A.11-05-003 at 10; CAW Exhibit 2 (CAW/Stephenson Direct) at 5 and § VII.

[28] A.11-05-003 at 11; CAW Exhibit 6 (CAW/Stephenson Rebuttal Errata) at Attachment 8.

[29] A.11-05-003 at 11 and CAW Exhibit 2 (CAW/Stephenson Direct) at 5 and § VIII.

For California-American Water's Application, DRA's testimony advocated the following recommendations:

- Capitalization of 52.2 percent long-term debt and 47.8 percent equity;[30]
- A cost of debt of 6.63;[31]
- A return on equity of 9.00 percent;[32]
- Discontinuation of the TIRBA[33] and a TIRBA balance of $1,817,073[34] to be recovered from ratepayers; and
- Continuation of the WCCM.[35]

As part of the comprehensive settlement, California-American Water and DRA agree to compromise on a capital structure consisting of 53 percent equity and 47 percent debt. The settlement on capital structure is independent of Special Requests #4 or #33 in California-American Water's pending GRC (A.10-07-007).[36] California-American Water and DRA agree to adopt DRA's recommended 6.63 percent cost of debt. The Parties agree to a return on equity of 9.99 percent for each Applicant as part of the comprehensive settlement. For California-American Water, this results in a rate of return of 8.41 percent.

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[30] DRA Exhibit 1 (DRA/Woolridge) at 54 (lines 11-12).

[31] *Id*. at 57 (lines 7-8).

[32] *Id*. at 3 (lines 7-8).

[33] DRA Exhibit 3 (DRA/Kotyrlo) at 20 (lines 14-16).

[34] DRA Exhibit 5 (DRA/Kotyrlo Errata) at 14 (lines 1-4).

[35] DRA Exhibit 3 (DRA/Kotyrlo) at 4 (lines 6-7).

[36] On June 7, 2012, the Commission issued D.12-06-016 in A.10-07-007, approving a settlement between California-American Water and DRA which includes approval of these Special Requests.

Golden State Water Company

In A.11-05-004, direct testimony, and rebuttal testimony, Golden State Water Company (Golden State or GSW) sought Commission approval of the following:

- Capitalization of 44.4 percent long-term debt and 55.6 percent equity;[37]
- A cost of debt of 6.99 percent;[38]
- A return on equity of 11.50 percent;[39]
- A rate of return of 9.49 percent;[40]
- Discontinuation of the TIRBA and authorization to dispose of the credit balance in the TIRBA by way of Golden State's GRC filed on July 21, 2011, or alternatively via an advice letter to be filed and resolved by the Commission no later than the Commission's resolution of Golden State's GRC; and[41]
- Continuation of the WCCM, with a base year of 2012.[42]

For Golden State's Application, DRA's testimony advocated the following recommendations:

- Capitalization of 47.0 percent long-term debt and 53.0 percent equity;[43]

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[37] GSW Exhibit 1 (GSW/Tang Testimony) at 2.

[38] *Id.*

[39] *Id.*

[40] *Id.*

[41] GSW Amendment to Application at 2.

[42] GSW Amendment to Application at 3.

[43] DRA Exhibit 1 (DRA/Woolridge) at 55 (lines 4-5).

- A cost of debt of 6.99 percent;[44]
- A return on equity of 8.75 percent;[45]
- Discontinuation of the TIRBA[46] and a TIRBA balance of $2,883,003 to be returned to ratepayers; and[47]
- Continuation of the WCCM.[48]

While Golden State originally requested a debt/equity ratio of 44.4 percent/55.6 percent and DRA originally requested that the values be 47.0 percent/53.0 percent, Golden State and DRA compromised on a capital structure of 45.0 percent/55.0 percent as part of the comprehensive settlement. DRA accepts Golden State's cost of debt of 6.99 percent, which reflects Golden State Water's actual cost of borrowing (including transactional costs). The Parties agree to a return on equity of 9.99 percent for each Applicant as part of the comprehensive settlement. For Golden State, this results in a rate of return of 8.64 percent. DRA does not oppose Golden State's proposal to discontinue the TIRBA. DRA accepts Golden State's calculation of the TIRBA balance ($407,797) as part of the Agreement, and Golden State agrees to a one-time customer surcredit to amortize that balance. The Agreement provides that within 30 days of the effective date of this decision, Golden State shall file a Tier 1 advice letter to implement the surcredit. DRA does not oppose continuation of the WCCM. Golden State and DRA agree that the above settlement terms will provide ratepayers with reasonable rates sufficient to maintain the financial soundness

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44 *Id.*

45 *Id.* at 2 (line 18) to 3 (line 8).

