

Decision 03-09-022 September 4, 2003

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
CALIFORNIA-AMERICAN WATER COMPANY
(U 210 W) for a Certificate that the Present and
Future Public Convenience and Necessity
Requires Applicant to Construct and Operate the
24,000 acre foot Carmel River Dam and Reservoir
in its Monterey Division and to Recover All
Present and Future Costs in Connection
Therewith in Rates.

Application 97-03-052
(Filed March 28, 1997)

(See Appendix A for a list of appearances.)

**DECISION RESOLVING MOTIONS BY
CALIFORNIA-AMERICAN WATER COMPANY REGARDING
DESIGNATION OF LEAD AGENCY AND RATEMAKING ISSUES**

I. Summary

This decision designates the Commission as the lead agency for environmental review of the Monterey Bay desalination Coastal Water Project, resolves certain ratemaking issues related to the Coastal Water Project and an earlier Coastal River Dam project, and dismisses this application without prejudice to our requirement that a new application be filed. This proceeding is closed.

II. Background

California-American Water Company (Cal-Am) filed this application in March 1997. The purpose of the application was to seek a certificate of public convenience and necessity (CPCN) and ratemaking treatment for a new water supply to replace existing supply taken from the Carmel River to serve its Monterey Division customers. The existing water supply must be replaced because the State Water Resources Control Board has ordered Cal-Am to find an alternative source for 10,730 acre feet of water currently taken from the Carmel River, approximately 69% of Cal-Am's current water supply for the Monterey Division. In the March 1997 application, Cal-Am proposed to construct a dam and storage reservoir to serve this purpose. The Monterey Peninsula Water Management District (District) served as the lead agency under the California Environmental Quality Act (CEQA) for purposes of reviewing the dam.

Cal-Am is not the first entity to propose a similar dam project to serve customers on the Monterey Peninsula. The proposed project has been pursued by other local entities in the past and has been the subject of considerable public controversy. Voters in the affected community have opposed construction of a dam in the location proposed by Cal-Am in the past.

After Cal-Am filed its application, the state legislature adopted legislation (Assembly Bill 1182, Chapter 797, Stats. 1998, Keeley) directing the Commission to identify a long-term water supply contingency plan to replace the 10,730-acre feet from the Carmel River. The Commission engaged consultants to assist in the development of the water supply alternative, commonly referred to as Plan B. The Plan B Project Report was issued in August 2002.

On February 11, 2003, Cal-Am filed two motions and an amendment to its March 1997 application. The amendment modifies Cal-Am's application in this

proceeding to request a CPCN to construct a Coastal Water Project,¹ consisting of a desalination facility and aquifer storage and recovery component instead of the previously proposed Carmel River Dam. On March 12, 2003, the assigned Administrative Law Judge (ALJ) issued a ruling granting part of the relief sought in the motions, and requesting additional information prior to ruling on the lead agency and ratemaking issues. Cal-Am complied with that ruling on April 1, 2003, and comments were filed on April 11, 2003. The District filed comments on May 7, 2003 and Cal-Am responded on May 9, 2003.

Testimony was served by Cal-Am on ratemaking issues on April 1, 2003 and by the Office of Ratepayer Advocates (ORA) on May 7, 2003. Cal-Am served rebuttal testimony on May 9, 2003. ORA served surrebuttal testimony on May 13, 2003. Evidentiary hearings were held on May 14, 2003.

III. Relief Sought

Cal-Am's motions made several requests but only three remain outstanding after the ALJ's March 12, 2003 ruling. First, Cal-Am requests that this Commission be designated as lead agency under CEQA to conduct, prepare and certify the environmental assessment required for Applicant's proposed Coastal Water Project / Plan B. Second, Cal-Am seeks authorization to establish appropriate ratemaking accounts to book costs and expenses for future recovery incurred for environmental review of the Carmel River Dam and that will be incurred in connection with the review of the Coastal Water Plan. Finally, Cal-Am asks that it be directed to prepare and file its Proponent's Environmental

¹ The proposed Coastal Water Project is the same as the project identified in the Plan B Project Report to replace the 10,730 acre feet of water from the Carmel River. We will refer to Cal-Am's current proposal as the Coastal Water Project.

Assessment (PEA) for the Coastal Water Project as soon as possible. We also use this decision as an opportunity to review the ongoing need for this proceeding to remain open, given the significant change in Cal-Am's proposed project.

IV. Lead Agency Designation

In order for this Commission to reach a conclusion about whether it is properly designated as the lead agency for CEQA purposes, the ALJ directed Cal-Am to file additional information identifying all of the affected jurisdictions and permits required for the Coastal Water Project, and providing notice to those entities. Cal-Am complied with this ruling. The various filings identify as many as 28 state, federal, county, local and other agencies with potential permitting authority over the Coastal Water Project.

The ALJ also allowed any interested entity to file comments on Cal-Am's motion regarding Lead Agency designation. In response, four entities submitted comments expressing the belief that they, or other agencies, rather than the Commission would be the appropriate lead agency under CEQA for the Coastal Water Project. Only two, apart from the Commission, are suggested as potential lead agencies. Specifically, Monterey County ("the County") and the Monterey County Water Resources Agency ("MCWRA") assert that the County should assume the role of lead agency in cooperation with the MCWRA. The Marina Coast Water District (MCWD) supports the County in cooperation with MCWRA as lead agency. The Monterey Peninsula Water Management District (District) asserts that it should assume the role of lead agency, and the Citizens for Alternative Water Solutions (CAWS) support the District as lead agency.

