

Decision 90-10-036 October 12, 1990

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the 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.)

Application 89-11-036
(Filed November 30, 1989)

Messrs. Steefel, Levitt & Weiss, by Lenard G. Weiss, Attorney at Law, for California-American Water Company, applicant.

Randy Benthin, for California Department of Fish & Game; William F. Hurst, for Monterey County Flood Control & Water Conservation District; Messrs. De Lay & Laredo, by David C. Laredo, Attorney at Law, for Monterey Peninsula Water Management District; and Alan Williams, for himself and Clint Eastwood; interested parties.

Lawrence O. Garcia, Attorney at Law, and Arthur A. Mangold, for the Commission Advisory and Compliance Division.

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O P I N I O N

Summary of Decision

This decision authorizes California-American Water Company (Cal-Am) to increase rates for water service provided in its Monterey District. Increased revenues will be used to pay for expenses incurred by the company for studies performed in connection with the resolution of a longstanding long-term water shortage problem besetting the Monterey Peninsula. The decision allows \$1,534,231 in expenses, to be amortized over five years with interest on unamortized amounts at the 90-day commercial paper rate. The decision disallows \$307,788 in expenses incurred between 1973 and 1986 on the basis of their not being timely sought, and \$10,000 in public relations expenses. The company is also advised that it should not expect to receive authority to increase rates to offset expenses for further studies concerning this long-term water shortage problem, unless specifically directed by the Commission to conduct such studies. This is because the Monterey Peninsula Water Management District (The District), an agency created by the California Legislature, is the agency primarily charged with remedying those long-term problems.

The Application

By this application Cal-Am requests increases in rates for water service in its Monterey District. Increases would be used to recover costs associated with certain studies related to a proposed long-term water supply project known as the Canada Offstream Storage Reservoir Project (Canada project).

Proposed increases would produce new revenues amounting annually to \$234,000, or 1.52% over current revenues. In its application, the utility stated that costs incurred up to that time had, or would, by June 1990, amount to \$1,585,788. However, responses to data requests show that such expenditures would have increased by September 1990 to \$1,945,176. Cal-Am requests rate

base offset or, alternatively, amortized expense treatment of these costs.

A prehearing conference was held on the application in Monterey on February 13, 1990. A Public Participation Hearing (PPH) was conducted on April 16, followed immediately by four days of evidentiary hearing in Seaside before Administrative Law Judge (ALJ) John Lemke. The matter was submitted with the filing of concurrent briefs on June 4, 1990. Briefs were filed by Cal-Am, by The District, and by the Commission's Water Utilities Branch (Branch).

Background

Cal-Am acquired its Monterey District in 1966. The district's two dams and reservoirs are old and very small. San Clemente Dam was built on the Carmel River in 1923, and has a present capacity of 611 acre-feet (AF). Los Padres Dam was built in 1947, and can store 1,967 AF. Since the 1950s the need for additional long-term has been universally acknowledged, but efforts to achieve this additional capacity have been unsuccessful. In the meantime, two major droughts have occurred: the 1976-77 drought, until now the most severe on record; and the current drought which started in 1986 and appears likely to continue through the fall of 1990.

During the 1970s and the pendency of Case 9530, an investigation into the need to augment the water supply in its Monterey district, Cal-Am expended over \$10 million to develop about 5000 AF of new water supply through the establishment of new wells and other sources of supply and related treatment, storage and distribution facilities. Today, Cal-Am's Monterey District continues to experience severe shortages, with its customers subjected to the second consecutive year of 20% rationing in spite of an exceptional history of successful water conservation. Further, the area remains subject to a modified construction moratorium.

A number of studies and activities were undertaken for the purpose of developing additional water supply, e.g., a new San Clemente Dam, a new Los Padres Dam, new wells and a feasibility study exploring the construction of a desalination plant. The District was created in 1977. The District's goals were intended to fulfill three purposes - fishery enrichment, enhancement of the Carmel River environment, and water supply. On the other hand, Cal-Am's Canada project has focused on the single objective of water supply. Subsequently, The District changed the purpose of its long-term supplementary water supply investigation from a multi-purpose goal (fishery enhancement, Carmel River enhancement, and water supply) to a single water supply goal. On March 2, 1989, the Canada project became one of The District's alternatives to be analyzed in its environmental report process.

The District's changed focus led to a conflict between it and Cal-Am on the question of lead agency status for environmental analysis of the Canada project. Currently, the Monterey County Flood Control and Water Conservation District (Flood Control District) and The District would both like to assume the role of lead agency. If Cal-Am were to pursue an independent Environmental Impact Report (EIR), The District believes it would be wasteful and cause delay. The District requests of the Commission that it require a single EIR to be prepared, consistent with The District's authority as the principal water planner on the Monterey Peninsula. Cal-Am states that if The District is selected as the lead agency, Cal-Am's role in performing the environmental impact report EIR would be suspended.

Public Participation Hearings

PPHs were conducted during the morning and evening of April 16 in Seaside. About 10 persons attended each session, expressing concerns principally about the possible duplication of efforts and costs by Cal-Am and The District as to the Canada project, and the passing on of these duplicate costs for studies

and EIR's to the residents of the Monterey Peninsula. One customer expressed concern over the increase in service charges as a result of this proceeding, and the impact thereof upon customers on fixed incomes. A representative of a builder's exchange spoke in support of the application, and a concerned citizen recommended granting inclusion of 91% of the study costs in rate base, said amount purportedly representing the total cost reimbursement, less profit.