46 DRA Exhibit 3 (DRA/Kotyrlo) at 20 (lines 14-16).

47 DRA Exhibit 5 (DRA/Kotyrlo Errata) at 15.

48 DRA Exhibit 3 (DRA/Kotyrlo) at 5 (line 15-16).

and stability of Golden State.

Discontinuation of the TIRBA for Cal Water, California-American Water, and Golden State

In D.09-05-019, the Commission adopted the TIRBA for Cal Water, California-American Water, and Golden State in order to "remove the uncertainty of debt financing costs during the current financial market and credit dislocation,"[49] referencing "the highly unusual problems in the 2008 financial markets."[50] The TIRBA therefore tracked the difference between actual debt interest costs, and the interest costs included in the cost of capital adopted in D.09-05-019.[51] DRA, Cal Water, California-American Water, and Golden State agree that the extreme financial circumstances precipitating the Commission's adoption of the TIRBA are not anticipated for the period of January 1, 2012 through December 31, 2014, and that the TIRBA accounts should be discontinued after disposition of the current balances as described in the Agreement.

Continuation of the Water Company Cost of Capital Mechanism for all Applicants

In D.09-07-051 in the first consolidated cost of capital proceeding for Class A water companies, the Commission adopted a settlement agreement establishing a WCCM for Cal Water, California-American Water, and Golden State.[52] The WCCM is based on the Cost of Capital Mechanism (CCM)

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[49] D.09-05-019, mimeo. at 47 (Finding of Fact 29). San Jose does not have a TIRBA and was not a party to A.0805-002 et al., the proceeding in which the Commission adopted the TIRBA for the other Applicants.

[50] *Id*. at 41.

[51] *Id*. at 41-42.

[52] D.09-07-051.

of the large investor-owned energy utilities, which the Commission adopted in D.08-05-035 to replace the utilities' annual cost of capital applications[53] and to streamline their cost of capital process.[54] With some modifications, a WCCM was adopted for San Jose in D.10-10-035.[55] As discussed above, each Applicant requested continuation of its respective WCCM. DRA does not oppose continuing the WCCMs, but recommends making San Jose's WCCM consistent with those of the other Applicants.[56] The Parties agree that the WCCM adopted in D.09-07-051 fairly balances customer and shareholder interests, and should be adopted for all Applicants for any adjustment to the base year 2012 return on common equity for the subsequent years 2013 and 2014. The new benchmark period should be October 1, 2010 through September 30, 2011.

4. Discussion

In general, it is good policy to authorize a return on equity for a water utility that is the lowest rate sufficient to permit the company to raise enough capital to provide reliable service at reasonable rates. In seeking equity, utilities compete with other sellers of common stock. The average non-utility stock is riskier than an average utility stock,[57] and subject to greater price fluctuations,

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[53] D.08-05-035, mimeo. at 3.

[54] *Id*. at 16.

[55] D.10-10-035, mimeo. at 62.

[56] DRA Exhibit 3 (DRA/Kotyrlo) at 3-6.

[57] The Greek letter Beta stands for an accepted measure of stock price volatility. The average Beta of the broad market is around 1.00. Stocks with Betas less than 1.00 are less volatile; conversely, stocks with Betas much above 1.00 display extreme price volatility. In general, utility stocks have Betas between 0.50 and 0.65, roughly one-half to two-thirds the volatility of the average traded non-utility security.

and a non-utility is more likely to reduce or eliminate annual dividend payments when its profits are down. For these reasons, utility stocks are generally regarded as relatively safe havens for an investor's money, especially in times of economic uncertainty. On the other hand, the upside potential of utility stocks is also limited by the regulatory ceiling on allowed returns. Thus, a typical investor in utility stocks is buying a low risk of loss coupled with a steady stream of dividends.

When the Commission engages in setting the authorized cost of capital for a water utility, it considers various metrics, including the returns allowed by this Commission in the past, the returns allowed by other commissions for similar companies, and general economic conditions, including short- and long-term interest rates, the company's bond rating, and the willingness or ability of banks and other financial intermediaries to lend. The determination of the authorized return on equity may consider two numbers: the forecasted risk-free rate of interest,[58] and the "equity risk premium," the amount of additional return required to produce a return on equity high enough to attract the necessary capital. In this case, expert testimony establishes the equity risk premium as historically ranging from 600 to 1,000 basis points. The applicants' experts and DRA's expert differ on the size of the equity risk premium in the 9.99 percent return specified in the agreement, but it appears to be in the range of 550 to 700 basis points.

