

Decision 06-12-040 December 14, 2006

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California-American Water Company for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project to Resolve the Long-Term Water Supply Deficit in its Monterey District and to Recover All Present and Future Costs in Connection Therewith in Rates.  
(U 210 W)

Application 04-09-019  
(Filed September 20, 2004)

**(See Appendix A for List of Appearances)**

**OPINION ON REQUEST FOR INTERIM RATE RELIEF**

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## OPINION ON REQUEST FOR INTERIM RATE RELIEF

### **I. Summary**

The Commission authorizes California-American Water Company's (CalAm) proposed Special Request 1 Surcharge to allow recovery of already incurred preconstruction costs related to its Coastal Water Project. Commencing January 1, 2007, the surcharge will be 4% on customer bills, then beginning July 1, 2007, will increase to 7%. Beginning January 1, 2008, the surcharge will increase to 10% and remain at the 10% level until the full amount authorized for preconstruction costs is collected.

The Commission also authorizes CalAm's proposed Special Request 2 Surcharge commencing after the Commission issues a Certificate of Public Convenience and Necessity (CPCN) for the Coastal Water Project, or alternative long-term supply solution. Initially, the surcharge will be 15% on customer bills, increasing to 30%, 45% and 60%, respectively, on July 1 and January 1 each year, and will remain at the 60% level through completion of the approved long-term water supply project. The revenues collected will be treated as a customer contribution to reduce the capital cost of the approved long-term supply project.

The Commission has reviewed CalAm's Coastal Water Project preconstruction costs through 2005 and concluded that public outreach costs of \$1,353,831 and project management costs of \$1,639,429 were reasonable, and CalAm is authorized to recover these costs through the Special Request 1 Surcharge. However, at the request of the Division of Ratepayer Advocates (DRA), the Commission deferred review of \$5,670,073 in engineering and environmental costs so that DRA could hire a consultant to assist DRA in its review. These 2005 engineering and environmental costs, along with 2006

preconstruction costs, will be reviewed for reasonableness for a Commission decision by year-end 2007.

CalAm is directed to file a new application early in 2008 for reasonableness review of 2007 preconstruction costs, for a Commission decision by year-end 2008.

This proceeding remains open for the reasonableness reviews described above and for the selection of a long-term water supply solution and review of the Environmental Impact Report (EIR) for the project.

## **II. Background**

The Coastal Water Project, or an alternative water supply solution, is necessary for CalAm to comply with State Water Resources Control Board (SWRCB) Order 95-10, which directed CalAm to develop and implement a plan to replace the 10,730 acre-feet per year of water it historically diverted from the Carmel Valley Aquifer. This amounts to approximately 69% of CalAm's water supply for its Monterey District.

The Coastal Water Project proposal replaced the Carmel River Dam and Reservoir Project, which CalAm originally proposed to meet the requirements of SWRCB Order 95-10. CalAm had sought a CPCN to construct and operate the Carmel River Dam and Reservoir Project (A.97-03-052) in 1997. Despite CalAm's attempts to move forward with the Carmel River Dam and Reservoir Project, it stalled due to various circumstances, including active opposition to dams on live streams and newly listed "threatened" species under the Endangered Species Act. The Commission subsequently issued Decision (D.) 98-08-036, which required CalAm to prepare a long-term water supply contingency plan describing the program or combination of programs that it would pursue if it could not complete the Carmel River Dam and Reservoir Project. In 1998,

Assembly Bill 1182 directed the Commission, in consultation with CalAm and other interested parties, to prepare this long-term contingency plan.

In August 2002, the Commission issued its long-term contingency plan (commonly referred to as Plan B) recommending the construction of a desalination facility and aquifer storage and recovery (ASR) project. CalAm determined that the desalination and ASR facilities, which became the proposed Coastal Water Project, would address the directives of the SWRCB and the Endangered Species Act issues on the Carmel River and that it could construct and operate the Coastal Water Project in a manner to minimize environmental impacts and maximize operational efficiency. In D.03-09-022, the Commission dismissed CalAm's Carmel River Dam application without prejudice, ordered it to file a new application for the Coastal Water Project, and authorized two memorandum accounts, one to track on-going costs and the other to track public information costs.

CalAm then filed the instant Application (A.) 04-09-019 and undertook steps to proceed with the Coastal Water Project, including environmental review and preparation of its PEA.

### **III. Procedural Summary**

On September 24, 2004, CalAm filed its application requesting a CPCN to construct and operate the Coastal Water Project and recover all past, present, and future costs in rates.<sup>1</sup>

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<sup>1</sup> CalAm initially sought recovery of some of the Coastal Water Project costs as part of the Monterey District general rate case (GRC), Application (A.) 05-02-012. A May 31, 2005 Assigned Commissioner and Administrative Law Judge's (ALJ) Ruling and Scoping Memo (Scoping Memo) determined that recovery of those costs should be included in this proceeding, A.04-09-019.

On July 14, 2005, CalAm filed a motion for interim rate relief along with an amended CPCN application and its Proponent's Environmental Assessment (PEA).

In a September 6, 2005 ruling, the ALJ determined that there should be two distinct phases to this proceeding: (1) Phase I – interim rate relief and (2) Phase II – selection of a water supply solution. A Scoping Memo issued May 23, 2006 set forth the schedule for Phase I of this proceeding. Evidentiary hearings on the interim rate relief request were held on July 25 through July 28, and August 1 and 10, 2006. Opening briefs were filed on September 1, 2006 by CalAm, DRA, Independent Reclaimed Water Users Group (IRWUG), Pajaro/Sunny Mesa Community Services District (PSMCSD), and Monterey Peninsula Water Management District (MPWMD). Reply briefs were filed on September 22, 2006, by CalAm, DRA, IRWUG, and MPWMD, and the interim rate request was submitted for decision on that date.

A separate Phase II proceeding to address the selection of a water supply solution will commence after the EIR on the proposed Coastal Water Project is further under way.

#### **IV. Public Participation Hearings**

Public participation hearings were held in Monterey and Seaside on July 18 and September 16, 2006, respectively. The hearings were well attended. Several speakers expressed concern over the uncertainties associated with the surcharges proposed, as well as with the project itself. Some questioned the propriety of assessing surcharges for preconstruction costs when the project has yet to be issued a permit and there is an alternative project proposed by PSMCSD under consideration as well. Many acknowledged the need for major improvement in the water provision system, but worried that the rate increase was excessive.

## **V. Relief Requested**

CalAm seeks interim rate relief for the purpose of mitigating the potential rate impacts of the Coastal Water Project's currently estimated cost of \$191 million, which could produce a near doubling of current rates in CalAm's Monterey District. Specifically, CalAm requests that the Commission issue an order authorizing the surcharges described in Special Requests 1 and 2 below.<sup>2</sup> CalAm proposes that the surcharges be calculated as percentages of the overall customer bill, exclusive of other surcharges, such as those to true-up memorandum accounts or fund MPWMD. CalAm would treat the revenues generated by the surcharges as a contribution, thus reducing the capitalized portion of the Coastal Water Project or alternative long-term supply solution.