Issues

The issues involved in this proceeding concern (1) the amount of expenses incurred by Cal-Am which may be recovered through increased rates, (2) the duplication or "separate track" issue, and Branch's request for limitations on Cal-Am's efforts to develop a new long term supply for its Monterey District, and (3) rate design.

I. Expenses

Branch Position

The expenses sought by Cal-Am are summarized in Branch witness Arthur Mangold's Exhibit 11, (page 4) and are as follows:

Expenditures

<u>Period</u>	<u>Application</u>	<u>Response To Data Request</u>
Prior to 1989	\$ 307,788	\$ 307,788
Subtotal	\$ 307,788	\$ 307,788
From May 1989 to October 31, 1989	\$ 262,914	-
From November 1, 1989 to June 1990	\$1,015,086	-
From May 1989 to January 31, 1990	-	\$ 527,070
From Feb 1, 1990 to June 30, 1990	-	\$ 543,090
From July 1, 1990 to Sep 30, 1990	-	\$ 567,228
Subtotal	\$1,278,000	\$1,637,388
Total	\$1,585,788	\$1,945,176

1. Pre-1989 Expenses

As indicated, Cal-Am seeks to recover \$307,788 for various expenses incurred prior to 1989 including:

- a. \$146,066 incurred May 1973 to July 1974 for geophysical explorations of a future dam;
- b. \$9,319 incurred during the period January 1980 to November 1981 for offstream storage study; and,
- c. \$152,403 incurred between 1982 and 1987 for studies of a New San Clemente Dam.

With respect to the expenditures of \$146,066 in connection with the geophysical exploration of a future damsite, Branch argues that if Cal-Am believed they were reasonable, it should have brought them to the attention of the Commission in general rate cases (GRC) nearer in time to the actual expenditures. Branch states it is in fact possible that Cal-Am did so and that the Commission either authorized rates based on estimates of those expenditures or found them to be unreasonable for ratemaking purposes.

Branch similarly believes that the expenditures of \$9,319 for the Carmel River offstream storage study made during 1980 and 1981 should, and may have been, considered in a GRC closer to the time they were incurred.

Regarding the \$152,403 incurred in connection with the study between 1982 and 1987 for the New San Clemente Dam, Branch also believes that these expenses should have been brought to the attention of the Commission earlier. Further, Branch argues that the New San Clemente Dam is an alternative investigated in great detail by The District, that the further investigation by Cal-Am was an unnecessary duplication, and that much of this cost is for legal services not shown to have been reasonably incurred for purposes of this proceeding, i.e., relief for expenditures related specifically to the proposed Canada project.

2. Expenditures from May 1989 to September 30, 1990

Cal-Am's latest estimate of \$1,637,388 for total expenditures from May 1989 forward exceeds its estimate of \$1,278,000 submitted with the application, because the time for the project has been extended from June 1990 to the end of September 1990.

Branch separated these expenditures into two categories: those it deems closely related to the development of the Canada project, and those considered more useful for comparison with alternative projects. Mangold testified that the objective of the latter comparisons is to find the best long term solution to the company's water supply problem. He recommends that expenditures for comparisons, if reasonable, be expensed. For expenditures serving both the development and comparison functions, Mangold has made equal allocations to each.

The estimates of expenditures from May 1989 to September 1990 are itemized in Mangold's Exhibit 11 as follows:

	<u>Comparison of Alternatives</u>	<u>Canada Project Development</u>	<u>Total</u>
1. Project Management	\$ 102,500	\$ 102,500	\$ 205,000
2. Conceptual Study	12,418	-	12,418
3. Preliminary Environmental Assessment	104,470	-	104,470
4. Project feasibility Environmental Assessment	125,000	125,000	250,000
5. Phase 1A Engineering Feasibility	114,000	114,000	228,000
6. Phase 1 Hydrologic Evaluation	8,240	32,960	41,200
7. Phase 1B Geotechnical Investigation	84,100	84,100	168,200
8. Sediment Transport Investigation	-	200,000	200,000
9. Phase 2 Engineering Feasibility	-	244,100	244,100
10. Public Relations Consultant	5,000	5,000	10,000
11. Rate Recovery Coordination	50,000	50,000	100,000
12. Interest	-	74,000	74,000
Total	\$ 605,728	\$1,031,660	\$1,637,388

Branch notes that the Canada project is one of several competing new long-term supply alternatives; that if the project is eventually developed, it is probable that it will be publicly owned. Financing plans are currently being investigated by both The District and the Flood Control District.

Branch believes that some, but not all, of the expenditures were and will have been prudently incurred by Cal-Am in fulfilling its obligations as a public utility. It believes those expenditures are useful in elevating Canada project to the status of a feasible project in The District's on-going Water Supply Project, the vehicle through which it hopes to develop a major new long-term supply. Branch recommends that those

expenditures, amounting to \$427,570, be expensed and spread over five years. The resultant annual rate increase would be \$85,510 (0.46%). Branch believes it is premature to include in rate base expenditures directly related to project development, and recommends that most of such expenditures continue to be held in a deferred debit account. Branch also recommends that no further studies on the Canada project be undertaken by Cal-Am without Commission approval.

Mangold testified that the Preliminary Environmental Assessment (Item 3) concentrated on technical baseline data and field investigation in response to The District's request for information for their EIR/Environmental Impact Statement (EIS). The study proposal, which included Item 3 as Phase 1a, also included a Phase 1b in the amount of \$46,394. Phase 1a, Mangold states, was authorized by a purchase order dated June 2, 1989. Phase 1b was not done as proposed; rather, Cal-Am decided to expand the scope of its investigation to project feasibility. A purchase order for the expanded environmental feasibility study was issued on August 16, 1989 in the amount of \$195,000. On February 1, 1990 the estimate was increased to \$250,000 (Item 4). Mangold believes that the expansion of Cal-Am's efforts to project feasibility requires that a distinction be made between expenditures which should be capitalized or expensed. For that reason, he has separated expenditures.

In explaining his separations, Mangold testified essentially as follows:

Item 1 expenditures through January 31, 1990 amounting to \$128,707 were almost entirely for American Water Works Service Company charges. Smaller amounts were for other consultants, payroll, and miscellaneous expenses. To the extent current rates are based on projections of historic expenses for payroll and outside services employed, further rate relief is not warranted. Consideration of Item 1 should be deferred to the next GRC when those accounts will be analyzed.

Cal-Am and the land owners who proposed the Canada project shared equally the cost of an early seismic study. Item 2 represents Cal-Am's share. The study was undertaken to test the validity of what was assumed to be The District's reason for never seriously considering a reservoir at the Canada site, i.e. seismicity. It has not been demonstrated that seismicity was the reason The District did not consider that alternative. The value of the Item 2 seismic testing has not been shown. More detailed seismic studies have been done in connection with both the environmental assessment and engineering feasibility. Item 2 should be excluded for ratemaking purposes.

Item 3, and one-half of Items 4, 5 and 7 involved unusual expenditures; Cal-Am should be authorized to charge these, amounting to \$427,570, to Administrative and General Expenses Account 798, Outside Services Employed, and to recover the expenses in rates. The expenses should be spread over five years.

The initial expenditures for Item 6, involving the Carmel Valley Simulation Model (CVSIM) were required to rectify errors made in studies included in Item 3. The consultant for Item 6, Brown and Caldwell, observed:

"An important aspect of evaluating the feasibility of the Canada Reservoir project is determining the incremental yield that the facility would provide. Unless the project will add significant benefit in terms of water supply to the Cal-Am system, it is not worth constructing. Incremental and system yields have been previously estimated... However, in our opinion, (the estimate) does not accurately reflect the true system behavior."

The consultant went on to say,

"An initial set of 10 runs...will define some of the system extremes. . . . Our conclusions from this initial set of runs will be presented in our Phase 1A report. The remaining runs would be made during Phase 2 of our feasibility study."

The purchase order for Item 6 was dated January 30, 1990. Two earlier purchase orders were issued for services of Brown and Caldwell. The amount for Item 5 was that given in Brown and Caldwell's original proposal. For Item 7, Cal-Am's service company requested extra work which caused the amount to be higher than in the proposal. Item 6, on the other hand, was not in the proposal because the work was assumed to have been done satisfactorily. The extra work represented by Item 6 should not be charged to ratepayers.

Item 10, amounting to \$10,000 for a public relations consultant, should be excluded for ratemaking purposes. Cal-Am has met its responsibility by elevating Canada project to the status of an alternative being considered by The District. Cal-Am's customers are well aware of the water problems affecting them, and will not benefit from further promotional efforts.

Item 11, amounting to \$100,000 is an Administrative and General expense (Regulatory Commission Expense and/or Outside Services Employed); to the extent that the rates adopted in Decision 89-02-067 (the last GRC) for Monterey District are based on historic projections of those expenses, further rate relief is not warranted. Item 11 should be deferred until the next GRC when that relationship can be analyzed. Expenditures through January 31, 1990 for Item 11 were \$20,521.

Mangold urges that Item 12 be excluded for ratemaking purposes. If and when the Canada project is eligible to be transferred from a Deferred Debit to Construction Work in Progress, it may be reasonable to include Item 12 in rate base or to accrue an allowance for funds used during construction. If the Commission does not adopt this recommendation, and decides that the deferred debit should accrue interest, Mangold recommends that such interest be allowed at the 3-month commercial paper rate published monthly by the Federal Reserve Board.

Inclusion of Expenditures in Rate Base

Mangold maintains that the fundamental criteria for inclusion of expenditures in rate base are that they be for utility plant owned by the utility, and will be used and useful in the near future. He notes that the Canada project is only one of several being considered for the Monterey peninsula; that only one project will be developed, and that may or may not be the Canada project. If the Canada project is eventually constructed and becomes used and useful, there are reasons not to include "pre-project study costs" in rate base, the witness asserts. For example, it is not known whether, or to what extent, Cal-Am would hold title to the project facilities. It is likely that such facilities, if constructed, will be publicly owned. Expenditures for a project not owned by a utility should not be included in its rate base.

Mangold suggests that if eventually Cal-Am has some share in ownership of the project, it would be reasonable that current expenditures for project development be included in plant accounts and rate base. But he believes it is premature to include those expenditures in rate base at this time, and recommends that the project development expenditures continue to be carried as Deferred Debits in Account 142 - Preliminary Survey and Investigation Charges. These expenditures are those incurred for one-half of Items 1, 4 and 5, \$32,960 of Item 6, and the entire amounts for Items 8 and 9. The total amount is \$902,660. Of that amount, about \$451,000 will have been expended after June 30, 1990. Mangold believes it unlikely that the Canada project will be on-stream in the near future.

Mangold finally recommends that Cal-Am be ordered not to undertake any further studies of the Canada project other than those shown in the above tabulation, until the project is approved for construction, unless a proposed study is specifically authorized by the Commission. Further, he urges that expenditures for current studies be capped at the amounts shown in that

tabulation, in order that the project not degenerate into a financial sinkhole.

Rate Impact

Under the staff recommendation, \$427,570 of expenses will be included in rates and spread over five years. Annual increases will be \$85,510, or 0.46%. About 38% of Cal-Am's fixed costs are presently recovered through service charges. Because the Commission's rate design policy allows 50% of fixed costs to be recovered through service charges, Branch recommends that whatever increase is authorized be recovered therefrom.

Cal-Am Evidence Regarding Pre-1989 Expenses

Concerning the pre-1989 expenses, Cal-Am responded to Mangold's testimony through the testimony of witnesses Larry Foy, its Vice President and Division Manager, and John Barker, the company's Regional Financial Manager and Secretary-Treasurer. Barker stated that the utility understood by Commission directives in Case (C.) 9530 that it was to investigate future sources of supply, and that the Commission had not fixed a particular amount which could be spent by Cal-Am for this purpose.

Cal-Am argues that these studies and related expenses were undertaken as part of the company's obligation to assure adequate water supply to its customers, as required pursuant to orders in C.9530. (Decision (D.) 84527, dated June 10, 1975, among others, directed that "...California American Water Company shall file status reports on its program in augmenting the intermediate and long range water requirements of its Monterey District.") John Barker testified that it has been Cal-Am's expectation that since there was no cap placed by the Commission on the amount of expenditures for such studies, the prudence thereof would be examined later. Foy stated that \$140,453 of the \$146,066 for geographical exploration went to its consultant, Kennedy Engineers, during the period 1973-1974 to perform studies regarding the San Clemente Dam, which studies have been shared with The District. He

stated that the \$9,319 expense incurred during 1980-1981 was for engineering studies of various offstream storage sites, but that the concept was deferred because of The District's proposed onstream project. He also testified that the \$152,403 was primarily for legal expense incurred in working with The District, meetings with their staff, meeting with the Department of Fish and Game, and other agencies regarding the new San Clemente Dam being studied by The District during 1984-1986. .

Cal-Am maintains that such deferrals are standard practice for expenses which give rise to potential rate base treatment when and if a project results. The utility refers us to Uniform System of Accounts, Section 142. The company insists that the entire \$307,788 in pre-1989 expenses has to date been accounted for exactly as Branch recommends it should account for its Canada-related project development expenses.

Barker testified that the primary reason Cal-Am has filed this application is the magnitude of the expenditures for the study. He observed that the company will sometimes undergo much smaller studies and request rate approval during the next GRC; but in this case, it was felt they were dealing with over \$1.5 million, a substantial amount to have at risk not knowing whether the outcome would be to allow the company to earn on those funds, or amortize them. He stated that if Branch's recommendation that a substantial portion of this request be put into a deferred debit account is adopted, it is Cal-Am's position that such action would probably kill the project.

Discussion of Pre-1989 Expenses

In support of its recommendation that the pre-1989 expenses be disallowed, Branch refers us to D.79873 dated April 4, 1972 in Application 52794 (73 CPUC 222, 230 - P. T. & T. Co. request to increase rates to offset labor increases). In that decision the Commission stated:

"The basic concept of a test year is to establish the relationships between revenues,

expenses and rate base that are indicative of the operations to be expected when the new rates are in effect. The passage of a few weeks or months does not invalidate a test year, provided known significant changes during that short interval are given recognition by means of suitable modifications to the test year results.

"Most of the arguments presented against the use of a 1970 test year were based upon the elapsed time from the test year to the date any revised rates would become effective, but at one point the Cities of Los Angeles and San Diego advocated going back still farther to a 1967 test year. Although we consider 1970 to be recent enough, it is not appropriate to go back another three years."

Some of the pre-1989 expenditures are stale by any definition, particularly those incurred in 1973-1974, and even those in the early 1980s. But their accuracy is not impugned. Other parties, such as The District, do not oppose our granting the application, and even allowance of the increases. A question of fairness is involved in this issue of "rusted" expenditures, because the company apparently incurred some of them in response to directives contained in C.9530 decisions. For example, Ordering Paragraph 12 of D.84527 dated June 10, 1975 ordered Cal-Am to "...file status reports on its progress in augmenting the intermediate term and long-term water requirements of its Monterey District." Of those expenses incurred after 1981, totaling \$152,403 for the New San Clemente Dam study, about \$102,000 was spent in 1984, and almost \$33,000 in 1985. A little over \$8,100 was spent in 1986. There is no question about the prudence of the expenditures except by Branch in its assertion that some of the expenses have been for studies also performed by The District.

On the other hand, in equity the doctrine of laches proclaims the maxim: "Equity aids the vigilant." Those who sleep on their rights are likely to lose them. After consideration, we

believe that the pre-1989 expenditures are simply too old to be recovered at this late date. The utility's revenue needs have been examined several times since these expenses were incurred, and rate relief granted based upon then current revenue requirements. The likelihood expenses have been considered, if not specifically included in past GRC's, is too great for us to authorize their separate recovery now.

Cal-Am should have sought recovery of the pre-1989 expenses at an earlier date. Such action would have obviated the need for unnecessarily complicating this proceeding, and likely resulted in recovery thereof at that time. Should similar circumstances arise hereafter, the company is urged to seek recovery of appropriate expenses as soon as practicable.

Post-1989 Expenses - Cal-Am Evidence and Discussion

Branch recommends allowance of \$427,570 of expenses to be recovered in rates, spread over five years, for an annual increase of \$85,510 or 0.46%. The specific expenses Branch recommends be allowed are set forth in Exhibit 11 and described above. The dispute between Cal-Am and Branch is \$1,158,218 based upon Cal-Am's original filing (\$1,585,788 less \$427,570) or \$1,517,606 based upon Cal-Am's updated figures submitted in response to Branch's data requests (\$1,945,176 less \$427,570).

Cal-Am takes exception to Mangold's division of the 1989-and-later expenditures: those closely related to development of the Canada project (to be deferred) and those more useful for comparison with alternative projects (to be allowed).

Mangold testified that "...to the extent that it (Cal-Am) was doing generic-type studies and not committed to a particular project, I think it's reasonable that some of those expenditures should be expensed at this time."

Cal-Am maintains that its entire undertaking from the outset has been to do a step-by-step analysis of the environmental, engineering and economic feasibility of a possible Canada offstream

storage site. The entire process, it contends, is staged so that it can be halted without further expense if at any point it proves infeasible, or a "fatal flaw" appears in the feasibility studies.

Cal-Am insists that it has focused on the Canada site from the outset and throughout the process; that there has been no transition from baseline data to project feasibility, as Branch suggests. A transition will in fact occur, the utility asserts, only if the Canada project is found feasible and Cal-Am then reaches the EIR/EIS preparation and design phases. Cal-Am has clearly stated that it would come to the Commission for a certificate of public convenience and necessity before it designs a project. In other words, Cal-Am has not determined that it will build the Canada project, and its request here is to recover costs only for feasibility studies. Whether the project is feasible will not be known until after Cal-Am's consultants complete the Phase 2 studies this fall. If feasible, how the Canada project will be handled through the environmental process - whether by one EIR/EIS with The District, or by two separate ones - and who will finance, build, and own the project are unknowns until the overall engineering, environmental, and economic feasibility of the project is determined. These latter issues would apparently be the subjects of a further proceeding before this Commission either in a GRC, or, more likely, in a separate matter involving the issuance of a certificate of public convenience and necessity.

The District argues that Cal-Am should not be allowed to proceed with an independent EIR/EIS on the Canada project. However, The District and Branch both concede that the Canada project is an alternative being considered today only because of the independent actions of Cal-Am, and that having revived the project as a potential alternative to be considered, The District must now have the work Cal-Am is doing to complete its own EIR.

The following is a recapitulation of Branch's recommendations regarding the 12 items being sought by Cal-Am, in addition to the \$307,788 requested for pre-1989 expenses:

<u>Item</u>	<u>Description</u>	<u>Staff Recommendation</u>
1.	Project Management (\$205,000)	Defer to next GRC
2.	Conceptual Study - Original Grice Report (\$12,418)	Disallow
3.	Preliminary Environmental Assessment (Phase 1A) (\$150,196)	Allow in full
4.	Project Feasibility Environmental Assessment (Duffy Report) (\$263,485)	Allow half; balance to deferred debit account
5.	Phase 1A Engineering Feasibility (Brown & Caldwell) (\$268,261)	Allow half; balance to deferred debit account
6.	Phase 1 Hydrologic Evaluation (B&C) (\$41,200)	Disallow
7.	Phase 1B Geotechnical Investi- gation (B&C) (\$215,888)	Allow half; balance to deferred debit account
8.	Sediment Transport Investigation (B&C) (\$200,000)	All to deferred debit account
9.	Phase 2 Engineering Feasibility (B&C) (\$244,100)	All to deferred debit account
10.	Public Relations Consultant (\$10,000)	Disallow
11.	Rate Recovery Coordination (\$100,000)	Defer to next GRC
12.	Interest (\$74,000)	Disallow

Cal-Am comments as follows with respect to each of these items:

Item 1, Project Management, and Item 11, Rate Recovery Coordination. Branch urges that each of these items be deferred to the company's next GRC. Branch believes those expenses may be covered already in Cal-Am's present rates by Cal-Am's projections of historical expenses for payroll and outside and regulatory expenses. However, the Branch witness conceded that he did not examine the utility's request for regulatory commission expense in its last GRC, and that his comments were generic rather than specific to Cal-Am. Cal-Am witness Close testified that Item 11

expenses were not included in the company's last GRC. Since the Canada project was not contemplated at the time of the last GRC, Item 1 could not have been considered. Witness Barker, the company's chief financial officer, stated that he researched this specific overlap issue after it was raised during the hearing. He found, with respect to Item 1, that there could be a maximum possible \$19,157 of Service Company payroll from the last rate case. To assure that there is absolutely no possible duplication, Cal-Am has deducted that sum from this request. Barker stated that no other duplication regarding Item 1 could possibly exist,

Regarding Item 11, Barker testified that Cal-Am estimates its regulatory expense on a rate case-by-rate case basis, then amortizes that expense over the three year period of the new rates. He professed that the company's use of historical projections would necessarily not include anything for a proceeding of this type. The company has satisfactorily explained its purpose in incurring these expenses. The expenditures were prudently incurred and should be allowed.

Item 2 - Grice Study. This was a conceptual first step study. Total cost, \$24,836, was split by Cal-Am with several affected landowners interested in finding a solution to the water supply problem. The resultant report was the critical element which forced The District to reconsider the Canada project as a possible alternative to be incorporated in the EIR/EIS if further studies showed its feasibility. Mangold stated in Exhibit 11, page 7:

"Had Cal-Am not initiated its investigation of Canada, it is unlikely that the Project would be considered by MPWMD as an alternative in its Water Supply Project. It was prudent for Cal-Am to incur expenditures to achieve that objective in connection with its obligation to obtain a long term water supply as specified in Case No. 9530."

Mangold urges disallowance of Cal-Am's portion of this expenditure because he believes there was an overlap, and therefore wasted effort. It appears that the company has tried to proceed carefully in order to assure a feasible project before incurring expense to do more investigations. This early investigation led to the next series of steps, and had it not been conducted the entire Canada investigation would likely have ended. The expense incurred by Cal-Am should be allowed.