Below we consider the role of the named potential agencies under CEQA's criteria for lead agency status, and evaluate whether the Commission should act

as lead agency under CEQA for environmental review of the Coastal Water Project.

A. Legal Standard for Determining Lead Agency

Under CEQA, where the project is to be carried out by nongovernmental entities, the lead agency will normally be the public agency “with the greatest responsibility for supervising or approving the project as a whole.” (Cal. Code Regs., tit. 14 § 15051(b).) Usually, this is the agency with the broadest governmental powers. (Cal. Code Regs., tit., 14, § 15051(b)(1).) However, where two or more public agencies have relatively equal responsibility, “the lead agency which will act first on the project in question shall be the lead agency.” (Cal Code Regs., tit., 14 § 15051(c).) This is consistent with the legislative goal of assuring environmental impact assessment in governmental planning at the earliest possible time. (*Citizens Task Force on Sohio v. Board of Harbor Comrs.* (1979) 23 Cal.3d 812, 814.) Where the identity of the lead agency cannot be determined by the foregoing criteria, the possible candidates may simply agree among themselves which will be the lead agency. (Cal. Code Regs., tit., 14, § 15051(d).) Where two or more public agencies cannot resolve which agency should act as the lead agency, the dispute may be submitted to the Office of Planning and Research for resolution. (Cal. Code Regs., tit., 14, § 15023, 15053, and 16012 et seq.)

Relevant case law instructs that the roles of the various agencies should be evaluated in the context of the scope of the project in question. (*City of Sacramento v. State Water Resources Control Board* (1992) 2 Cal.App.4th 960.) The project is generally considered to be “the whole of an action, which has a potential for resulting in a physical change in the environment...” (Cal. Code

Regs., tit., 14, § 15378(a).) The project is “the activity which is being approved and which may be subject to several discretionary approvals by governmental agencies. The term ‘project’ does not mean each separate governmental approval.” (Cal. Code Regs., tit., 14, § 15378(c), *City of Sacramento*, supra.)

B. Role of Monterey Peninsula Water Management District

The District states it should be the lead agency for the Coastal Water Project because it has extensive and refined expertise regarding Monterey Bay Area water supply options, constraints, and impacts. Much of this has been gained through its role as lead agency under CEQA for Cal-Am’s application for permit of the Carmel River Dam and Reservoir Project. The District references its prior development of data relating to reservoir alternatives and desalination plants. The District contends that since it plans to pursue its own Sand City desalination plant project and act as lead agency for that project, it would be confusing, inefficient, and possibly conflicting to produce separate environmental analyses. Further, the District states that it is the primary public agency with regulatory control over Cal-Am’s water systems operations, and the aquifer storage and recovery component of the project would be constructed and operated entirely within the District.

CAWS supports the District primarily on the basis of the District’s prior experience in evaluating the relevant environmental issues, as compared to the Commission, which it says has no such expertise, and the County, which it says has erred in its management of County water resources and prior water supply projects. CAWS states that the District will have the major management task after the project is complete.

The County provides examples of the District's limited role in relation to the Coastal Water Project and contends that the District is not qualified to act as the lead agency under CEQA's criteria. In particular, District territory is specific to the Monterey Peninsula and adjacent Carmel Valley. The majority of the proposed Coastal Water Project facilities are not located within the District's boundaries or permitting authority. In addition, the District has only limited jurisdiction over water resources because it manages those resources for only a segment of the County population. It is the MCWRA that has the responsibility and jurisdiction to manage water resources throughout the entire County.

The County also points out that under a Memorandum of Understanding, the District must obtain the written consent of the MCWRA before undertaking any project in the County of Monterey which is wholly or partially outside the District's boundaries, including the use of water resources located outside those boundaries.

We believe the District possesses valuable knowledge and experience in evaluating relevant environmental issues in the Monterey area. We also do not question that the Coastal Water Project will require Cal-Am to obtain certain permit approvals for the project from the District. However, qualification as a lead agency is contingent upon the agency's overall responsibility in relation to the whole of the project activities. Because many of the proposed project facilities fall outside the District's jurisdictional boundaries and authority, it follows that the District is not the agency with "the greatest responsibility for supervising or approving the project as a whole." Accordingly, we find that CEQA's criteria do not support the District as lead agency for the Coastal Water Project.

C. Role of Monterey County and the Monterey County Water Resources Agency

The County states that it, in coordination with the MCWRA, should act as lead agency for the Coastal Water Project because it has the general governmental powers and responsibility to implement land use regulations applicable to the project, it is uniquely capable of analyzing local and regional environmental impacts of the project, and represents the community most affected by the project. The County acknowledges the MCWRA has responsibility and jurisdiction to manage water resources throughout the County, but states that because MCWRA would work together with the County, it makes sense for the County to be lead agency.