In the Ruling, the ALJ took note of the fact that interest rates and inflation rates have been and are forecasted to remain at historically low levels. Given

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[58] The so-called "risk free rate" is generally defined as the forecasted yield on the 10-year or 30-year Treasury bond over the next several quarters.

this trend, in evaluating the agreement, we must ask if the historical rate-setting procedure described above is appropriate in the current circumstances. Applicants' experts contend that the low interest rates on US Treasury obligations reflect investors' "flight to quality" because they seek safety in a time of economic uncertainty. Extending the same rationale, water utility stocks also benefit from the same "flight to quality." We do not address in this proceeding the extent to which investors have bypassed utility stocks in favor of government-guaranteed debt or, in the alternative, have moved from riskier stock investments to the relative safety of utility stocks. The record is devoid of evidence on this point and in considering whether to accept the settlement we are bound by the record as it stands.

We are similarly bound by the record in considering whether the appropriate proxy for the risk-free rate of return is the next six quarters' forecasted yields on the 30-year Treasury bond.[59] While applicants' expert Vilbert conceded in response to a question from the ALJ that use of the forecasted yields on the 10-year Treasury bond is now the most widely accepted measure of the risk-free rate,[60] the rate used by the applicants' experts for their return on equity analyses was the rate on the 30-year bond. This probably raises the proposed return on equity by between 25 and 50 basis points compared to using the 10-year Treasury bond rate.[61]

The supplemental questions proposed by the assigned Commissioner include:

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59 Remarks of Michael Vilbert at Evidentiary Hearing Transcript at 20.

60 *Ibid*. at 35.

61 *Ibid.* at 36.

1. What is the effect on the utility bill of the average customer of a 100-basis-point change in the return on equity?
2. What is the effect on the operations of the company of such a change?
3. How does the authorized return on equity compare with the earned return? and
4. What is the historical relationship between the cost of equity and the authorized return on equity for each company?

The parties' answers to these supplemental questions, briefly summarized, are as follows.

Answer to supplemental question 1: The parties separately calculate the effects of the hypothetical 100 basis point reduction on their individual customers. According to their calculations, the average residential customer bill for each Applicant will be impacted as follows:

a. For Cal Water, the weighted average decrease in an average residential customer's bill is $0.91 per month.
b. For California-American Water, the weighted average decrease in the average residential customer's bill is $1.06 per month.
c. For Golden State, the weighted average decrease in the average residential customer's bill is $1.24 per month.
d. For San Jose, the decrease in the average residential customer's bill is $0.99 per month.

Answer to supplemental question 2: The parties list multiple adverse effects on operations, ability to raise capital, and plant maintenance, which they assert would follow from such a reduction in return on equity. The answers assume that allowed equity returns that are not competitive with the allowed equity returns of competing water companies would lead investors to seek those higher returns rather than invest in any of these companies. The parties summarize their answer this way: With a 100 basis point reduction from a 9.99 percent return on equity, the minimal short-term reduction in an average customer's water bill will likely be offset by increased long-term costs. Those costs will take the form of higher capital costs, less cost-effective investment in infrastructure for long-term reliability, and a weakened utility sector. The combination of these factors is likely to cost consumers more in the long term than they save in the short term.

Answer to supplemental questions 3 and 4: The companies in this group have both over- and under-earned their allowed returns in years past. However, as shown on Attachment 4 to Exhibit JT2, periods of under-earning have been far more frequent than periods of over-earning. Attachment 4 also contrasts the recent performance of Applicants with that of California's energy utilities to show that even while these water companies were under-earning over the past five years, California's large energy utilities were over-earning during that same period.

Overall, we find that the record to support the Agreement is thinner than we would like. However, the record is not insufficient enough to warrant re-opening the proceeding or to reject the Agreement. In future cost of capital proceedings, parties should be prepared to address the concerns we raise in this discussion.

5. Requirements for Accepting Settlement

The Agreement addresses all contested issues in this proceeding. Rule 12.1(d) requires that to approve a proposed settlement we must find it to be "reasonable in light of the whole record, consistent with law, and in the public interest." Although we are concerned that the Agreement provides the applicants with authorized returns on equity that may be somewhat excessive in light of current economic conditions, on balance we find that the Agreement satisfies these standards.

5.1. The Agreement Is Reasonable in Light of the Whole Record

The Agreement is reasonable in light of the whole record. As described in detail above, it is supported by the Applications and testimony of the Parties. Following discovery and settlement negotiations, the Parties reached a reasonable compromise on each of the issues in contention. The settlement negotiations were accomplished at arms' length over the course of several days and there was no collusion.