Items 3, 4, 5, 6, 7, 8 and 9. Branch recommends allowing all of Item 3, and half of Items 4, 5 and 7 as expenses in rates spread over the next five years. Branch further recommends that the remaining half of Items 4, 5 and 7 along with increased expenses for those items, most of Item 6 and all of Items 8 and 9 be placed in Deferred Debits Account 142 and, if no project results, written off.

The District wanted these Cal-Am studies. A number of them are being performed in conjunction with The District, involving use of The District's CVSIM computer program. The District has requested expansion of the studies, and would have to pay for them if Cal-Am did not. The company requests that it be allowed either to fully rate base, or fully expense all of these expenditures.

Craig Close, a Senior Design Engineer with American Water Works Service Co., Inc., testified at length regarding the project feasibility evaluation undertaken by Cal-Am in connection with the Canada project. He described how, based upon the favorable results of the Preliminary Environmental Assessment prepared by Denise Duffy & Associates, Cal-Am implemented a pragmatic feasibility evaluation process for the project. The project feasibility effort was segregated into three areas of evaluation: engineering, environmental, and financial. The witness explained in detail why and how each of the changes and additional expenses described above have occurred, and will continue to occur, and why they are a

necessary part of this sophisticated and difficult investigative process.

It appears, based upon Exhibits 6 and 7 and the testimony of witness Close, that Cal-Am's approach to this important and admittedly expensive investigation has been prudent and necessary. Further, it was performed in response to Commission directives. It would be unjust for the Commission to direct the undertaking of studies, and not allow the utility to be compensated for that undertaking. This is so regardless of whether the studies lead to the ultimate construction by the company of the studied project. If the study leads to a construction project, and there is a reasonable time nexus between the study and the construction and placement on line of the project, the expenditures should be allowed rate base treatment. If not, the expenditures, if prudent, should be expensed. These expenses will be allowed, but not accorded rate base treatment, as discussed below.

Item 10, Public Relations Consultant. Branch recommends disallowance of Cal-Am's \$10,000 request to cover public relations expense, stating that "Cal-Am has met its responsibility by elevating Canada to the status of an alternative being considered by MPWMD. Cal-Am's customers are well aware of the water problems affecting them and will not benefit from further promotional efforts." Company witness Foy testified that Cal-Am feels the community needs to be aware of its position with respect to the Canada project. The District circulates a monthly newsletter explaining its actions, and Cal-Am believes it ought to do the same. We concur with Branch on this issue. The amount involved is not great. However, we view the company's public relations efforts in this regard as unnecessary. Information which needs to be conveyed to customers with respect to the Canada project can be done through bill inserts.

Item 12 - Interest. Branch urges complete denial of Cal-Am's request for \$74,000 in interest, but recommends that if

interest is allowed, it be at the 3-month commercial paper rate published monthly by the Federal Reserve Board. The company suggests that its shareholders should not be required to invest these substantial sums to investigate a vital new water supply in a water short area at no cost to the ratepayer. It believes that allowance for funds used during construction is the best way to compensate Cal-Am for that part of its investment which is not in rate base. Cal-Am argues that if the Commission decides that these expenditures should not be rate based, and should, instead, be amortized over five years, then the company should earn a return on the unamortized portion of that account. It should be entitled to either reasonable interest on the construction work in progress, or to rate base treatment, Cal-Am contends. In these special circumstances, we concur on this issue with the company. The utility should be allowed to earn a reasonable return on the use of the funds invested in this study, undertaken at the direction of the Commission. If these expenditures were to be authorized rate base treatment, the company would be allowed to treat them as construction work in progress, or, alternatively, an allowance for funds used during construction.

After consideration, we find that since there is no expectation that any of the projects studied will be eventually owned by Cal-Am, none of the allowable expenditures should be treated as rate base items. Rather, the company should be allowed to expense the various 1989-1990 items as discussed above, other than the \$10,000 expense for public relations costs and the \$19,157 withdrawn by Cal-Am in connection with Item 1 (project management). Thus, of the expenses incurred during 1989-1990, totaling \$1,637,388 (\$1,945,176 less \$307,788 in pre-1989 expenses), \$74,000 is attributable to interest expense. That amount, plus \$19,157 in project management costs deleted by the company, and the disallowed \$10,000 for public relations costs total \$103,157 and will be deducted from the total allowed to be recovered. The resultant

allowable expenses total \$1,534,231. The company will be authorized to recover that amount, with interest on the unamortized portion allowed at the average 90-day commercial paper rate for the first six months of 1990, as published in the Federal Reserve Bulletin, over a period of five years. Recovery of these expenditures can be best accomplished through publication in Cal-Am's tariff of a surcharge provision.

II. Duplication, or Separate Track Issue;
Branch's Request For Limitation on Cal-Am's
Continued Efforts To Develop A Long-Term Supply

At the close of hearings, the ALJ reviewed the issues to be briefed, and referred to the possible duplication of charges which could be experienced by Cal-Am's ratepayers to the extent the company replicated efforts performed by The District. Cal-Am suggests that this is a non-issue as it relates to this application and the studies covered herein. The testimony of witnesses Close and Bell demonstrate, the company maintains, that there has been no overlap or duplication, thus far with respect to the pre-1989 studies which make up this application.

Cal-Am points out that The District has requested expansion of Cal-Am's studies, and observes that if Cal-Am were not doing and paying for this work, The District would have done so. The company emphasizes that the real "duplication" issue is the one framed by Laredo, counsel for The District, and The District's witnesses, Heuer and Bell, as the "separate track" or "two EIR" issue. The District requests that we impose the following specific controls over Cal-Am to avoid this potential "two track" EIR possibility:

"The Water Management District requests that the PUC include the following in its order on Cal-Am's rate application:

"As a condition precedent to any rate modification to recover expenditures for

studies on the Canada Reservoir project, Cal-Am shall recognize the Monterey Peninsula Water Management District as the lead agency for CEQA review, and shall plan to consolidate the Canada Reservoir analysis in that District's EIR/EIS. Further, Cal-Am shall coordinate its environmental analysis with the Monterey Peninsula Water Management District. Specifically, Cal-Am shall use its best efforts to make full and complete responses to information requests by the District, and shall include the District as a full participant in the preparation of scopes of work, attendance at meetings with contractors and resource agencies, and in the review of administrative and final drafts of reports."

Branch had originally asked that Cal-Am be directed not to undertake any further studies (other than those included in the tabulation on page 6 of Exhibit 11, covered above) of the Canada project until the project is approved for construction, unless a proposed study is specifically authorized by the Commission. Branch (witness Mangold) also urged that expenditures for current studies be capped at the amounts shown in Exhibit 11.

However, Mangold also testified during the hearing that the utility may do whatever studies it chooses, but should be alerted that in so doing it would be assuming serious risk that the Commission would not automatically approve costs incurred in connection with those further studies in a future rate case. Branch is in effect urging through this testimony that the directive contained in the C.9530 decisions (that Cal-Am perform studies concerning the enhancement of water supply) be rescinded, and is apparently arguing that if Cal-Am expends further funds on studies of the Canada project, it will have a much greater burden of proof than the one carried thus far to justify the recovery of such expenditures.

Cal-Am requests that the Commission not entangle itself in the politics of the Monterey Peninsula. It believes that is what will occur if we adopt The District's recommendations to

inhibit the utility's independent efforts. The company is saying that the Commission should not become involved in the micromanagement of Cal-Am.

Branch urges that any rate relief granted here be conditioned so as to require Cal-Am's best efforts to foster one EIR/EIS process in order to complete the project ultimately decided upon. Branch calls our attention to D.89195 dated August 8, 1978 in C.9530 in which we found that The District is the appropriate public agency to be concerned with the solution of long term water supply development on the Monterey Peninsula.

The Flood Control District has adopted a resolution to become the lead agency for the Canada project. The District disputed that resolution, and has by letter to the Office of Planning and Research (OPR) dated October 12, 1989 asserted that it has a clear charge and legislative mandate to act as lead agency for water supply projects of the character proposed by Cal-Am.

Section 21165 of the Resources Code governs resolution of disputes between public agencies. It vests authority to designate lead agency status in the OPR. This section states:

"Section 21165. Lead agency; preparation of impact report.

"When a project is to be carried out or approved by two or more public agencies, the determination of whether the project may have a significant effect on the environment shall be made by the lead agency; and such agency shall prepare, or cause to be prepared by contract, the environmental impact report for the project, if such a report is required by this division. In the event that a dispute arises as to which is the lead agency, any public agency, or in the case of a project described in subdivision (c) of Section 21065 the applicant for such project, may submit the question to the Office of Planning and Research, and the Office of Planning and Research shall designate, within 21 days of receiving such request, the lead agency, giving due consideration to the capacity of such

agency to adequately fulfill the requirements of this division."

As of the date of hearings it was premature for the OPR to resolve the lead agency dispute, because a notice of preparation had not been circulated. Branch observes that while it may be true that this Commission can order a utility subject to its jurisdiction to submit to a specific public agency as the lead agency for one of the utility's projects, the Commission cannot undo either the resolution of the Flood Control District to assume that role, or the protest of The District to OPR. Thus, the OPR must resolve the dispute between the two public agencies.

After consideration, we believe it is unnecessary for this Commission to become mired in the lead agency dispute, or any other political dispute which may arise in connection with the Monterey Peninsula. It is sufficient for us to exercise oversight over Cal-Am's rates and services. In the circumstances we believe the utility has satisfied the demands required of its role in assisting in the resolution of the long-term water shortage problems experienced in this district. It is sufficient that Cal-Am's Canada project studies have been adopted by the District. That agency is the proper one to carry out the further necessary studies and activities involved in resolving the problem, as we have already found in D.89195.

Cal-Am is advised here that it should not expect to receive rate increases for expenses incurred in the performance of further studies concerning the Canada project, beyond those found reasonable and prudent in this proceeding, unless such studies are specifically directed by this Commission. Nothing set forth in this Decision is intended to limit the authority of Cal-Am to explore, study, and undertake source of supply projects such as new wells, treatment plants, and distribution systems subject, of course, to the usual scrutiny by this Commission relating to the prudence and cost of such projects.

Cal-Am's ratepayers will be better served if we leave the actual implementation of Cal-Am's management decisions to the utility, and confine our oversight to the prudence of the company's decisions. There does not appear to be evidence of any quantifiable duplication thus far on the part of Cal-Am in its Canada project studies and attempted resolution of the long-term water supply problems besetting the Monterey Peninsula. In fact, its independent approach has led to a result conceded to be favorable to that resolution because the Canada project is now a part of the District's EIR/EIS.

Cal-Am asserts that it does not now know in what direction it will go when the current feasibility studies for the Canada project are concluded, or if and when the proposed Canada project passes through all of the "fatal flaws" analyses underway. It maintains that it has a long history of close working relationships with The District, which is continuing and will continue.

III. Rate Design

Branch notes that about 38% of Cal-Am's fixed costs are presently recovered through its service charges. It recommends that since the Commission's rate design policy ordinarily allows 50% of fixed costs to be recovered through service charges, whatever increase is authorized as a result of this decision be assigned to and recovered from the company's increased service charges. Although the sought increases are relatively small, Cal-Am is particularly sensitive to the public perceptions favoring conservation in its Monterey District and has proposed a pro rata spread of the proposed new rates between quantity rate and service charges based upon the current 62%-38% ratio approved in the last general rate case. In the circumstances, since the company is willing to accept a lesser amount of recovery through service

charges, and in view of the ongoing rationing program in the district and the continuing need for conservation, the company's request will be adopted.

In accordance with Public Utilities Code Section 311, the ALJ's proposed decision was mailed to parties on August 31, 1990. Comments were received from Cal-Am and from The District. The District concurs with the comments of Cal-Am and has no objection to the proposed decision, if modified in accordance with Cal-Am's suggested modifications.

Cal-Am has a single generic comment concerning Finding of Fact 9, which it believes to be overboard. The Finding as stated in the ALJ's proposed decision states:

"It is unnecessary for Cal-Am to be concerned with further studies of the water shortage problems within its Monterey District, since The District is charged with resolving those problems and is capable of performing such studies."

Cal-Am believes that the scope of Finding 9 was intended to be limited to the Canada project. Indeed, Cal-Am notes, the primary focus of the entire proceeding has been on the Canada project. The company is presently engaged in extensive efforts to develop additional new water supplies, including new wells in the Seaside basin. It is not our intent to terminate that or other similar projects.

We concur with Cal-Am's comments. Finding 9 is amended to clarify this important point. Certain minor changes will also be made in the text of the Opinion to reflect our intent on this subject.

Findings of Fact

1. There has been and continues to be a need for a long term solution to the water shortage problems besetting the Monterey Peninsula.

2. Cal-Am in its application requested compensation for expenses totaling \$1,585,788 for studies performed to aid in resolving these shortages.

3. Cal-Am will have expended \$1,945,176 by September 30, 1990 in study costs incurred in connection with those studies.

4. The pre-1989 study costs sought by Cal-Am, totaling \$307,788, were incurred between 1973 and 1986, and are too old at this point in time to be allowed for recovery in the company's rates.

5. The company's 1989-1990 Canada project study expenses, except for \$19,157 spent in connection with the project management costs, and \$10,000 spent in connection with public relations costs, have been prudently incurred.

6. Of the Canada project expenses incurred during the period 1989-1990, totaling \$1,637,388 (\$1,945,176 less \$307,788 in pre-1989 expenses), \$74,000 is attributable to interest expense, \$19,157 for project management costs, and \$10,000 for public relations costs. These latter three items, totaling \$103,157, should be excluded from any cost recovery allowed in this proceeding. Cal-Am should be allowed to recover the remainder, totaling \$1,534,231, plus interest at the average 90-day commercial paper rate for the first six months of 1990, as published in the Federal Reserve Bulletin. That average six-month figure is 8.20%. It will be reasonable if this amount is amortized over a five-year period.

7. It will be reasonable if increases authorized herein are published in Cal-Am's tariff as a percentage surcharge, and applied uniformly to each customer's total bill. The applicable surcharge, based upon current annual 1990 adopted revenues of \$15,396,900, as set forth in D.89-02-067, dated February 24, 1989 in Application 88-03-047, is 2.5%.

8. Cal-Am's studies of the Canada project have been useful in elevating the project to one eligible for consideration by The

District. The District is the agency created by the Legislature to be primarily concerned with resolution of the long-term water shortage problems besetting the Monterey Peninsula.

9. Beyond the \$1,534,231 plus interest allowed by this Decision, it is unnecessary for Cal-Am to be concerned with further studies of the Canada project, unless such studies are specifically directed by this Commission, since the District is charged with resolving the long-term supply problems and is capable of performing such studies.

Conclusions of Law

1. Cal-Am should be allowed to increase rates for water service performed within its Monterey District in accordance with the provisions of this decision.

2. The increases authorized by this decision should be published in Cal-Am's tariff as a percentage surcharge, to expire 60 months after initial publication.

3. Because there is an immediate need for rate relief, this decision should be effective on the date of signature.

O R D E R

IT IS ORDERED that:

1. California-American Water Company (Cal-Am) is authorized to publish, on 5 days' notice, a surcharge of 2.5% applied to its customer's bill, in its tariff schedules for water service provided in its Monterey District.

2. Pursuant to Public Utilities Code Section 792.5, Cal-Am is directed to establish and maintain a balancing account for this surcharge.

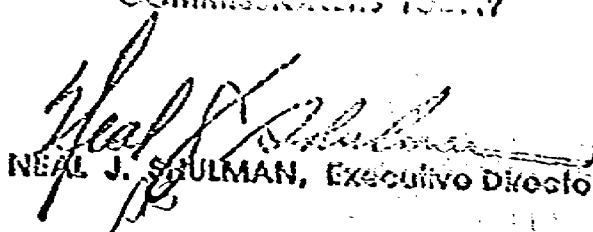
3. Cal-Am shall notify the Commission to (1) terminate the surcharge if there is an overcollection in the balancing account before the end of the 60-month period, or (2) transfer the over or undercollection to combine with other balancing accounts by the end of the 60-month period to be amortized at a later time.

This order is effective today.

Dated October 12, 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

I CERTIFY THAT THIS ORDER
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY


NEAL J. SULMAN, Executive Director