### **Special Request 1: Recovery of Preconstruction Costs**

The purpose of the Special Request 1 Surcharge is to recover the Coastal Water Project preconstruction costs that CalAm is tracking in the memorandum accounts approved in D.03-09-022. CalAm proposes that the Commission allow it to recover these costs (plus interest at CalAm's authorized rate of return) through a three-phase surcharge. CalAm proposes that the surcharge begin on January 1, 2007, with a 4% surcharge on customer water bills. Then, beginning July 1, 2007, CalAm would increase the surcharge to 7%. Starting January 1, 2008, CalAm would increase the surcharge to 10%, which is expected to remain in place through 2014, unless the full amount is recovered sooner. At that point,

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<sup>2</sup> While CalAm's July 14, 2005 motion made four special requests for surcharges and a connection fee to recover costs of the Coastal Water Project, CalAm subsequently withdrew this request and replaced it with the above request to implement two surcharges.

CalAm would add any remaining uncollected preconstruction costs to the overall Coastal Water Project or alternative long-term supply solution costs.

**Special Request 2: Offset Costs of a Long-Term Water Supply Solution**

The purpose of the Special Request 2 Surcharge is to generate revenues to offset the ultimate cost of a long-term water supply solution for CalAm's Monterey District, whether it is the Coastal Water Project or an alternative. CalAm proposes that the surcharge be implemented as follows: (1) a 15% surcharge on all customer bills beginning January 2007; (2) an increase to a 30% surcharge in September 2007; and (3) a further increase to a 45% surcharge in April 2008. If the Coastal Water Project (or alternative long-term water supply solution) has not been completed by January 2009, CalAm would increase the surcharge to 60% of the customer's bill and would continue at that level until the Coastal Water Project, or other approved long-term supply solution, is completed.<sup>3</sup>

**VI. Implementation of Surcharges**

**A. Position of CalAm**

CalAm requests that both surcharges be implemented commencing January 1, 2007. CalAm argues that, under its proposal, Monterey District customers will actually pay less for preconstruction items than they would under more traditional rate recovery methods. First, by paying for preconstruction costs now, rather than after the Coastal Water Project is completed, customers avoid paying years of interest on these costs. Since preconstruction costs will be

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<sup>3</sup> The term "completed" is used by DRA and CalAm to mean online or used and useful. In other words, once a long-term water supply solution is operational, the surcharge would be replaced with an alternative cost recovery mechanism.



in the millions, this represents significant savings. Second, under its proposal, CalAm would treat preconstruction costs as reimbursed expenses rather than additions to CalAm's ratebase. CalAm points out that keeping preconstruction costs out of ratebase means that customers will only have to reimburse CalAm for expenses (and interest) incurred and will not have to contribute to a return on its preconstruction investments.

CalAm submits that the proposed surcharges are consistent with the Commission's policy objectives for water utilities as set forth in the December 2005 Water Action Plan, calling for new methods and approaches that may be necessary to enable water utilities to undertake major capital projects with minimal impact on ratepayers. (See Water Action Plan, pp. 20-22.)

#### **B. Position of DRA**

DRA opposes allowing CalAm to begin recovery of preconstruction costs before the Commission issues a CPCN for the Coastal Water Project and before such costs are reviewed for reasonableness. DRA, however, is willing to allow CalAm to begin recovery of these costs before the plant is placed into service and has been determined to be used and useful to help mitigate the eventual rate shock that would likely occur if recovery of both preconstruction and construction costs happened all at once.

DRA notes that the Commission has provided guidance on when re-evaluation of the ordered ratemaking treatment of Coastal Water Project preconstruction costs should occur. The Commission stated: "[a]s 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." (D.03-09-022, p. 22, emphasis added.) DRA believes that the Commission should continue to adhere to the ratemaking treatment provided in

D.03-09-022 and deny CalAm's request to begin recovering preconstruction costs before the Commission grants CalAm a CPCN for the Coastal Water Project.

DRA argues that shareholders, not ratepayers, should bear the risk of preconstruction costs for a project that has not and may not be approved. While DRA does not propose delaying recovery of preconstruction costs under the Special Request 1 Surcharge until the project is used and useful, it does recommend that the Commission proceed carefully when departing from traditional ratemaking. DRA cautions that even if the Commission issues CalAm a CPCN for the Coastal Water Project, or approves an alternative long-term supply solution, it is still possible that the project may never be built. DRA points out that numerous other agencies, including the California Coastal Commission, will need to approve the project, several environmental groups oppose this project, and there is no evidence that ratepayers are willing to have their rates doubled to pay for this project despite CalAm's public outreach campaign. Thus, DRA contends that allowing CalAm to recover preconstruction costs before the project is in service shifts significant risks from shareholders to ratepayers for what could turn out to be an abandoned project.

Nevertheless, DRA sees some merit in allowing CalAm to begin recovering some preconstruction costs after a CPCN is issued but before the final project is placed into service to address the potential rate shock that could exist if recovery is deferred until the project is completed. However, DRA believes this departure from traditional ratemaking should only occur if all costs are thoroughly reviewed for reasonableness before allowing recovery.

With regard to CalAm's proposed Special Request 2 Surcharge to pre-collect funds for the project to be approved, DRA opposes CalAm's request to implement this surcharge in January 2007. DRA recommends that this surcharge not be implemented until the project is permitted and construction has begun.

### **C. Position of Intervenor**

MPWMD and IRWUG, (as does DRA), argue that the Commission should wait until a CPCN is issued before authorizing any surcharge. PSMCSD, the proponent of the competing desalination project, recommends that the Commission order CalAm to wait until it completes the Coastal Water Project to implement both surcharges. The intervenors share DRA's concerns regarding shifting project risk to ratepayers.

### **D. Discussion**

There appears to be general acceptance that, sooner or later, a surcharge is necessary to avoid rate shock that will result if the total project cost of a long-term water supply solution is included in rates at one time. Therefore, the real issue before the Commission is the implementation dates for the proposed surcharges. We note that under CalAm's proposal, the combined surcharge would initially be 19% (4% under Special Request 1 and 15% under Special Request 2), and if CalAm's proposal is approved, both surcharges would commence on January 1, 2007. Our concern is that at the same time Monterey District ratepayers would have recently received a significant rate increase resulting from the recent General Rate Case (GRC) proceeding. We believe that adding a combined 19% surcharge to the GRC increase would be excessive. Therefore, CalAm's surcharge proposals need some adjustment to moderate rate shock to customers, who face potentially high rates.

On the other hand, we agree with CalAm that the sooner the Commission allows CalAm to implement the proposed surcharges the more it will be able to mitigate the rate impact of a long-term water supply solution on Monterey District customers. As stated previously, the environmental review and CPCN phase for a long-term water supply solution is progressing on a separate track from the interim rate request phase. As matters now stand, (1) environmental

review has taken significant time, (2) \$8.7 million in preconstruction costs have been booked through 2005, and (3) it could be a year at least before the Commission issues a CPCN or adopts an alternative long-term water supply solution in this proceeding. If the Commission delays implementing the surcharge until a CPCN is issued, this means one year at least of: (1) additional interest charges accruing on preconstruction costs; (2) cash-flow issues related to the carrying cost for the preconstruction costs; and (3) lost revenue that will not be available to offset the capitalized cost of the project. Moreover, any delay will unfairly shift a larger portion of the cost burden on to future customers rather than to current customers, who should begin paying for the water supply solution being pursued for their benefit.

On balance, we conclude that the Special Request 1 Surcharge should be implemented effective January 1, 2007, as proposed by CalAm. However, implementation of the Special Request 2 Surcharge should be delayed until the CPCN is issued for the Coastal Water Project, or alternative long-term supply solution. Staggering introduction of the surcharges will allow CalAm to gradually ramp-up rates to moderate rate shock that will otherwise be severe, and prepare customers for future rate increases. The surcharges are carefully designed to introduce necessary rate increases gradually and will also allow customers an opportunity to change their consumption habits, if necessary, to control their own bills. The surcharges will impact both existing and future ratepayers which is appropriate given that the Coastal Water Project is a project to replace existing supplies, necessitated by SWRCB Order 95-10.

We appreciate DRA's concern that PSMCSD has a competing desalination project and CalAm's project could turn out to be an abandoned project. However, it is CalAm, not Monterey County or PSMCSD, that is subject to SWRCB Order 95-10, and is subject to major fines if there is no action towards

compliance. Therefore, CalAm cannot simply stand by and wait for Monterey County or PSMCSD to develop a desalination plant that will fulfill CalAm's obligations. As CalAm points out, although PSMCSD actively participated in this proceeding, it has provided no evidence to date that its proposed regional project is viable and can meet the objectives and needs of CalAm. Also, MPWMD admits that its own project has been put on hold by the MPWMD Board. We believe that, in the meantime, the Commission has a responsibility to enable CalAm to comply with SWRCB Order 95-10 and the Endangered Species Act. Furthermore, in authorizing the proposed surcharges, we emphasize that the Commission has not foreclosed a regional solution to the water supply needs of CalAm's Monterey District. If project ownership is shared or sold, the Commission, after hearing, will ensure that ratepayers are compensated for their contributions collected by CalAm under the proposed surcharges.

Our decision to grant CalAm's Special Request 1 Surcharge commencing January 1, 2007 prior to completion of the reasonableness review, reflects the fact that CalAm did provide the Commission with a complete showing to support its request for interim rate relief, and as discussed below it is not CalAm's fault that the reasonableness review of costs through 2005 was not completed.

## **VII. Reasonableness Review of Preconstruction Costs Through 2005**

CalAm seeks recovery of \$8,663,334 in preconstruction costs through 2005. Of this, \$5,670,073 is for engineering and environmental costs; \$1,353,831 is for public outreach; and, \$1,639,429 is for project management, legal, administrative, and other costs.

DRA recommends that the Commission should: (1) set aside the \$5,670,073 in engineering and environmental costs and track it separately until DRA's consultant is able to evaluate these costs for potential duplication and

reasonableness; (2) disallow \$1,193,831 of the requested \$1,353,831 in public outreach costs as unreasonable and find the remaining \$160,000 of public outreach costs reasonable; (3) approve recovery of \$1,639,419 in other costs; and, (4) allow recovery of these costs only after the Coastal Water Project, or alternative project, is certified by the Commission. DRA's recommendations are discussed below.

#### **A. Reasonableness Review of Engineering and Environmental Costs**

CalAm seeks recovery of \$5,670,073 in engineering and environmental costs incurred through 2005. DRA recommends that the Commission defer approval so that DRA can hire a consultant under a reimbursable contract to assist DRA in its review of these costs. As discussed below, we grant DRA's request and defer reasonableness review of this item to 2007.

DRA states that the bulk of engineering and environmental costs was paid to RBF Consulting (RBF), the firm CalAm hired to develop the Coastal Water Project and to prepare the required PEA. The work RBF did for CalAm includes such tasks as preliminary design and permitting of the pilot plant facility, horizontal directional drilling feedwater supply investigation, water hydrodynamic modeling, marine biological resources assessment, hydrogeologic analysis associated with the ASR projects, evaluation of membrane cleaning solutions, geology and soils investigations, and much more.

DRA argues that if PSMCSD's plant is the final project that is built, CalAm ratepayers could potentially have to pay for pilot plant costs twice and pay for other duplicative costs because the PSMCSD desalination plant would be a regional plant that would provide wholesale water to CalAm to meet its water supply needs. DRA contends an expert in the area of desalination and ASR is needed to review the reasonableness of CalAm's preconstruction costs, and also

determine whether the costs were duplicative and could have reasonably been avoided. According to DRA, it does not have the required expertise on staff to perform this review.

DRA says it has retained a consultant to assist with its Phase II review of the Coastal Water Project or alternative long-term supply solution. The consultant has confirmed that if the contract with DRA is amended, or a separate contract is established, his team can do a reasonableness review of preliminary engineering and environmental costs through 2005, and 2006, assess the reasonableness of the costs, and determine to what extent, if any, duplication of studies has occurred. According to DRA, the review is estimated to cost \$30,000 to \$50,000, and could be concluded by mid-2007.

DRA also recommends that the Commission order CalAm to file a separate application in early 2008 for approval of 2007 costs. DRA says that the cost for a consultant to assist in the review of 2007 costs would be approximately \$25,000, and the review could be completed by mid-2008.

CalAm opposes any delay in Commission approval of its preconstruction costs through 2005. CalAm argues that it did provide a complete showing to support its request for recovery. The activities CalAm undertook through 2005 include: (1) performing preliminary engineering studies and preliminary design for the entire project; (2) preparing and submitting the PEA, including evaluation of alternatives in the PEA; (3) obtaining necessary permits and performing necessary analyses for the Pilot Project to come on-line; and, (4) implementing an extensive public outreach program to educate Monterey District customers and other affected parties about the Coastal Water Project. CalAm points out that DRA's own audit report confirms that the preconstruction costs requested are of the type the Commission normally allows utilities to recover, were properly accounted for and adequately supported by invoices, and included interviews of

CalAm personnel by DRA to obtain information from the Company regarding its internal accounting processes, data collection, and analysis.

We agree that CalAm has provided the required showing to support its request. However, DRA has a valid concern and we grant DRA's request for an outside consultant to assist in the reasonableness review of these particular costs. As a condition to granting DRA's request, we require DRA's report on the reasonableness of preliminary engineering and environmental costs through 2005, and preconstruction costs for 2006, to be issued no later than June 30, 2007. The assigned ALJ should convene a prehearing conference shortly thereafter to schedule hearings so that the Commission may issue its decision on the reasonableness of these costs before year-end 2007. At the same time, any needed adjustment to the surcharges may be addressed.

Also, we direct CalAm to file a new application for reasonableness review of 2007 preconstruction costs no later than March 31, 2008. Also, we authorize DRA to extend its contract so that the consultant can assist DRA in the review of 2007 preconstruction costs. DRA should issue its report no later than June 30, 2008. The assigned ALJ should convene a prehearing conference shortly thereafter and schedule hearings so that the Commission may issue its decision on the reasonableness of 2007 preconstruction costs before year-end 2008. Any needed adjustment to the surcharges may be addressed at the same time.

#### **B. Reasonableness Review of Public Outreach Costs**

CalAm seeks recovery of \$1,135,028 for public outreach costs and \$226,553 for administrative costs incurred by Nossaman, Gunther, Knox, and Elliot (Nossaman), a lobbying firm CalAm retained to conduct community outreach and education to the business community, agencies, legislators, and stakeholder groups and to provide project management related to public awareness of the



Coastal Water Project. Taken together, CalAm spent a total of \$1.36 million through 2005 on public outreach.<sup>4</sup>

CalAm states that it provided hundreds of pages of monthly legal invoices documenting the legal services that were provided in connection with the Coastal Water Project. These invoices contain detailed billing entries for the legal fees incurred by CalAm through 2005 for specialized legal services rendered for water supply rights issues with appropriate redactions to protect confidential information protected by the attorney-client privilege, the entitlement process and environmental review of the project, as well as Commission approval of the project. Also, CalAm removed \$521,245 from its request to avoid any dispute that these costs included lobbying expenses, which the Commission typically disallows.

CalAm contends that the total cost of the program amounts to roughly 0.5% of the estimated \$191 million project cost. CalAm argues that the public outreach costs incurred through 2005 amount to \$10 per year per customer and are entirely consistent with the Commission's prior recovery of public education costs. CalAm submits that it has a responsibility to both its customers and other parties affected by the Coastal Water Project to provide the necessary information for them to be able to evaluate the proposed project. According to CalAm, it prudently developed and executed an extensive public outreach

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<sup>4</sup> CalAm's outreach program includes: 1) formal and informal briefings with elected officials, public agencies, and citizen boards; 2) formal presentations in the affected communities in CalAm's service territory and neighboring communities; 3) formal briefings, presentations, and discussions with individual stakeholders and non-governmental organizations; 4) public information provided through the print and, broadcast media; 5) easy public access to all project information through a web page; 6) easy local public access to a project library and permit coordination center facility; and 7) continued focus on water conservation.

program, which included approximately 70 town hall and community meetings, mailings to customers and stakeholders, newspaper advertisements, and a web site dedicated to the Coastal Water Project.

DRA argues that CalAm's spending was unreasonable, excessive, and unnecessary. DRA contends that CalAm also spent significant amounts on educating Monterey residents about desalination technology and the permitting process through community meetings, an expensive process that reached an unknown number of people. Also, according to DRA, CalAm spent a disproportionate percentage of its public outreach campaign trying to educate ratepayers about the all too familiar water supply problems and details of desalination technology, in comparison to educating customers about the most important aspect of the project – how it would affect their water rates and monthly water bill.

DRA recommends that the Commission allow CalAm to recover only \$160,000 for public outreach, which is approximately \$4.25 per customer. According to DRA, it appears that CalAm allowed *carte blanche* spending on public outreach. DRA contends there is little, if any evidence that CalAm made attempts to keep costs to a minimum. Detailed budgets were not produced, contracts were not followed, and CalAm paid for multiple consultants to attend the informational meetings. And, according to DRA, CalAm made little or no attempt to measure the success of its outreach program to justify its extravagant expenditures.

Further, DRA argues that CalAm's public outreach costs amount to more than \$35 per customer, far exceeding comparable campaigns of other water agencies. According to DRA, the San Diego County Water Agency spent \$435,855 on the public outreach campaign for its desalination project. Spread over the approximately one million customers in the county, the total cost per

customer is \$0.44, substantially less than the \$35 per customer CalAm spent. Also, DRA points out that Orange County Water District spent about \$3.0 million over a six-year period on their outreach program to convince customers to overcome their aversion to drinking water reclaimed from waste water, a very high hurdle to overcome. Spread over approximately 767,000 customers, the cost per customer is \$3.91, again significantly less than the \$35 per customer spent by CalAm.

CalAm responds that contrary to DRA's contentions with regard to the services rendered by Armanasco Public Relations (Armanasco), Energy Resources International (ERI), and Nossaman, CalAm followed routine business practices where it is not uncommon for a vendor to provide services on an hourly basis without explicitly spelling out the specific tasks to be provided by these vendors. CalAm believes it has already sufficiently documented the cost of the services by providing the underlying invoices for all services it seeks recovery, which have been audited. According to Kevin Tilden, CalAm's Director of External Affairs, Armanasco "had a schedule of hourly fees, and they would check with us on scope of work before they began and we would usually sign to start work on, for instance, town hall meetings or other things."

CalAm argues that DRA's claim that ERI and Armanasco did not complete certain tasks that were included in the original contracts is meaningless. As CalAm witness Tilden explained, the vendor's proposal was certainly not the final word and CalAm exercised discretion in determining which tasks the vendor should complete.

Further, CalAm disputes DRA's recommendation that CalAm should not be able to recover its public outreach costs unless it has demonstrated that the public outreach has successfully persuaded the public or special interest groups to accept the project. According to CalAm, the purpose of its public outreach

program was to provide information to its customers and other affected parties so that they could evaluate the proposed project, not to advocate the project. CalAm contends that it effectively reached out to customers through its public outreach program. CalAm believes this is wholly evident by the customers' statements at the Public Participation Hearings that customers recognized the need for a long-term water supply solution. According to CalAm, it is obvious that the public is now fully aware of this need and it is doubtful that customers would be as informed without the public education that CalAm provided. Given that the purpose of the program was education, not advocacy, CalAm submits that recovery of public outreach costs should not be dependent upon the public's acceptance of the project.

Addressing DRA's argument that a budget was not followed, CalAm responds that from the outset, it designed its public outreach program to be flexible to address the needs of the public affected by the Coastal Water Project. CalAm contends that, as the record shows, in addition to having a semi-annual budget in place, CalAm's Coastal Water Project team met regularly to discuss what action was needed for public outreach.

We conclude that CalAm's request for a total of \$1.36 million for public outreach costs through 2005 and administrative costs should be approved. The public outreach costs of other projects, or the cost per customer,<sup>5</sup> while useful information, cannot serve as the yardstick for determining the reasonableness of CalAm's outreach costs. Each project and the constituency the outreach program is designed to reach, is different. Two previous attempts to solve the Monterey

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<sup>5</sup> CalAm's figure of \$10 per customer per year cannot be directly compared to DRA's \$35 cost per customer.

District water supply problem have failed. In order for the project to have a chance at success it was essential that CalAm conduct extensive and early outreach. CalAm had to decide what was necessary to get the job done. While DRA may disagree with CalAm's approach, we are not persuaded that CalAm simply threw money at the project, or wasted ratepayer funds. We believe that a project of this controversial nature and impact on the community justifies an aggressive outreach program, especially given the numerous stakeholders and the need to meet with interest groups not only within CalAm's Monterey District but with communities impacted by the project. Accordingly, CalAm is authorized to recover its public outreach costs through 2005 of \$1,135,028, and administrative costs of \$226,553 by Nossaman.

In its comments on the proposed decision, DRA claims that the Commission has not evaluated the public outreach costs. We believe that the proposed decision is based upon a full and complete evidentiary record, including thousands of pages of supporting documentation as well as transcripts from several days of evidentiary hearing focused exclusively on public outreach costs, which demonstrates that CalAm's public outreach costs were reasonable and prudent. DRA's own audit report demonstrates that the preconstruction costs are the type the Commission normally allows utilities to recover, were properly accounted for and were adequately supported by invoices or for labor, by hours spent. Therefore, we give no weight to DRA's claims that the public outreach costs were not fully evaluated. Also, we give no weight to DRA's claim that CalAm had deficient business practices. Accordingly, DRA's claims are rejected.

### **C. Reasonableness Review of Other Costs**

CalAm requests recovery of \$1,639,419 for project management, legal, administrative and other costs through 2005. DRA reviewed these costs and

recommends approval. However, DRA recommends recovery of this amount only after the Coastal Water Project, or alternative project, is certified by the Commission. DRA's request to delay recovery is denied because ratepayers should not be required to pay unnecessary interest charges on costs that have been approved. Such delay is not in the public interest. We authorize CalAm to recover these costs booked in the memorandum account through the Special Request 1 Surcharge.

**D. Recovery of Approved Preconstruction Costs**

DRA recommends that CalAm should not be authorized to begin recovery of approved 2005 preconstruction costs until a CPCN is issued. DRA argues that should the Commission not grant a CPCN to CalAm for the Coastal Water Project, the Commission should reconsider recovery of these costs under the guidelines for recovery of costs for abandoned projects.

We are not persuaded by DRA's recommendation. When the Commission approves any preconstruction cost item in this proceeding, it is implicit that the cost was reasonably and properly incurred in the pursuit of a long-term water supply solution. Therefore, even if the project is abandoned, CalAm should be allowed to recover such costs. Furthermore, approving the cost and then allowing interest charges to accrue on the approved cost, makes little sense. Accordingly, DRA's recommendation is rejected.

Also, DRA recommends that recovery of approved costs be limited to 50% to limit ratepayer risk of the project being abandoned. We are not persuaded that this is necessary because \$8.7 million in preconstruction costs have already been incurred through 2005, additional costs have been incurred through 2006, and even if the Special Request 1 Surcharge is implemented on January 1, 2007,

the memorandum account will be undercollected and accruing interest charges for a long time. Therefore, we reject DRA's recommendation.

In their comments on the proposed decision, DRA and MPWMD argue that it is legal error to depart from applicable Commission precedent regarding abandoned plant without evidence supporting the change. DRA and MPWMD reargue their position that recovery of such preconstruction costs should not begin until there is more certainty that this project will not be abandoned.

We find that authorizing CalAm to implement the proposed decision surcharges is wholly consistent with prior Commission case law that there are valid exceptions to the general rule limiting recovery of capital project expenditures to projects that are used and useful. The proposed decision properly finds that CalAm's "need to comply with the SWRCB Order 95-10 and the estimated \$191 million cost of a project to comply with that order creates special circumstances warranting a departure from standard rate making practice, which allows project costs to be included in rates only after the project is found to be 'used and useful.'" (Proposed Decision, p. 32, Conclusion of Law 1.)

Also, the Commission has authorized water utilities to recover costs related to a capital project through a surcharge prior to the completion or construction of capital project when (1) the costs were reasonably incurred; (2) the project was undertaken pursuant to an order of the Commission or a sister state agency; and (3) unusual or exigent circumstances surrounding the plant's construction warranted recovery or interim relief.<sup>6</sup> Here, the evidentiary record

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<sup>6</sup> E.g., Application of California-American Water Company (U 120 W) for an order authorizing it to increase its rates for water service in its Monterey District, D.90-10-036(1990) 38 CPUC 2d 15, 1990 Cal.PUC LEXIS 912 (hereinafter "D.90-10-036"); Application of Hillview Water Company, Inc. (U-194-W), for Authority to Issue Evidence of Indebtedness (Promissory Note and Loan Agreement) and to Grant

*Footnote continued on next page*

demonstrates that the proposed surcharges meet these three criteria. First, CalAm's preconstruction costs, which include environmental studies, permitting, public outreach and engineering services, are necessary to determine whether the Coastal Water Project was feasible and to comply with the Commission's environmental review requirements. The proposed decision finds that "CalAm did provide the Commission with a complete showing to support its request for interim rate relief." Second, the purpose of the Coastal Water Project is to satisfy a state order, in this case, SWRCB Order 95-10. Third, the proposed decision recognizes the unique and exigent circumstances existing with the Coastal Water Project which would justify interim recovery of costs. Also, the proposed decision explains that (a) CalAm is subject to SWRCB Order 95-10 and subject to major fines if there is no action toward compliance, and (b) The Commission has a responsibility to enable CalAm to comply with SWRCB Order 95-10 and the Endangered Species Act.

Assuming for the purposes of discussion that the proposed decision departs from Commission precedent, which it does not, it is not legal error for the Commission to deviate from prior Commission decisions because the Commission is not bound by its own precedent. (*In re Pacific Gas & Electric Co.* (1988) 30 CPUC2d 189, 223-225). The California Supreme Court explained this long-held principle as follows:

The departure by the Commission from its own precedent or its failure to observe a rule ordinarily respected by it is made the subject of criticism, but our reply is that this is not a matter under the control of this court. We do not perceive that such a

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Security Interest in Its Assets, D.02-11-015 (2002) 2002 Cal. PUC LEXIS 722 (hereinafter "D.02-11-015").



matter either tends to show that the Commission had not regularly pursued its authority, or that said departure violated any right of the petitioner guaranteed by the state or federal constitution. Circumstances peculiar to a given situation may justify such a departure. (*Postal Telegraph-Cable Company v. Railroad Commission of the State of California* (1925) 197 Cal., pp. 426, 436-437.)

Furthermore, the Commission has afforded itself a measure of flexibility in its authority to grant interim rates. "There is no single established formula for granting interim rate relief."<sup>7</sup> Here, the proposed surcharges are in the public interest because they protect ratepayers from rate shock and provide the significant customer benefits enumerated above. Therefore, we reject DRA's and MPWMD's claims that the proposed decision is not supported by Commission Law and amounts to legal error.

#### **VIII. Interest on Memorandum Account**

CalAm requests that the Commission allow it to earn its authorized rate of return on preconstruction costs rather than interest at the 90-day commercial paper rate, as ordered by the Commission in D.03-09-022. CalAm states that the 90-day commercial paper rate represents only a fraction of its actual carrying costs and is impairing cash flow and increasing perceived risk on the part of investors because it is currently borrowing funds to pay for the interest on the project. CalAm contends that the difference also impacts financial statements because it is not recovered in rates, and this reduces earnings below the Commission-authorized level, which also creates perceived risk for investors. According to CalAm that increased perceived risk by investors leads to increased difficulty attracting capital and thus increased capital costs, which are ultimately

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<sup>7</sup> D.86-04-080, 1986 Cal. PUC LEXIS 276, \*6.

borne by ratepayers. And, while ratepayers would benefit from reduced carrying costs, CalAm is foregoing the opportunity for future earnings on these investments.

CalAm's request is opposed by DRA and intervenors. DRA argues that in denying CalAm's request previously, the Commission stated:

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 specialized CWIP ratemaking treatment offered to short duration water projects. In addition, the costs at issue here are predecessor cost 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. (D.03-09-022, pp. 21-22.)

We conclude that, as ordered in D.03-09-022, CalAm should continue to book preconstruction costs in an interest bearing memorandum account, which will accrue interest at the 90-day short-term 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 request by CalAm. In the meantime, we deny CalAm's request for the reasons stated in D.03-09-022.

#### **IX. Safeguards for Customer Contributions to Utility Plant**

DRA argues that CalAm has not addressed what it proposes to do with funds collected if the proposed surcharges are implemented now and the project eventually becomes a publicly owned plant. DRA points out that it is possible that the Commission could approve a regional publicly owned facility through

the CEQA process and could even consider PSMCSD's competing desalination project as an alternative project in the EIR evaluation.

Further, DRA takes issue with the fact that CalAm wants to recover costs from ratepayers now and require any public agency that may take over the project to compensate ratepayers for all of the preconstruction or construction costs ratepayers have paid for. According to DRA, the risk associated with the final ownership structure of the Coastal Water Project is a risk that should remain with CalAm's shareholders and not be transferred to ratepayers, given that negotiations will be largely within the purview of CalAm's management.

CalAm responds that the potential for a regional alternative does not create uncertainty about the Coastal Water Project, nor does it justify any delay in implementation of the proposed surcharges. CalAm argues that moving forward with the Coastal Water Project is the prudent and necessary course of action for CalAm. Failure to develop an alternative water supply source for the 10,730 acre-feet of water historically withdrawn from the Carmel River Aquifer would place CalAm and its customers at risk for millions of dollars in fines. Accordingly, CalAm has diligently pressed forward in developing its water supply solution.

CalAm argues that although the development of a regional project remains a possibility, it remains questionable at this point in time. According to CalAm, although Monterey County has expressed some interest in spearheading a regional project, it has not yet moved beyond the preliminary discussion stage. Similarly, PSMCSD has proposed a regional alternative, but has not provided evidence that its proposed project is viable and can meet the objectives and needs of CalAm with its proposed project. CalAm points out that the comparative analysis of the various water supply projects commissioned by MPWMD repeatedly notes the lack of substance and reliability in PSMCSD's proposal.

CalAm says it is open to the possibility of a regional project, but given its unique regulatory mandate to secure a long-term supply solution in its Monterey District, CalAm cannot wait for other parties to finalize their proposals.

According to CalAm, it has cooperated with MPWMD, Monterey County and other local government agencies in their exploration of the feasibility of a regional project that could serve the needs of water users other than the Company's customers. CalAm believes there are numerous ways that any such regional project could unfold, ranging from a public/private partnership for a regional project to the subsequent addition of components over time to the Coastal Water Project by participating government agencies to increase capacity to serve other parts of the Monterey area.

CalAm believes that both the proposed Coastal Water Project and the proposed surcharges provide it with the flexibility to adapt to an alternative proposal, including the implementation of one of the alternatives analyzed in CalAm's PEA. According to CalAm, if a regional project ever does come to fruition, future cost sharing could be adjusted to reflect the proper sharing of any costs recovered.

We agree DRA has a valid concern regarding compensation of ratepayers should a private corporation or a public agency take over the project. Also, we do not dispute that the least risky approach from the ratepayer perspective is to wait until the project is built and operational before allowing the cost into rates. But, as we have discussed above, that would be the most expensive approach and will exacerbate rate shock if the total project cost is included in rates at one time. Therefore, we conclude that the magnitude of the project cost, approximately \$191 million spread over 38,000 customers, requires some departure from standard ratemaking practice. We have carefully considered DRA's recommendation that the Commission should wait until the CPCN is

issued, all permits are obtained and construction has commenced before implementing any surcharge to ameliorate total project costs. While the DRA recommendation is certainly a step in the right direction, we believe another year (or more) should not be allowed to elapse before imposing the surcharge to collect preconstruction costs that have already been incurred and are accruing interest charges. As discussed above, funds for preconstruction costs will be collected in a memorandum account, and there will be timely reasonableness review of costs, thereby affording ratepayers protection against unreasonable expenditures.

Further, DRA proposes that ratepayer contributions to utility plant be subject to the same type of rules and procedures the Commission established in D.06-03-015 for government financed funds, such as grants and loans.

We believe DRA's recommendation is premature. If CalAm decides to transfer ownership of the project, it is required to file an application with the Commission for approval (Public Utilities Code Section 851). That would be the appropriate time to decide how ratepayers should be compensated for their contributions to the project, including the return of funds in the memorandum accounts collected pursuant to Special Request 1 and 2 Surcharges that have not been disbursed to CalAm following a reasonableness determination by the Commission. Accordingly, DRA's proposal is rejected at this time.

**X. Monterey County Health Code  
Section 10.72**

DRA claims that Monterey County Health Code Section 10.72 makes the Coastal Water Project uncertain because the local ordinance requires a desalination plant to be owned and operated by a public entity. CalAm responds that although it does not necessarily plan to challenge the ordinance in court, it believes that the ordinance is unenforceable because it conflicts with and is

preempted by state law. According to CalAm, there are three likely outcomes regarding the ordinance: (1) a public/private partnership will develop; (2) Monterey County will rescind the ordinance; or (3) if necessary, CalAm will challenge the ordinance in court. Nevertheless, CalAm says it will continue to cooperate with Monterey County and other local government agencies in their exploration of the feasibility of a regional project that could serve the needs of water users other than the Company's customers.

We agree that Section 10.72 must be addressed sooner or later, but at this time we are not persuaded that the issue creates a level of uncertainty sufficient to justify delaying implementation of the proposed surcharges.

In their comments on the proposed decision, citing Monterey County Health Code § 10.72, DRA and MPWD argue that it is legal error to require ratepayers to contribute to an "illegal project."

We note that the project, which has yet to be approved by the Commission, has not been declared illegal by any court. Also, the proposed decision sets out the steps to be taken by CalAm to address the Monterey County Health Code issue. We reject the assertions of DRA and MPWD.

## **XI. Surcharge Rate Design**

DRA recommends that the surcharges be structured as a volumetric charge on each unit of water rather than calculated as a percentage of the customer's bill as proposed by CalAm. DRA is concerned that there are inequities that need to be addressed in customers being charged different amounts for the same water usage.

CalAm opposes DRA's proposal, contending that its own proposal will maintain the per capita rates under which customers who consume more water will continue to pay more for increased usage.

We adopt CalAm's proposal for a flat rate percentage applied to the customer's bill because it is simple to understand and implement. Moreover, rate design for Monterey District is a controversial matter which belongs in the GRC proceeding. Accordingly, DRA's volumetric charge proposal is rejected.

## **XII. PAR Customer Rate Relief**

In its comments, DRA argues that the proposed decision violates Section 739.8(b) of the Public Utilities Code because it does not address the impacts of the proposed surcharges on PAR (Low-Income) customers in CalAm's Monterey District. This code section states:

739.8(a) Access to an adequate supply of healthful water is a basic necessity of human life, and shall be made available to all residents of California at an affordable cost.

(b) The commission shall consider and may implement programs to provide rate relief for lo-income ratepayers.

Currently, Monterey District PAR customers receive an exemption from the monthly service fee which varies from \$6.91 to \$10.36 for the smaller size meters. DRA recommends that, in addition, PAR customers receive a discount of one-half of the proposed surcharge percentage.

CalAm states that although PAR customers receive a significant discount in Monterey since they do not pay the monthly service fee, CalAm does not object to DRA's proposal. CalAm points out that the higher the subsidization for PAR customers, the more other customers have to pay to fund that subsidization.

We should observe that since PAR customers already receive the above discount which results in a lower bill compared to other customers, and the proposed new surcharges will be a percentage of the bill, PAR customers will actually pay a lower surcharge amount compared to other customers. Therefore, we conclude that the question of further relief for PAR customers should be

deferred to the next general rate case proceeding. DRA's recommendation is not adopted.

### **XIII. IRWUG Exemption from Surcharges**

IRWUG<sup>8</sup> seeks an exemption from the adopted surcharges for water used to irrigate golf courses located in the Del Monte Forest. According to IRWUG, the exemption is needed to prevent an inequity resulting from the contractual price Del Monte Forest golf courses<sup>9</sup> pay MPWMD for reclaimed water, which is being tied to the price of potable water supplied by CalAm.

IRWUG argues that the Del Monte Forest golf courses are not responsible for CalAm needing to build the Coastal Water Project, because they have spent millions of dollars to sponsor, build and purchase reclaimed water from the Carmel Area Wastewater District and the Monterey Peninsula Water Management District (CAWD/MPWMD) Water Reclamation Project (Monterey Reclamation Project). As a result, the Del Monte Forest golf courses have reduced their use of potable water by over 80% since 1994 (an average of 750 acre feet per year), and they will reduce their use of potable water for golf course irrigation to zero in September 2007, when an expansion of the Monterey

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<sup>8</sup> IRWUG is an unincorporated association of the Monterey Peninsula Country Club (Monterey Peninsula), the Cypress Hills Country Club (Cypress Hills), and the NCGA Poppy Hills Golf Course (Poppy Hills). The Pebble Beach Company is not a member of IRWUG.

<sup>9</sup> The Del Monte Forest golf courses include not only the three golf courses that make up IRWUG, but also the Pebble Beach Company. All four golf course owners are major participants in the Monterey Reclamation Project as large purchasers of reclaimed water. In addition, the Pebble Beach Company provided a financial guaranty for the revenue bonds MPWMD issued to finance the construction of the Water Reclamation Project. Those bonds are repaid with revenue from the sale of reclaimed water, most of which is purchased by the four Del Monte Forest golf courses.



Reclamation Project (Expansion Project) goes into service. Thereafter, all of their irrigation water needs will be met through the use of reclaimed water, replacing 100% of the Carmel River water previously supplied by CalAm.

Further, IRWUG points out that the Del Monte Forest golf courses have contributed significantly to CalAm's compliance with SWRCB Order 95-10, thereby providing important benefits to CalAm and all other CalAm ratepayers by preventing the imposition of financial penalties CalAm would have incurred if it exceeded the pumping limits imposed by the order.

IRWUG contends that the requested exemption will not unfairly shift costs to other CalAm ratepayers because the Del Monte Forest golf courses will no longer purchase potable water from CalAm for irrigation beginning in September 2007, when the Water Reclamation Expansion Project goes into service. IRWUG points out that as a result, even if the CalAm tariff for water furnished to the Del Monte Forest golf courses did include the surcharges, no additional revenue will be received by CalAm. Instead, the revenue would be paid to the Monterey Reclamation Project as part of the golf courses' purchase of reclaimed water.

In its comments on the proposed decision, MPWMD states that it will work with IRWUG and the Pebble Beach Company to modify the language in the Agreements for Sale of Recycled Water so that the Special Request 1 and 2 Surcharges are not part of the cost of reclaimed water.

We commend MPWMD for offering to address this matter. This is a contract issue which should be resolved by the parties. Hopefully, the parties will reach agreement. Therefore, we deny IRWUG's request for a special tariff exempting the golf courses from the Special Request 1 and 2 Surcharges.

#### **XIV. Future Review of Project Costs**

We believe that for the next few years, at least, the Commission's review of costs related to the Coastal Water Project, or alternative supply solution, should remain outside the GRC process. The reason is that the processing of GRC's for Class A water companies is on a fixed schedule, which precludes sufficient time to properly evaluate final project costs and proposed recovery mechanisms. Therefore, we agree with DRA that the Coastal Water Project, or alternative supply solution, is too important and complex a matter to be considered as part of a GRC proceeding. We will review project costs through 2007 for reasonableness each year in accordance with the schedule set forth in the ordering paragraphs below.

#### **XV. Comments on Proposed Decision**

The proposed decision of ALJ Patrick in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and Rule 14.2(a) of the Commission's Rules of Practice and Procedure. Comments were filed by CalAm, DRA, IRWUG, and MPWMD. Reply comments were filed by CalAm, IRWUG and MPWMD.

In response to the comments, we have made several clarifications and corrections to the proposed decision where appropriate.

#### **XVI. Assignment of Proceeding**

Michael R. Peevey is the assigned Commissioner and Bertram D. Patrick is the assigned ALJ in this proceeding.

#### **Findings of Fact**

1. The Coastal Water Project or an alternative water supply source is needed for CalAm to comply with SWRCB Order 95-10.

2. The SWRCB Order 95-10 requires CalAm to develop and implement a plan to replace 10,730 acre feet per year of water it historically diverted from the Carmel Valley Aquifer.

3. The 10,730 acre feet per year of water to be replaced amounts to approximately 69% of CalAm's water supply for its Monterey District.

4. In August 2002 the Commission issued its long-term contingency plan (commonly referred to as Plan B) recommending the construction of a desalination facility and ASR project for the Monterey District.

5. As directed by the Commission in D.03-09-022, CalAm filed the instant A.04-09-019 and undertook steps to proceed with the Coastal Water Project to comply with the SWRCB Order 95-10 and the Endangered Species Act.

6. The Coastal Water Project, which is currently estimated to cost \$191 million, could produce a near doubling of current rates.

7. For purposes of mitigating the rate impact of the Coastal Water Project, CalAm proposes a Special Request 1 Surcharge to recover preconstruction costs, and a Special Request 2 Surcharge to pre-collect revenue to offset the cost of the Coastal Water Project, or alternative supply solution.

8. Interest charges are accruing on \$8.7 million in preconstruction costs incurred through 2005. Also interest charges will be accruing on 2006 and 2007 preconstruction costs, thereby increasing overall project cost and contributing to rate shock.

9. If the estimated \$191 million in project costs is implemented in rates at one time after the project is completed, rates will nearly double, thereby causing rate shock to customers.

10. CalAm requests recovery of \$8,663,334 in preconstruction costs incurred through 2005. This amount comprises: (1) \$5,670,073 for engineering and

environmental costs; (2) 1,353,831 in public outreach costs; and (3) 1,639,429 for other costs.

11. DRA recommends: (1) recovery of engineering and environmental costs be deferred until it hires a consultant to assist DRA in its review; (2) recovery of public outreach costs be no more than \$160,000; and, (3) other costs of \$1,639,429 be approved for recovery after a CPCN is issued.

12. IRWUG seeks a limited exemption from the surcharges for golf course irrigation water supplied by CalAm to Del Monte Forest golf courses, which include the Pebble Beach Company, the Monterey Peninsula Country Club, the Cypress Hills Country Club, and the NCGA Poppy Hills Golf Course.

13. Beginning September 2007, Del Monte Forest golf courses do not expect to use CalAm water for golf course irrigation after the Water Reclamation Expansion Project goes into service.

14. IRWUG seeks an exemption from the surcharges because the price Del Monte Forest golf courses pay MPWMD for reclaimed water is tied to the price paid to CalAm for potable water, and being subject to the surcharges as part of the CalAm tariff rate will significantly increase the cost of reclaimed water used to irrigate the golf courses.

15. Since the proposed new surcharges will be a percentage of the customer's bill, and the PAR customer already receives a lower bill on account of being exempt from the customer charge, PAR customers will pay lower surcharge amounts.

### **Conclusions of Law**

1. CalAm's need to comply with the SWRCB Order 95-10 and the estimated \$191 million cost of a project to comply with that order creates special circumstances warranting a departure from standard rate making practice, which

allows project costs to be included in rates only after the project is found to be “used and useful.”

2. It is in the public interest to implement CalAm’s proposed Special Request 1 Surcharge effective January 1, 2007, because it will reduce overall project cost and help reduce rate shock.

3. To allow for a more gradual ramping-up of rates, implementation of Special Request 2 Surcharge should not coincide with the implementation of the Special Request 1 Surcharge.

4. Given that Monterey District customers will experience a significant GRC rate increase in January 2007 in addition to the Special Request 1 Surcharge, implementation of the Special Request 2 Surcharge should be deferred to coincide with issuance of the CPCN for the Coastal Water Project, or alternative supply solution.

5. The reasonableness of the \$5,670,073 requested for engineering and environmental costs through 2005, should be addressed in hearings to be scheduled for 2007. These costs should remain in the memorandum account until the reasonableness review has been completed.

6. The \$1,353,831 in costs expended for public outreach through 2005 are found to be reasonable, and CalAm should be authorized to recover this amount booked in the memorandum account.

7. The \$1,639,429 in other costs expended through 2005 are found to be reasonable and CalAm should be authorized to recover this amount booked in the memorandum account.

8. CalAm’s request to be allowed to earn its authorized rate of return on preconstruction costs booked in its memorandum account should be denied for the reason that it remains unclear at this time when (or whether) any plant construction will commence. All preconstruction costs should be booked in an

interest bearing memorandum account and accrue interest at the 90-day short term commercial rate.

9. DRA should be authorized to extend its consultant's Phase II contract to assist DRA in its review of CalAm's engineering and environmental costs incurred through 2005, and in 2006 and 2007.

10. CalAm should be required to issue its report on reasonableness of 2006 preconstruction costs no later than March 30, 2007.

11. CalAm should be required to issue its report on reasonableness of 2007 preconstruction costs no later than March 30, 2008.

12. DRA should be required to issue its report on reasonableness of CalAm's engineering and environmental costs through 2005, no later than June 30, 2007, for hearing and decision by year-end 2007.

13. DRA should be required to issue its report on reasonableness of CalAm's 2006 and 2007 preconstruction expenses no later than June 30, 2007 and June 30, 2008, for hearing and decision by year-end 2007 and 2008, respectively.

14. IRWUG's request for a special tariff for golf course irrigation water should be denied because this is a contract matter which should be resolved between IRWUG, MPWMD, and the Pebble Beach Company.

15. CalAm should be authorized to file tariff sheets to implement the Special Request 1 Surcharge effective January 1, 2007.

16. CalAm should be authorized to file tariff sheets to implement the Special Request 2 Surcharge after a CPCN is issued for the Coastal Water Project or alternative supply solution.

17. Collection of the Special Request 1 Surcharge should cease after all preconstruction costs are recovered.

18. Collection of the Special Request 2 Surcharge should cease after the project adopted by the Commission, to provide a long-term supply solution to the Monterey District, is completed.

19. Since PAR customers will pay lower surcharge amounts compared to other customers, Pub. Util. Code § 739.8(b) has been complied with.

## **O R D E R**

### **IT IS ORDERED** that:

1. California-American Water Company (CalAm) is authorized to implement the proposed Special Request 1 Surcharge commencing January 1, 2007. Initially, the surcharge shall be 4%, then beginning July 1, 2007, shall increase to 7%. Beginning January 1, 2008, the surcharge shall increase to 10% and remain in place until the full amount authorized for preconstruction costs is collected.

2. CalAm is authorized to implement the proposed Special Request 2 Surcharge after the Commission issues a Certificate of Public Convenience and Necessity (CPCN) for the Coastal Water Project, or alternative long-term supply solution, in Phase II of this proceeding. Initially, the surcharge shall be 15%, increasing to 30%, 45%, and 60%, respectively, on January 1 and July 1 of each year, and shall continue at the 60% level until the project is completed.

3. The Division of Ratepayer Advocates (DRA) is authorized to hire a consultant to assist in the review of CalAm's engineering and environmental costs through 2005, 2006, and 2007. The cost of the consultant shall be reimbursed by CalAm and be charged to project costs.

4. DRA's request that the reasonableness review of CalAm's engineering and environmental costs through 2005 be deferred until its consultant has had the opportunity to review these costs is granted.

5. DRA shall issue its report on the reasonableness of CalAm's engineering and environmental costs through 2005, no later than June 30, 2007.

6. CalAm shall issue its report on the reasonableness of its 2006 preconstruction costs no later than March 31, 2007. DRA shall issue its report on these costs no later than June 30, 2007. Thereafter, the assigned Administrative Law Judge (ALJ) shall convene a prehearing conference and hold hearings so that a proposed decision is issued on the reasonableness of CalAm's engineering and environmental costs through 2005, and preconstruction costs for 2006, before year-end 2007.

7. CalAm shall file a new application and issue its report on the reasonableness of its 2007 preconstruction costs, no later than March 31, 2008. DRA shall issue its report on these costs no later than June 30, 2008. Thereafter, the ALJ shall convene a prehearing conference and hold hearings so that a proposed decision on the reasonableness of 2007 preconstruction costs is issued before year-end 2008.

8. As part of the above reasonableness reviews, the adopted surcharges shall be reviewed and adjustments made, as necessary.

9. As discussed herein, CalAm is authorized to recover through the memorandum account \$1,353,831 in public outreach costs and \$1,639,429 in other costs, incurred through 2005.

10. CalAm is authorized to file new tariffs to implement the Special Request 1 Surcharge to commence on, or after, January 1, 2007. The tariff shall become effective following approval by Water Branch.

11. CalAm is authorized to file new tariffs to implement the Special Request 2 Surcharge to commence after a CPCN is issued for the Coastal Water Project, or alternative supply solution, in Phase II of this proceeding.



12. IRWUG's request for a special tariff for golf course irrigation water is denied.

13. Phase I of this proceeding shall remain open for purposes of reviewing the reasonableness of CalAm's engineering and environmental costs through 2005, and preconstruction costs for 2006 and 2007.

14. Phase II of this proceeding shall remain open to select a long-term water supply solution for Monterey District and approve the Environmental Impact Report currently under preparation.

This order is effective today.

Dated December 14, 2006, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
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**\*\*\*\*\* SERVICE LIST \*\*\*\*\***

**Last Update on 11-OCT-2006 by: LIL  
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**(END OF APPENDIX A)**