The County goes on to explain the scope of its responsibilities related to the proposed project. It states that it has permitting authority over the proposed desalination plant location, which is subject to its “plenary authority.” Specifically, development on the property is governed by a North County Land Use Plan as certified by the Coastal Commission in 1982 as part of the County’s Local Coastal Program. A County Coastal Development Permit is required for any portion of a project within the Land Use Plan that is not within the retained jurisdiction of the Coastal Commission. The Coastal Commission retains original permitting authority over development on tidelands, submerged lands, or on public trust lands. The Coastal Commission delegated authority to the County regarding development on unincorporated coastal areas of the County. The County states that the desalination plant, associated pipelines, and the Seaside Basin storage and recovery facilities are either in the unincorporated areas or outside the retained jurisdiction of the Coastal Commission. The County also refers to Monterey County regulations specifically governing “desalination

treatment facilities” and requiring County authorization for the construction and operation of those facilities.

In support of the County, MCWD states that the proposed Moss Landing desalination plant site is a valuable regional resource and that good stewardship will require the cooperation and oversight by regional entities. MCWD states that as the provider of water and wastewater services to the Marina and Ord Community, it has authority to build a desalination plant at Moss Landing, and has experience doing so at Marina. MCWD does not assert that it should be lead agency for the Coastal Water Project, rather it says as between the County and the Commission, the County has the greatest responsibility for approving the project as a whole.

The County has demonstrated that it, particularly in combination with the MCWRA, has jurisdictional responsibilities covering land use implementation and development, management of water resources, and facility construction and operation. We agree that this broad scope of jurisdiction, permitting authority, and oversight responsibility for the project as a whole are consistent with CEQA’s lead agency criteria.

D. Role of California Public Utilities Commission

Cal-Am reasons that the Commission should act as lead agency because the Coastal Water Project is a multi-jurisdictional project, and among the various federal, state, county, municipal and other agencies with permitting authority, only the Commission is a statewide public agency with broad jurisdiction. Cal-Am states that the Commission has general governmental oversight and responsibility for the project as a whole, must issue a CPCN for the project, and

has a legal obligation and ability to resolve issues relating to the costs and ratepayer impacts of the Coastal Water Project or project alternatives.

The Commission is a constitutionally established agency charged with responsibility for regulating public utilities within the State of California. The Legislature has specifically provided that “Private corporations and persons that own, operate, control, or manage a...system for the...furnishing of...water...are public utilities subject to control by the Legislature.” (Cal. Const., Article XII, Section 3.) Pursuant to the grant of authority found in Article XII, Section 2 of the California Constitution, the Commission may, “[s]ubject to statute and due process...establish its own procedures.”

As a regulatory body designed to “protect the people of the state from the consequences of destructive competition and monopoly in the public service industries” (*Sale v. Railroad Comm.* (1940) 15 Cal. 2d 612, 617), the Legislature has extended to this Commission broad, general powers to regulate public utilities as well as specific authority to act to promote the health and safety of the public. In particular, the Commission has jurisdiction to regulate the service of water utilities with respect to the health and safety of that service (Pub. Util. Code §§ 451, 761, 739.8, 768, 770(b)); the Commission has concurrent jurisdiction with the State Department of Health Services over the quality of drinking water provided by regulated water utilities (Pub. Util. Code § 770 and Health and Safety Code Section 116465); and the Commission has the power and obligation to determine that any rate is just and reasonable. (Pub. Util. Code §§ 451, 454.) Additionally, the Legislature has conferred upon the Commission the authority to “supervise and regulate every public utility in the State and [to] do all things which are necessary and convenient in the exercise of such power and jurisdiction.” (Pub. Util. Code § 701.)

No party contends that the Commission does not possess, generally, the nature of regulatory authority that would justify acting as Lead Agency. The Commission regularly acts in the role of CEQA Lead Agency for proposed utility projects and we believe we could do so here. However, determining the appropriate CEQA role for this agency should be evaluated based on the scope of our responsibility for supervising or approving the Coastal Water Project as a whole, particularly in relation to that of the County and the MCWRA.

We recognize that County (in combination with MCWRA) has responsibility and jurisdiction over, and the closest nexus with, a range of practical project issues involving land use implementation, water resource management, development, construction and operation. MCWRA has the authority to manage and protect water supply quality and quantity in Monterey County.

Nevertheless, CEQA's lead agency criteria look to "the agency with the broadest governmental powers." (Cal. Code Regs., tit., 14 § 150511(b)(1).) We believe that the above stated provisions enumerating this Commission's broad, and specific, statewide authority and responsibility to regulate public utility water companies require that we should assume lead agency status to conduct environmental review of the Coastal Water Project under CEQA. However, in expressing our intent to undertake this task, we believe efficient and effective environmental review will require extensive involvement by virtually all the responsible agencies with permit authority over the Coastal Water Project, and will particularly require drawing upon the knowledge and expertise of the District, the County and MCWRA. We take this opportunity to express our intent to undertake that close coordination and encourage their full and active participation in the CEQA process.

V. Preparation of PEA

Given our finding with respect to the lead agency issue, Cal-Am should undertake preparation of a Proponent's Environmental Assessment for the Coastal Water Project as soon as possible. Given the interest by the County and the water supply issues facing the County as a whole, not just Cal-Am's customers, we direct Cal-Am to thoroughly explore opportunities for partnerships with other regional water supply entities as it prepares its PEA and to incorporate such partnerships into the project if appropriate.

VI. Ratemaking Issues

In her March 12, 2003 ruling, the assigned ALJ directed Cal-Am to serve testimony clarifying the ratemaking treatment sought in its motion, and further describing the current ratemaking treatment for past and future costs of environmental review, development, permitting and other required approvals. Cal-Am complied on April 1, 2003. The ALJ allowed parties to prepare responsive written testimony and scheduled evidentiary hearings to examine the testimony on May 14, 2003. The ORA was the only party to serve testimony.

Cal-Am's ratemaking request covers three categories of costs:

1. Costs incurred or yet to be incurred in connection with the Carmel River Dam project;
2. Costs incurred associated with development of Plan B; and
3. Costs expected to be incurred in connection with the Coastal Water Project.

A. Carmel River Dam Costs

Costs in this category are related to initial, preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates. This category includes costs associated with

environmental review by the District of Cal-Am's Carmel River Dam project. Cal-Am's witness indicated that \$3,279,161 in costs have been incurred to date (Exhibit 1, 3:22) but that at least two invoices from the District have not been paid by Cal-Am and others may be submitted for payment in the future.

(TR 234:20-25.) Under cross-examination, Cal-Am's witness indicated that he was unaware of additional activities by the District or Cal-Am that might cause additional costs to be incurred in connection with the Carmel River Dam project. (TR 235:17-236:4.)

Decision (D.) 03-02-030 adopted ratemaking treatment for certain costs associated with the Carmel River Dam project. Costs incurred prior to 2002 (\$2,852,900) are classified as Construction Work In Progress (CWIP) and included in ratebase, earning Cal-Am's authorized rate of return. Cal-Am expects that once a long term water supply project is put in service, these costs will be included as part of the total project construction cost. (Exhibit 1, 4:7-9.)

D.03-02-030 authorized an additional \$750,000 in CWIP for the Carmel River Dam project in 2002 through 2004.

Cal-Am considers these authorized funds to be in support of a long-term water supply solution for its Monterey District, not only available for the Carmel River Dam project. Accordingly, Cal-Am expects that costs associated with initial, preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates for the Coastal Water Project will be treated the same way as these authorized costs for the Carmel River Dam project were in D.03-02-030. (TR 236:24-237:13.) Cal-Am asks that any costs incurred above the total amount authorized by D.03-02-030 (\$5,102,900) be booked in a deferred debit account earning an Allowance For Funds Used During Construction (AFUDC) at Cal-Am's authorized rate of

return. Cal-Am argues that it should be allowed to earn on these expenditures at its authorized rate of return because it is consistent with past precedent and pursuit of either project is mandated by government.

ORA initially proposed that the Carmel River Dam funds authorized in D.03-02-030 be removed from CWIP and instead be amortized over three years. (Exhibit 10, 3.) However, in subsequent testimony, ORA modified that position and now proposes that there be no change to the rate design authorized in D.03-02-030 at this time. (Exhibit 11, 2.) Instead, ORA recommends that the Commission state that in the next General Rate Case it will remove any Carmel River Dam costs incurred after May 14, 2003 from CWIP.² ORA also recommends that the Commission remove any dollars authorized, but not expended by Cal-Am, for the Carmel River Dam project from CWIP, and any expenditures in excess of those authorized by D.03-02-030 be disallowed.

D.03-02-030 adopted ratemaking treatment for Carmel River Dam project costs, not any project. Although we agree that the Coastal Water Project and the Carmel River Dam are potentially alternative water solutions, the adopted ratemaking treatment was solely for Carmel River Dam project costs. We will not modify the ratemaking treatment adopted in D.03-02-030, but in its next general rate case, Cal-Am should adjust its revenue requirement request to remove from CWIP any amounts adopted in D.03-02-030 that were not spent on the Carmel River Dam project. We will not adopt a specific date cut off by which we expect costs will no longer occur, as proposed by ORA, because it is possible

² ORA clarified under examination by the ALJ that costs incurred prior to May 14, 2003 but not invoiced until after that date should be treated as adopted in D.03-02-030. (TR 284:9-285:9.)

that there will be additional costs associated with the ongoing review of the Carmel River Dam project or winding down of that review process in light of Cal-Am's new project proposal. This ratemaking treatment will allow a clean separation of costs between Cal-Am's old project (the Carmel River Dam) and new project (Coastal Water Project).

B. Plan B Costs

In Resolutions W-4131 and W-4237, the Commission authorized the expenditure of \$1.75 million for development of an alternative water supply solution to the Carmel River Dam.³ Cal-Am was authorized to establish a memorandum account to track payments for this effort. Interest in this account accrues at the 90-day commercial paper rate. Cal-Am was directed to seek recovery of these costs by advice letter after full payment was made to the Commission. Cal-Am has also booked costs spent in connection with holding public meetings, notifying customers of public meetings and Commission proceedings, Cal-Am's legal and consultant fees to review Plan B, and accrued interest. As of May 9, 2003 (the date Cal-Am served its rebuttal testimony), Cal-Am indicated the Plan B expenditures (including the costs just described) totaled \$1,761,751.57.⁴

Cal-Am indicates that as of April 1, 2003 (the date it served its testimony), it had recovered \$554,992 through a surcharge. (Exhibit 1, 6:17-18.)

³ Of this amount, \$500,000 was to be financed through the Commission's budget, with \$1.25 million to be collected from Cal-Am's Monterey customers.

⁴ It appears that the Commission charged Cal-Am for the full amount of the Plan B development contract, rather than paying \$500,000 out of the Commission budget. Cal-Am indicates that it will seek reimbursement of \$430,000 from the Commission. (Exhibit 2, 7:1-3.)

The surcharge has since expired, but Cal-Am proposes to institute another surcharge to recover its remaining costs (Commission Plan B costs and other costs it booked to the memorandum account) as soon as Rulemaking (R.) 01-12-009 is resolved.

Cal-Am indicates that all Plan B related costs, including the costs of holding public meetings, notifying customers of public meetings and Commission proceedings, Cal-Am's legal and consultant fees to review Plan B, plus interest should be reimbursed, even if the resolutions authorizing the memorandum account did not specify these additional Cal-Am incurred costs. Cal-Am stated under examination by the ALJ that the costs booked to the memorandum account associated with holding public meetings and notifying customers of public meetings and Commission proceedings were required by the ALJ in the proceeding, although the witness could not identify particular rulings that required these expenditures. (TR 263:12-264:18.)

ORA opposes recovery of any costs booked by Cal-Am to the Plan B memorandum account beyond the costs authorized by W-4131, W-4205, and W-4237. Thus, ORA opposes recovery of the costs of holding public meetings, notifying customers of public meetings and Commission proceedings, and Cal-Am's legal and consultant fees to review Plan B. ORA did agree that the accrued interest should also be recovered. (TR 287:25-288:1.) ORA recommends that to the extent that Cal-Am does not seek timely recovery, by advice letter, of the costs that are properly booked to the Plan B memorandum account, that interest should no longer accrue. Under examination by the ALJ, ORA agreed that lack of resolution of R.01-12-009 could be considered a mitigating factor in

why Cal-Am has not filed an advice letter for recovery of the outstanding Plan B costs. (TR 288:28-289:12.)⁵

There are two primary issues outstanding with respect to recovery of costs associated with Plan B. First, should Cal-Am's costs beyond the Commission's Plan B costs be allowed to be booked into the Plan B memorandum account for recovery? Second, should interest on the amounts in the memorandum account continue to accrue interest at the 90-day commercial paper rate until recovered? We address these issues one at a time.

1. Booking of Cal-Am Costs Beyond Commission Plan B Costs

We have reviewed Resolutions W-4131, W-4205, and W-4237 which approved the establishment of the ratemaking accounts⁶ to book Commission Plan B costs. Resolution W-4131 states in Ordering Paragraph 1 that "Cal-Am shall reimburse the Commission for the costs of consulting services for the preparation of the long-term contingency plan and environmental assessments for its Monterey Division." This language does not contemplate that the account established will include any costs beyond Commission incurred costs. Resolution W-4237 increased the amount to be recovered from Cal-Am and again the ordering paragraph limited the costs to "the costs of consulting services to prepare the long-term contingency plan and environmental assessments" and for "payments to the Commission." (See Ordering Paragraphs 1 and 2.) Although Cal-Am states that it has incurred approximately \$80,000 in connection with

⁵ On June 19, 2003, the Commission issued D.03-06-072 resolving R.01-12-009.

⁶ The resolutions referenced refer both to memorandum and balancing accounts.

public meetings, customer notices, legal fees, and other expenses, the language of the resolutions regarding Plan B development costs simply does not provide for such Cal-Am costs to be booked to the ratemaking accounts authorized by those resolutions. Cal-Am argues that it was directed to incur these costs by the Commission, and thus they should be allowed recovery. However, Cal-Am did not identify under questioning by the ALJ or in its brief when the Commission, Assigned Commissioner, or Assigned ALJ directed it to incur these costs it now seeks to recover. Cal-Am simply relies on the fact that the Commission held numerous public meetings to gather information as a reason why these costs should be recovered. Given the clear language of the resolutions authorizing booking and recovery of Plan B costs, Cal-Am's additional costs cannot be found recoverable as Cal-Am proposes.

2. Continuation of Interest Accrual

With respect to accrual of interest, ORA suggests that interest no longer accrue on the memorandum account after the last Plan B expense was incurred. ORA argues this provides Cal-Am with an incentive to seek timely recovery of the remaining amounts in the memorandum account. Cal-Am counters that it must await the conclusion of R.01-12-009 until it seeks recovery of these costs through a surcharge.

Although we understand ORA's desire to have these costs recovered in a timely matter, it is inappropriate to suspend interest accrual once the final Plan B related cost is booked. Instead, as is standard practice, interest shall continue to accrue at the 90-day commercial paper rate until the costs are fully recovered by a new surcharge. We have reviewed R.01-12-009 and find that the purpose of that rulemaking does not extend to the type of reimbursable Commission costs we address here and find that Cal-Am should promptly file an

advice letter to propose a surcharge for recovery of the outstanding costs properly booked to the Plan B memorandum account.

C. Coastal Water Project Costs

As described above, Cal-Am proposes that costs associated with initial, preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates for the Coastal Water Project, up to the amount authorized in D.03-02-030, be treated as CWIP at Cal-Am's authorized rate of return. For costs incurred above the level authorized in D.03-02-030, Cal-Am proposes that those expenditures be booked in a deferred debit account accruing AFUDC at Cal-Am's authorized rate of return. (Exhibit 1, 6:1-8.) Cal-Am expects to propose in its next general rate case to transfer accumulated expenses in the deferred debit account to CWIP. (Exhibit 1, 7:18-23.)

ORA opposes Cal-Am's proposed ratemaking treatment. ORA proposes that all costs incurred related to the Coastal Water Project be booked in a memorandum account and accrue interest at the 90-day commercial paper rate. (ORA Brief, p. 12- 13.) ORA states that this treatment is consistent with the ratemaking treatment for long-term construction projects that do not earn their authorized rate of return until placed in service. ORA argues that the Coastal Water Project is unique from typical water projects because of its scale and lead time and thus should not earn at the full rate of return until placed in service. (Exhibit 10, 7.) ORA indicates that in D.00-03-053, the Commission adopted this ratemaking treatment (AFUDC at 90-day commercial paper) for the costs of the Carmel River Dam project.

Cal-Am also proposes to recover costs associated with a public information campaign it plans to undertake in support of its Coastal Water

Project. Cal-Am proposes that these costs be booked to a deferred debit account and accrue AFUDC at the authorized rate of return and then recovered as a surcharge on rates in the future. ORA states that Cal-Am has provided insufficient information regarding the public information campaign for these costs to be considered a legitimate expense. In addition, ORA states that the Commission has traditionally disallowed funding for public relations or advertising, and thus ORA would not allow recovery of these costs.

1. Coastal Water Project Ratemaking Treatment for Development Costs

As we described above, because the ratemaking treatment in D.03-02-030 relates specifically to the Carmel River Dam project, we decline to automatically treat any costs associated with initial, preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates for the Coastal Water Project, as CWIP at Cal-Am's authorized rate of return. Cal-Am and ORA agree that cost should be booked but differ as to the rate at which interest or AFUDC should accrue on these costs.

ORA argues that the type of ratemaking treatment proposed by Cal-Am is generally adopted for construction costs relating to capital expenditures that are underway but are not yet used and useful. ORA is concerned that there is significant risk that these costs (which are preliminary engineering and other costs prior to even beginning construction) will never be associated with a capital investment that is used and useful and thus should not earn the utility's authorized rate of return at this time. Cal-Am argues that the Commission typically grants water utility investments for and related to capital projects the company's authorized rate of return. ORA counters that this

approach was adopted for the water industry because water utilities generally had few long-term construction projects and that the average water construction project took four months. (See Exhibit 10, pp. 7-8.) Because the Coastal Water Project clearly does not meet these criteria, ORA recommends that its costs be handled like other long-term construction projects, i.e., earning interest at the 90-day commercial paper rate. ORA likewise favors use of a memorandum account over a deferred debit account because items tracked in a memorandum account are clearly subject to review for reasonableness.

As we previously held in D.94-08-031, water utilities:

“are uniquely able to seek construction work in progress (CWIP) accounting to recover the cost of financing plant under construction but not yet used and useful. Other utilities must rely on the less immediate ‘allowance for funds used during construction’ (AFUDC) accounting method, which defers recovery of construction financing costs until after the plant is placed in service. Water utilities are authorized to seek CWIP accounting because of a perception that water utility construction projects are generally shorter than other utility construction projects, and because CWIP accounting may cost ratepayers less than AFUDC accounting.” (See D.94-08-031, 1994 PUC LEXIS 474 at *7, note 2.)

Thus, we must evaluate whether or not the costs at issue here are related to a water utility construction project of generally short duration to determine whether or not the CWIP or AFUDC at authorized rate of return ratemaking treatment Cal-Am seeks is appropriate. Because the Coastal Water Project will clearly require a significant period of time for construction, distinguishing it from typical water utility construction projects, we conclude that it is not entitled to the specialized CWIP ratemaking treatment offered to short duration water projects. In addition, the costs at issue here are predecessor

costs to construction costs, in other words, construction work is not underway on the project and thus they are not funds used during construction. It remains unclear at this time when (or whether) any plant construction will commence. Therefore, allowing these preliminary costs to earn the utility's authorized rate of return now carries with it significant risk that the ratepayers may never receive the benefits of these expenditures.

For these reasons, we conclude that the most appropriate manner to track these costs is for Cal-Am to establish a memorandum account to books costs associated with initial, preliminary engineering studies, environmental studies, analysis of necessary permitting requirements, and development of cost estimates for the Coastal Water Project. The memorandum account shall accrue interest at the 90-day commercial paper rate. As the status of the proposed project becomes more certain (for example, if a CPCN is granted or construction is underway), we will consider modifying this ratemaking treatment upon application by Cal-Am.

2. Public Information Campaign Costs

Regarding public information costs, ORA raises legitimate concerns regarding the nature of the costs that Cal-Am proposes. Cal-Am has not provided sufficient information to allow us to determine whether these costs serve a legitimate public education function, which might be allowed, or are more in the nature of an advocacy effort that should not be funded by ratepayers. We will allow Cal-Am to track these expenditures in a memorandum account, and to accrue interest at the 90-day commercial paper rate. We utilize the 90-day commercial paper rate because these costs are expenses that are not typically capitalized and do not typically earn a utility's authorized rate of return. In its next general rate case, Cal-Am may make a reasonableness showing for the

recovery of these expenditures and recover the reasonable costs through a surcharge in addition to the rate adopted in that general rate case.

VII. Disposition of Application 97-03-052

This proceeding was opened in 1997. The nature of the project for which Cal-Am seeks authorization has changed significantly and the record developed with respect to the Carmel River Dam project is essentially moot for purposes of evaluating Cal-Am's new request for a CPCN for the Coastal Water Project. Because Cal-Am must prepare a thorough environmental review document in seeking authority to construct the Coastal Water Project, regardless of whether it is handled within the current application or a new application, we do not believe that a dismissal of the current application will delay Cal-Am's pursuit of a long-term water supply solution for its Monterey District.

For administrative efficiency, we will dismiss this proceeding without prejudice. At the same time, we expressly direct Cal-Am to file a new application to seek Commission authorization to pursue the Coastal Water Project. Development costs for the Coastal Water Project, including costs associated with any such new filing and new proceeding, should be booked as directed in this decision. This decision does not prejudge whether a CPCN should be granted for the Coastal Water Project or the reasonableness of future costs of any project ultimately approved.

VIII. Comments on Proposed Decision

This decision deals with certain issues that were the subject of evidentiary hearings, and other issues that were not the subject of hearings. For purposes of receiving comments, the decision is being issued as a proposed decision under Pub. Util. Code § 311(d).

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed by Cal-Am, ORA and the District. Joint comments were filed by the County and MCWRA.

Cal-Am supports the Proposed Decision in designating the Commission as Lead Agency under CEQA for the Coastal Water Project, dismissing this proceeding without prejudice, and ordering Cal-Am to immediately file a separate application for the Coastal Water Project. However, it urges (1) that the Commission further address recovery of Carmel River Dam project costs before dismissing this proceeding; (2) that the Commission authorize Cal-Am to charge upcoming Coastal Water Project costs to a deferred debit account with interest greater than the 90-day commercial paper rate, and (3) that prompt preparation of the PEA be reflected in the decision's Conclusions of Law and Ordering Paragraphs.

ORA in its reply comments states that Cal-Am has changed its position on Carmel River Dam project costs and that the treatment proposed mirrors much of ORA's original position. ORA would support Cal-Am's position, with several modifications. However, as discussed in the Proposed Decision, D.03-02-030 adopted the ratemaking treatment specific to Carmel River Dam project costs, and we continue to believe that resolution of these costs can best be dealt with in the utility's next general rate case. Similarly, for the reasons that we have discussed, we believe that the 90-day commercial paper rate for Coastal Water Project costs is fair to the utility and less risky for ratepayers than CWIP or AFUDC treatment at authorized rate of return. We agree with Cal-Am that our directions regarding the PEA should be reflected in the Conclusions of Law and Ordering Paragraphs, and we have revised the Proposed Decision accordingly.

The County and MCWRA urge that the Proposed Decision in its Ordering Paragraphs state that the Commission shall consider the regional nature and aspects of the Coastal Water Project during the environmental review process and, further, that public hearings regarding the project be conducted in Monterey County. As the Proposed Decision makes clear, regional considerations are important, but Cal-Am's primary concern is to obtain 10,730 acre feet of water to serve its service territory and its customers. We see no need to alter the Proposed Decision in this regard. The location of public hearings is a matter yet to be decided, but we will give considerable weight to the recommendations of the County and MCWRA in scheduling these hearings.

ORA supports the major findings of the Proposed Decision, but it urges that Cal-Am not be permitted to book public information costs into a memorandum account for possible recovery in Cal-Am's next general rate case. Cal-Am notes in its reply brief that Cal-Am will have to justify any public information expenditures before it can recover these costs. We believe that establishment of a memorandum account is a reasonable method of dealing with this issue. ORA also urges that the Commission explicitly require Cal-Am to explore possible regional partnerships for development of the Coastal Water Project without regard to whether that exploration is undertaken as part of an environmental review. We believe that objective is implied in the Proposed Decision. Changes in the Ordering Paragraphs are unnecessary.

The District supports the Proposed Decision, but it suggests that the Commission make the District co-lead agency under CEQA. We decline to do that but, as the Proposed Decision notes, we are committed to working closely with the District in carrying out our CEQA responsibilities.

IX. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner and Michelle Cooke is the assigned ALJ in this proceeding.

Findings of Fact

1. The State Water Resources Control Board has ordered Cal-Am to find an alternative source for 10,730 acre feet of water currently taken from the Carmel River.
2. The 10,730 acre feet of water represents about 69% of Cal-Am's water supply for its Monterey Division.
3. In this application, filed in 1997, Cal-Am sought approval to construct a dam and storage reservoir to provide an alternative source of water.
4. The District served as lead agency under the California Environmental Quality Act for purposes of reviewing the dam.
5. The dam, known as the Carmel River Dam, was opposed by voters in the community that would be affected by the construction.
6. In 1998, Assembly Bill 1182 required this Commission to identify a long-term water supply contingency plan to replace the 10,730-acre feet of water from the Carmel River.
7. The contingency plan was issued in August 2002 and proposed a desalination facility called the Coastal Water Project.
8. In February 2003, Cal-Am filed two motions and a proposed amendment to this 1997 application.
9. The proposed amendment would modify the application to request a CPCN to construct the Coastal Water Project.

10. Cal-Am recommends that the Commission be designated as lead agency under CEQA to certify the environmental assessment required for the proposed Coastal Water Project.

11. The County, MCWRA and MCWD urge that Monterey County be lead agency in cooperation with MCWRA.

12. The District and CAWS support the District as lead agency.

13. The District was the lead agency for Cal-Am's application to construct the Carmel River Dam, and the District has extensive experience regarding Monterey Bay water supply options.

14. Many of the proposed Coastal Water Project facilities fall outside the District's jurisdictional boundaries and authority.

15. The County represents the community most affected by the Coastal Water Project proposal, and has permitting authority over the proposed desalination plant location.

16. The County in combination with MCWRA has jurisdictional responsibilities covering land use, management of water resources, and facility construction and operation.

17. The Commission is a statewide public agency with broad jurisdiction over a multi-jurisdictional project like the Coastal Water Project.

18. Effective environmental review will require extensive involvement by virtually all the responsible agencies with permit authority over the Coastal Water Project.

19. Cal-Am's ratemaking request covers (1) costs incurred or yet to be incurred for the Carmel River Dam project; (2) costs incurred in development of Plan B/ Coastal Water Project, and (3) costs expected to be incurred with the Coastal Water Project.

20. The Carmel River Dam project has incurred costs of \$3,279,161 to date.

21. D.03-02-030 classified Carmel River Dam project costs as CWIP and included such costs in ratebase.

22. Resolutions W-4131 and W-4237 authorized expenditure of \$1.75 million for development of the Plan B/Coastal Water Project.

23. As of May 9, 2003, Plan B/Coastal Water Project development costs booked by Cal-Am totaled \$1,761,751.57.

24. ORA opposes CWIP treatment for Coastal Water Project costs and recommends that such costs be booked to a memorandum account and accrue interest.

25. The record developed on the Carmel River Dam project is essentially moot for purposes of evaluating Cal-Am's new request for a CPCN for the Coastal Water Project.

Conclusions of Law

1. Under CEQA, where a project is to be carried out by nongovernmental entities, the lead agency will normally be the public agency with the greatest responsibility for supervising or approving the project as a whole.

2. The Commission should assume lead agency status for the Coastal Water Project proposal, acting in close coordination with the other responsible agencies.

3. The Commission should not modify the ratemaking treatment adopted in D.03-02-030 for the Carmel River Dam costs.

4. In its next general rate case, Cal-Am should adjust its revenue requirement request to remove from CWIP any amounts adopted in D.03-02-030 that were not spent on the Carmel River Dam project.

5. Cal-Am's costs beyond the Commission's Plan B/Coastal Water Project development costs should not be booked to the ratemaking accounts authorized by the Commission's resolutions.

6. Interest on Plan B/Coastal Water Project development costs should continue to accrue until the costs are fully recovered by a surcharge.

7. Cal-Am should establish a memorandum account, with interest, to track ongoing costs of the Coastal Water Project.

8. Cal-Am should establish a memorandum account, with interest, to track public information costs for the Coastal Water Project.

9. A.97-03-052 should be dismissed without prejudice, and Cal-Am should be directed to file a new application for Commission authorization to pursue the Coastal Water Project and a Proponent's Environmental Assessment.

O R D E R

IT IS ORDERED that:

1. The Commission is designated the lead agency under the California Environmental Quality Act to conduct, prepare and certify the environmental assessment required for the Coastal Water Project proposal of California-American Water Company (Cal-Am).

2. The ratemaking treatment adopted in Decision (D.) 03-02-030 shall apply to costs incurred or yet to be incurred by Cal-Am in the development of its Carmel River Dam project in this application.

3. In its next general rate case, Cal-Am shall adjust its revenue requirement to remove from Construction Work in Progress (CWIP) any amounts adopted in D.03-02-030 that were not spent on the Carmel River Dam project.

4. Cal-Am is authorized to book only those Plan B/Coastal Water Project development costs authorized by Resolutions W-4131, W-4205 and W-4237.

5. Cal-Am is authorized to accrue interest at the 90-day commercial paper rate on Plan B/Coastal Water Project development costs until such costs are fully recovered by surcharge.

6. Cal-Am is authorized to establish a memorandum account, with interest at the 90-day commercial paper rate, to track ongoing costs of the Coastal Water Project.

7. Cal-Am is authorized to establish a memorandum account, with interest at the 90-day commercial paper rate, to track public information costs for the Coastal Water Project and to file a Proponent's Environmental Assessment.

8. Cal-Am is directed to file a new application for Commission authorization to pursue the Coastal Water Project.

9. Application 97-03-052 is dismissed without prejudice to the filing of a new application by Cal-Am.

This order is effective today.

Dated September 4, 2003, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners

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