5.2. The Agreement Does Not Contravene Any Rules or Laws

There is no statutory provision or prior Commission decision that would be contravened or compromised by the Agreement. The issues resolved in the Agreement are within the scope of the proceeding and produce rates within a range of reasonableness.

5.3. The Agreement Is In the Public Interest

The Agreement is in the public interest. The Commission has explained that a settlement which "commands broad support among participants fairly reflective of the affected interests" and "does not contain terms which contravene statutory provisions or prior Commission decisions" well serves the public interest. *Re San Diego Gas & Elec.*, D.92-12-019, 46 CPUC 2d 538, 552.

Together, the Parties fairly represent the affected interests: Applicants provide water service to customers in districts throughout California, and DRA is statutorily mandated to represent all ratepayers in California. The primary public interest affected by this proceeding is the delivery of safe and reliable water service at reasonable rates. The terms of the Agreement as described above advance this interest because they fairly balance each Applicant's opportunity to earn a reasonable rate of return against the needs of consumers for reasonable rates and safe, reliable water service. In addition, Commission approval of the Agreement will provide speedy resolution of contested issues, avoid unnecessary litigation expense, and conserve Commission resources. As the Commission has stated, "[t]here is a strong public policy favoring the settlement of disputes to avoid costly and protracted litigation." Re PG&E, D.88-12-083, 30 CPUC 2d 189, 221.

6. Reduction of Comment Period

Commission Rule 14.3 authorizes parties to submit comments on a proposed decision within 20 days of its service on the parties, and allows reply comments within five days later. Consistent with Rule 14.6(c)(2) and due to the all-party nature of the adopted Agreement, we will shorten the initial comment period to 10 days. We allow three days for reply comments.

Comments were received from San Jose on July 5, 2012. The comments argued that the decision should be modified to authorize the company to implement revised rates in accordance with the decision as of September 1, 2012. By that time, rate changes made pursuant to Advice Letters 438 and 439 will have been fully implemented before the company renders any bills reflecting the change of rates pursuant to this decision. Accordingly, the following new ordering paragraph is added to the decision:

> San Jose Water Company shall file a Tier 1 advice letter to implement revised rates consistent with the capital costs and capital structure approved herein to be effective as of September 1, 2012.

7. Admission of Exhibits into Evidence

During the October 17, 2011 evidentiary hearing in this proceeding, the ALJ marked documents provided by each Party as exhibits for the purposes of identification. All documents previously marked for identification are hereby admitted into evidence.

8. Assignment of Proceeding

The assigned Commissioner for this proceeding is Mark J. Ferron. The assigned ALJ is Karl J. Bemesderfer.

9. Categorization and Need for Hearings

These proceedings were initially categorized as Ratesetting and it was preliminarily determined that hearings are required. We affirm the categorization.

Findings of Fact

1. The Agreement is the product of good-faith, arms' length negotiation between Parties reflecting all of the affected interests.

2. Each of the financial terms of the Agreement is the result of good faith compromise.

Conclusions of Law

1. The Agreement is reasonable in light of the record as a whole.

2. The Agreement does not violate any laws or prior Commission decisions.

3. The Agreement taken as a whole is in the public interest.

4. The Agreement meets the criteria for approval of settlements in Rule 12(1)(d).

5. The Agreement should be approved.

6. San Jose should be required to file a Tier 1 advice letter as suggested in the comments.

O R D E R

Therefore **IT IS ORDERED** that:

1. The Settlement Agreement by and among Golden State Water Company, California Water Service Company, San Jose Water Company, California-American Water Company, and the Division of Ratepayer Advocates, as set forth in Appendix A, is approved.

2. The capital costs and capital structures set out in Table I of this decision are approved.

3. The dispositions of Temporary Interest Rate Balancing Accounts balances summarized in Table II of this decision are approved subject to each company filing an advice letter as directed in Table II.

4. No later than March 31, 2014, Golden State Water Company, California Water Service Company, San Jose Water Company and California-American Water Company shall file new applications for approval of their costs of capital for the three-year period beginning January 1, 2015.

5. San Jose Water Company shall file a Tier 1 advice letter to implement revised rates consistent with the capital costs and capital structure approved herein to be effective as of September 1, 2012.

6. Applications 11-05-001, 11-05-002, 11-05-003 and 11-05-004 are closed.

This order is effective today.

Dated July 12, 2012 at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners