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Decision 91-10-042 October 23, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Investigation on the Commission's own motion into measures to mitigate the effects of drought on regulated water utilities, their customers and the general public.	I.89-03-005 (Filed March 8, 1989)
And Related Matters. (Drought Phase)	I.90-11-033 Application 90-11-038, et al.

(See Appendix A for water management program applications.)

(See Appendix C for appearances.)

INDEX

INTERIM OPINION

1. Summary

The Commission in this part of the continuing Drought Phase investigation makes the following determinations:

- Water management programs certified as complete are accepted and approved.
- Utilities with approved water management programs are authorized to implement a surcharge to recover revenue shortfalls recorded in their drought memorandum accounts.
- Memorandum account revenue will be reduced by an amount equal to a 20-basis point reduction in return on equity from a utility's last rate case applied to the latest adopted rate base. The reduction recognizes reduced business risk represented by the memorandum account.
- Utilities under rationing that have collected penalties from customers for using more than their allotment of water are directed to use the penalties to offset memorandum account losses and fines collected by the utilities' wholesalers, and to refund any remaining funds to customers.
- All water management program applications are consolidated into this proceeding for disposition following a third round of hearings.
- The 1.5% public utility fee will not at this time be imposed on penalties collected from customers for exceeding their water allotment during rationing.
- Utilities' practice of adjusting customer penalties on a cumulative basis and "refunding" penalties for later conservation is deemed inconsistent with the tariffs.

- A Class B water company may file a water management program at any time prior to seeking recovery of a drought memorandum account.

- The requirement of filing a water management program prior to recovery of a drought memorandum account is waived for Class C and Class D water companies, but those utilities are urged to consider conservation in their resource mix.

- Utilities are authorized to file a generic Tariff Rule 14.1 to permit implementation of rationing plans.

- Utilities are authorized to file to discontinue rationing on five days' notice through advice letter filings.

- Any utility with a voluntary conservation plan is authorized to file an advice letter for recovery of the adjusted amount in its drought memorandum account.

Finally, the Commission directs that a third round of hearings be scheduled following today's order to take evidence on remaining Drought Phase issues. Parties that advocate positions on these issues have been directed to serve a statement on such issues 10 days prior to a prehearing conference on November 6, 1991. The prehearing conference has been rescheduled for November 13, 1991.

2. Background

California is in its fifth year of drought. Mandatory and voluntary rationing have become the norm, rather than the exception. Of 17 Class A water utilities (more than 10,000 connections) regulated by the Commission, 10 were required to implement mandatory rationing in some or all of their districts in 1990 and 1991. While some smaller water companies served by wells appear to have no immediate supply problem, many of the state's 233 regulated water companies and districts have on their own or at the

urging of public agencies introduced programs to encourage water conservation.[1]

On March 8, 1989, the Commission instituted this investigation (Order Instituting Investigation (I.) 89-03-005) to determine what steps could be taken to mitigate the effects of water shortages on the state's regulated utilities and their customers. All water utilities subject to the Commission's jurisdiction were made parties, and all Class A, B, and C utilities were required to provide information on their water supply outlook.

Following hearings and workshops that extended into March 1990, the Commission issued two interim opinions dealing with the drought. The first, Decision (D.) 90-07-067, effective July 18, 1990, authorized all utilities to establish memorandum accounts to track expenses and revenue shortfalls caused both by mandatory rationing and by voluntary conservation efforts. The second decision, D.90-08-055, required each Class A utility, and any other utility seeking to recover revenues from a drought memorandum account, to submit for Commission approval a water management program for each utility district addressing long-term strategies for reducing water consumption.

The Commission in D.90-08-055 also found that recovery of memorandum account revenues constitutes protection against normal sales risk. It left for this proceeding a determination of whether, and by what amount, to reduce revenue recovery to reflect reduced sales risk. Recovery of memorandum account revenue is contingent upon approval of a water management program and application of a risk reduction adjustment.

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1 The Commission recognized in D.90-08-055 that while it strongly encourages efforts to reduce water use and increase water supplies, any action by the Commission will have limited impact statewide because water use by customers of regulated utilities is less than 3% of total water use in the state.

Hearings on priority issues dealing with water management programs were held the week of June 3, 1991. Hearings on the risk reduction adjustment were held the week of June 24, 1991. Opening briefs were required by August 12, 1991, and reply briefs were required by August 26, 1991, at which time this part of the Drought Phase proceeding was deemed submitted for decision.[2]

3. Recovery of Memorandum Account Revenue

This decision authorizes utilities to file an advice letter setting forth a surcharge for recovery of memorandum account revenue. The procedure for recovery generally follows that set forth in D.90-08-055. That is, Class A and B water companies that have filed approved water management programs may (1) apply the risk reduction offset set forth in this decision to the remaining memorandum account balance; (2) offset net revenue losses recorded in the memorandum accounts with penalty funds, if any, collected as part of mandatory rationing; and (3) file for a one-year surcharge to amortize the remaining balance of the memorandum account. As discussed below, Class C and Class D water companies that establish drought memorandum accounts need not file a water management program, but they are required to apply the risk reduction offset to the recovery of memorandum account revenue. The risk reduction

2 On September 25, 1991, the Commission in D.91-09-065 authorized water companies with drought memorandum accounts recommended for approval to file advice letters implementing a surcharge to recover up to 75% of recorded revenue losses incurred due to mandatory rationing and voluntary conservation. Further recovery from the memorandum accounts was deferred pending today's decision.

offset is intended to apply each time a water company files for recovery of memorandum account revenue.[3]

4. Water Management Programs

A total of 60 water management programs have been developed by the utilities and submitted for approval by the Commission.[4] The Water Utilities Branch of the Commission Advisory and Compliance Division (Branch) has certified 38 of these programs as complete. (See Appendix A.)

The water management programs are blueprints for dealing with water conservation in each utility's service area. All set forth comprehensive conservation programs, complete with benefit-cost analyses; water resource management objectives, and long-range forecasts of supply and demand. All stress the importance of informing the public of conservation measures through bill inserts and meetings. Most report continuing efforts in such traditional techniques as leak detection and distribution of conservation kits (shower flow restrictor, toilet tank displacement devices and leak detection dye tablets).

Many utilities have begun unusual programs. The San Marino District of California-American Water Company (Cal-Am)

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3 The memorandum accounts also contain expenses for conservation activities that are not covered in existing rates (including costs of producing the water management programs.) For recovery of these expenses, see Section 9.3. Generally, this order contemplates that most conservation expenses must await recovery by advice letter filing and reasonableness review. An exception is the expense related to preparation of a water management program, which may be recovered by advice letter filing in the same manner as revenue shortfalls.

4 Water management programs were originally due on November 8, 1990. Only San Jose Water Company met that date. At the request of other water companies, the due date was extended 90 days to February 5, 1991. (See, generally, D.91-04-018, issued April 10, 1991.)

intends to conduct a large turf irrigation audit. Dominguez Water Corporation conducts an annual "smart garden contest" that in 1989 attracted 3,000 entrants. The Westlake District of California Water Service Company (CWS) plans to serve a country club and green belt areas with reclaimed water, and the company's Visalia District has developed a water conservation garden with more than 200 low water-use plants.[5] Park Water Company will test moisture sensor controls for automatic sprinkler systems. San Jose Water Company (SJWC) has trained three employees as "water watchers" to conduct water audits for customers on request. Suburban Water Systems proposes an incentive payment to contractors who install commercial xeriscaping, or minimum-water landscaping.

4.1 Approval of Water Management Programs

Branch urges that water management programs certified as complete be approved in this decision. However, it recommends that specific projects contained in the water programs not be approved at this time. Those projects that contemplate a change in rates (for example, introduction of inverted block structure for rates) must be subject to further review and public hearings. Those projects that do not affect regular rates (for example, distribution of shower flow restrictors) should be subject to review during a rate case or at the time a utility seeks to recover such costs. Branch notes that a project that is reasonable and would be approved today may not be reasonable if it is implemented at a time or in a manner when circumstances have changed.

SJWC testified that it anticipated and favors Commission action on each project described in a water management program, subject only to a later review of the manner in which a project is

5 Not all conservation programs succeed. Suburban Water Systems developed a drought-resistant garden on company property but discontinued it "because it attracted vagrants and a rodent population."

implemented. A utility then can proceed with assurance that it will be able to recover reasonable costs of a project. However, SJWC and all other parties join in urging that some matters in the water programs (most significantly, conservation incentives proposed by the utilities) be deferred for a later round of hearings in this proceeding.

4.2 Discussion

In this decision, we approve as complete those water management programs so certified by Branch. (See Appendix A.) We agree with Branch, however, that our action should not include approval for expenditures for projects contained in a water program. Each such project must be weighed on its merits as of the time it is implemented. We are influenced in this judgment by the parties' unanimous request for further hearings on particular aspects of the water management programs, including incentives. If parts of the water programs are subject to further review, it would be premature to approve as final other parts of the programs.

Our order contemplates that a utility will seek Commission approval before it embarks on a project that will require policy changes (i.e., introduction of inverted block rates). For most conservation projects, however, we contemplate that a utility will proceed without Commission approval, that it will book costs of such projects to its drought memorandum account or voluntary conservation memorandum account (unless already included in rates), and that it will justify the project and costs as reasonable when it seeks recovery of those expenses and lost revenue.

Toward that end, Branch at hearing supplied utilities with a generic "Best Management Practices List" (Exhibit 155) of

conservation projects that it deems generally reasonable.[6] Utilities, therefore, may proceed with conservation measures on this list with some assurance that the measures themselves will be approved. In addition, while the Drought Phase of this investigation remains open, a utility may by motion request advance approval of innovative conservation projects.[7] Recovery of actual expenditures will, of course, still have to stand the test of reasonableness.

4.3 Consolidation of Water Programs

Consistent with the discussion above, and pursuant to Rule 55 of the Rules of Practice and Procedure, we consolidate into this proceeding all 60 applications by utilities for approval of their water management programs. Those applications in which water programs have been certified as complete are approved, but the applications remain open pending consideration of further matters requested by the parties. Those applications in which water programs have not been certified as complete remain open for further consideration and, if necessary, evidentiary hearings.

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6 The Best Management Practices List is derived from a May 28, 1991, draft memorandum by the California Department of Water Resources. It sets forth conservation practices that "are established and generally accepted...among water suppliers" and that "are technically reasonable and economically sound." Among such practices are low-flow showerhead kits, water audit programs, public information programs, waste water prohibitions, and leak detection and repair.

7 By ruling dated March 12, 1991, the administrative law judge established a Branch-sponsored method by which utilities may file a motion in this proceeding seeking an interim order by the Commission approving in advance the costs of an innovative conservation project. One such motion has been filed. It was denied by the Commission on the basis that it was not the type of innovative project for which advance approval was necessary. (See D.91-09-005, dated September 6, 1991.)

No party has addressed the final disposition of the water management programs. That is, what procedure should be followed in monitoring efforts by utilities to carry out their long-range water plans? Should the Commission require a periodic update and progress report on implementation of the water management programs?[8] Should an update or progress report be required as part of a general rate case? Should the requirement come at the time a utility seeks recovery of its memorandum account? If the drought ends, should the progress reports continue? We ask parties to address this issue in the next scheduled hearing in these proceedings. It is our intention that, at the close of those hearings, the record will be sufficient to permit us to take final action and close the applications for approval of water management programs.

5. Disposition of Penalty Monies

The Commission has authorized certain water utilities to collect fines or penalty money from customers for using more than their allotment of water during mandatory rationing. Utilities were required to place fines in a suspense account until further Commission order. In D.90-08-055, we authorized those utilities to use penalty funds collected through the date of that order (August 8, 1990) to offset net revenue loss recorded in the memorandum accounts and to pay fines levied by a utility's wholesaler. We directed that any remaining funds in the suspense account as of August 8, 1990, be refunded to customers by incorporating them into the utility's expense balancing account.

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8 Every California water supplier providing water for municipal purposes to more than 3,000 customers or supplying more than 3,000 acre-feet of water annually is required to prepare and adopt an urban water management plan and to review and amend the plan at least once every five years. (See, Urban Water Management Planning Act, Water Code $$ 10610-10656. The act was known as Assembly Bill (AB) 797 while pending before the Legislature.)

No party has contested this disposition of rationing penalties. In this order, we adopt the same procedure for rationing penalties collected since August 9, 1990. Each time a utility files for recovery of memorandum account revenue, it should as of that date, calculate rationing fines, if any, accumulated in its suspense account and use such penalty funds as an offset in the manner set forth above. Any remaining funds in the suspense account as of that date should be incorporated into the utility's expense balancing account. Penalty funds should then continue to accumulate in the suspense account until the utility again seeks recovery of memorandum account revenue, or until further order by the Commission.

6. Risk Reduction

The single most contentious issue in this proceeding is the amount by which a utility's drought memorandum account should be reduced to reflect a reduction in normal business risk. The Financial and Economic Analysis Branch of the Division of Ratepayer Advocates (DRA) presents an analysis supporting a reduction in return on equity (ROE) of 50 basis points (one-half of a percentage point) to reflect reduced risk. DRA's application of its formula to last established rate of return results in a reduction in memorandum accounts of approximately $28,000 for the San Carlos District of CWS; $485,000 for SJWC; $159,000 for the Metro District of SoCalWater, and $133,000 for the Monterey District of Cal-Am (Exhibit 153).

Utilities argue that no reduction in risk is warranted because normalized sales (as calculated in a general rate case) exclude effects of drought and this exclusion eliminates the likelihood that a water company will recover through a memorandum account any sales losses that are not attributable to drought. Alternatively, SoCalWater, supported by other utility parties, presents an analysis seeking to show that DRA overstated normal

sales risk, and that adjustment of the methodology produces a more appropriate 10 basis point reduction in ROE.

6.1 Position of DRA

DRA begins with the assumption, as expressed by the Commission, that a drought memorandum account eliminates some degree of normal business risk. That is, if a utility under rationing has sales that are below normalized sales in a drought year, and if the utility is permitted to recover losses up to the normal sales level through a memorandum account surcharge, at least some part of that recovery represents lost sales that might have occurred in the absence of drought. To that extent, the utility will have escaped normal business risk of lost sales.

To measure this risk, DRA examined the historical variance in sales for four large utilities over a period of up to eight years. It applied a standard error analysis to the Commission's modified Bean method[9] of determining forecasted sales, providing a measure of sales variance. It identified the variance mathematically, then translated the removal of the variance into a reduction in authorized return on equity. The mathematical model is set forth in the footnote below.[10]

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9 Historical water sales are calculated in rate cases by use of a modified Bean analytical model, determining residential sales as a function of three variables: temperature, rainfall, and year. In years when temperature is low and rainfall is high, sales are likely to decline. In years when temperature is high and rainfall is low, consumers generally use more water.

10 DRA states that regression analysis establishes a band within which 90% of actual sales fall in relation to the regression equation, expressed in the following formula:

$$Y \pm t \times SE$$

where Y = average sales level of the sample
SE = standard error of the regression

(Footnote continues on next page)

Through its model, DRA finds average annual sales variances of 1.8% for SoCalWater, 2.9% for CWS, 3.9% for Cal-Am, and 5.2% for SJWC. That is, historical water sales vary at plus or minus 1.8% above or below normal sales for SoCalWater, and a larger variance of plus or minus 5.2% can be anticipated for SJWC. DRA translates the downside risk of this variance into a reduction in the return on equity calculation in a utility's last rate case.[11] That results in an ROE reduction of 47 basis points for SoCalWater, 70 basis points for CWS, 153 basis points for Cal-Am, and 193 basis points for SJWC. DRA then exercises its judgment in recommending that the low end of this spread (50 basis points) be applied to the ROE of each utility seeking recovery of a memorandum account.

DRA's witnesses testified that this is the first time that the division has sought to quantify a reduction of risk of this nature. Analyst Junaid Khan explained that the method is not intended to produce precise mathematical results, but instead

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(Footnote continued from previous page)

t = a constant, the value for which varies with the number of explanatory variables of the regression and the number of observations used to model the regression.

The factor (t x SE) represents the variance of actual sales. The forecasted sales variance is derived by applying the formula F ± t x SE, where F equals the forecasted sales for the next year. Hence, the ratio of actual historial sales variation (t x SE) to forecasted sales (F) is used to represent the forecasted percentage sales variability.

11 Under DRA's proposal, rates established in a utility's last general rate case would be unchanged. However, while a memorandum account is active, the return on equity and rate of return components in the rate case would be computed with a reduction of 50 basis points. The resulting revenue reduction would be deducted from the utility's memorandum account.

develops a range within which reasonable judgments may be drawn. When asked whether DRA's methodology was the most accurate that it considered, Khan explained:

> "'Accurate' has its own connotations. Depending on the sample you use, depending on the data you use, depending on the time frame that you use, the results of any methodology can change, and it is a question of selecting a representative sample and coming up with a range of results. As I have mentioned earlier, the results are not an 'accurate' number. That's why we have not relied on mathematical results. So it's not saying that of all the alternatives that were considered, this is the most accurate method, but it is the most representative method that we found to be useful." (Tr., p. 1607.)

In examination of another DRA witness, it became clear that the analysis includes at least some degree of drought risk within its assumption of normal business risk. The witness described this as "normal" drought risk, as opposed to the "serious" drought risk in which mandatory rationing applies. (Tr., p. 1464.) DRA also acknowledged that it had not applied its 50-basis point recommendation to the rate bases of utilities to determine the bottom-line reduction in memorandum accounts. On the final day of hearing, DRA produced estimated calculations for four utilities. The reductions in memorandum accounts range from 5% to 25%.[12]

6.2 Position of Utilities

Utilities presented evidence to show that the normalized sales level is developed using a 30-year average of rainfall and

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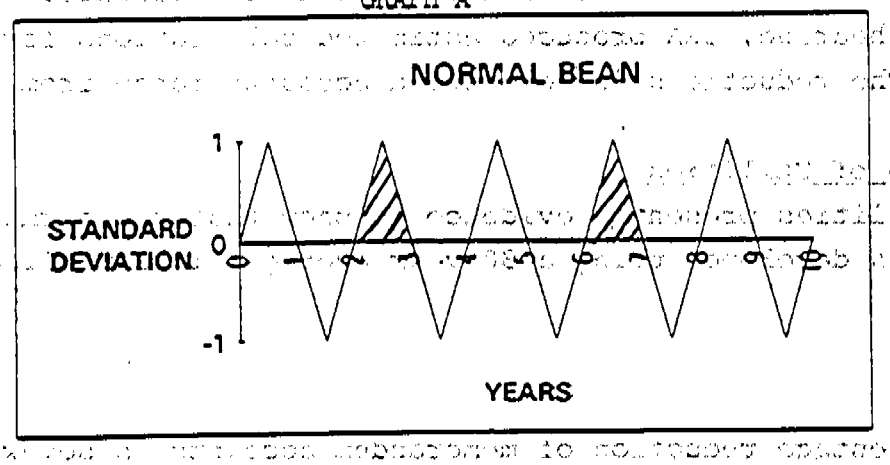
12 The percentage reduction of memorandum accounts is somewhat misleading. The DRA method produces a fixed dollar reduction based on a utility's last rate case. This amount is deducted from the memorandum account. The larger the memorandum account, the smaller will be the percentage reduction.

temperature data, and such data excludes periods of drought. CWS witness Francis S. Ferraro testified that this "normalized weather" produces rates that by design will yield less than normal sales during cool/wet years and more than normal sales during warm/dry years, and that these results average out over time. By limiting memorandum account recovery to the normalized sales level (instead of the higher-than-normal sales that could be expected during a warm/dry year), Ferraro said, the Commission already has denied recovery of non-drought sales. Because above-normal sales are excluded in a drought year, the memorandum account has a built-in reduction in ROE which in CWS's case equates to 70 basis points. (Exhibit 152.)

SJWC testified similarly. In its brief, it illustrated its testimony with the simple graph reproduced below. Graph A shows 10 hypothetical periods with sales variances equal to +1 or -1 spread equally in five periods each. This is a normal Bean expectation and results in an average zero variance from the line. The result changes, however, if it is assumed that the shaded areas

GRAPH A



in periods 3 and 7 represent years of drought and rationing. For those years, the memorandum account provides recovery to the normal sales level, but sales above the line are lost. The equation now produces three +1 years and five -1 years. SJWC witness Fred R. Meyer testified that the "lost" opportunity to earn above-average revenue during warm/dry years because of conservation reduces ROE as compared to what the Bean model predicts for the same period, excluding drought. On cross examination, Meyer acknowledged that SJWC had record sales in 1987, despite a conservation program in place at the time, and above-normal sales in 1988. Sales dropped when mandatory rationing began in April 1989.

6.3 Alternative Proposals of CWS, SoCalWater

CWS opposes any ROE adjustment. In seeking interim relief, however, CWS proposed the only other risk reduction formula presented on this record. Significantly, CWS like DRA concludes that if risk reduction is to take place, it is best reflected through a reduction in return on equity. The CWS formula, discussed in the footnote below,[13] results in approximately the same 50 basis point ROE reduction that is recommended by DRA.

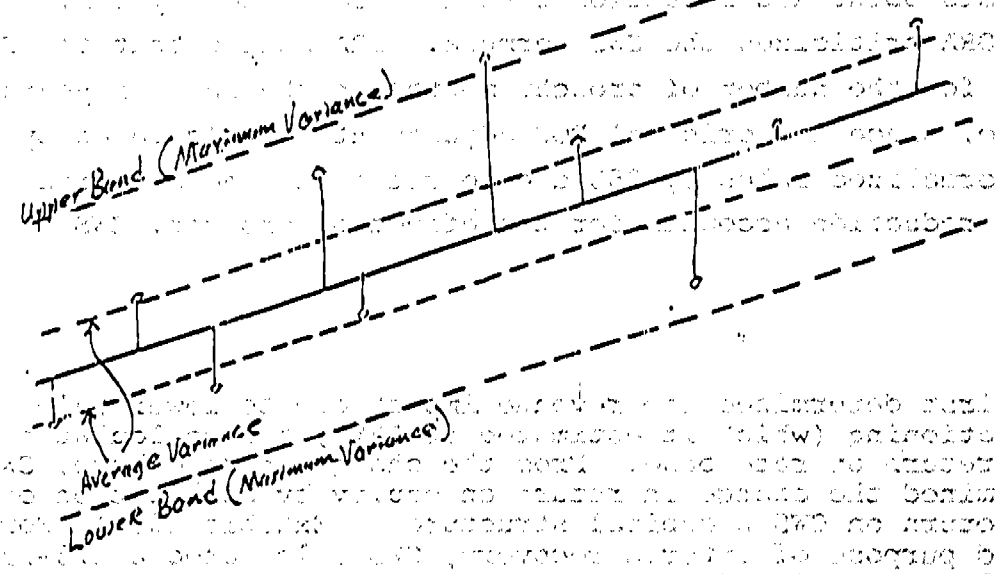
DRA criticizes the CWS formula. DRA states that the CWS adjustment for the number of drought months in the last 15 years is duplicative, since its original ROE adjustment is calculated by reducing normalized sales by 25% due to rationing and conservation. Since this reduction accounts for the effect of drought, CWS's

13 CWS first determined the revenue impact due to lower sales based on rationing (which it estimated at 25%), then calculated the change in return on rate base. From the change in rate base, CWS then determined the change in return on equity by application of the rate return on CWS's capital structure. (Exhibit 103.) For the limited purpose of interim recovery, CWS calculated a 123-basis point (1.23%) reduction in return on equity. For a permanent reduction, CWS factored in all 21 of its districts and added a sales fluctuation analysis for a risk assessment of 51 basis points. (Exhibit 128.)

further adjustment to ROE to account for districts under rationing skews results of the formula. CWS has not rebutted DRA's testimony and it effectively has withdrawn its model because the subject of interim recovery has become moot.

SoCalWater joins other utility parties in arguing that no reduction in memorandum accounts is justified. Alternatively, its witness Joel A. Dickson testified that DRA's methodology overstates the degree of protection that a memorandum account provides for lost sales unrelated to drought. Dickson introduced the chart reproduced below. According to Dickson, the DRA method reflects the maximum risk of lost sales below the normalized sales line. In fact, he testified, lost sales will fall randomly below the standard line and should be averaged. (Graph B.) Adjusting the DRA method to average lost sales produces a significantly lower ROE.

GRAPH B



reduction. The reduction would be 7 basis points for SoCalWater (instead of the 47 points calculated by DRA); 29 basis points for CWS, instead of 70; 35 basis points for Cal-Am, instead of 153, and 43 basis points for SJWC, instead of 193. Like DRA, SoCalWater elects the lower end of this spread to recommend a 10 basis point reduction, if a reduction is deemed warranted.

DRA presented an authority on statistical analysis as a rebuttal witness, and he testified that SoCalWater's "average variance" analysis does not conform to principles of stochastic (or randomly determined sequences) modeling. On cross-examination, however, he acknowledged that he was not familiar with DRA's analysis nor with the standard error analysis that Dickson purported to follow. The authors of the DRA methodology did not respond to the SoCalWater proposal.

6.4 Discussion

Before analyzing risk reduction, it is important to identify the risk with which we are dealing. The record shows a good deal of confusion on this point, due in part, perhaps, to our own necessarily limited discussion in D.90-08-055.

The reduction in memorandum account revenue to reflect reduction in risk is not a "drought penalty," as alleged by some utilities, nor is it a quid pro quo, as implied by Branch, for the privilege of recouping lost revenues.

In numerous decisions, dating back to the drought of 1976-1977, the Commission has made it clear that water companies should be permitted to recover reasonable lost revenue and expenses caused by drought. The recovery is made through increased rates or surcharges reflecting these losses, less cost savings, up to a utility's normalized sales level. In effect, the surcharge takes the place of the higher price a non-regulated company would seek to charge for a commodity that has become scarce.

Thus, in responding to the 1976 drought, the Commission in D.86959 (February 8, 1977) directed large water companies to

take conservation measures, and it authorized the companies to file for rate increases "designed to recover any reasonable expenses or revenue losses" caused by the conservation efforts. (D.86959, Ordering Paragraph 11.) Similarly, in a series of proceedings in 1988 and 1989,[14] the Commission authorized utilities with mandatory rationing to establish memorandum accounts "to accrue revenue losses due to reduced sales and related changes in water production costs." (D.90-08-055, p. 15.) Each of these utilities was authorized to implement a surcharge to recover revenue losses incurred through August 8, 1990. (D.90-08-055, pp. 55-56.)

Responding to the current drought, the Commission instituted this investigation to consider, among other things, "(t)he need for and magnitude of rate adjustments to accommodate utilities' increased conservation expenditures and sales reductions." (OII 89-03-005, p. 3.) The Commission later authorized all water utilities to establish memorandum accounts "to track conservation expenses and revenue fluctuations related to both mandatory and voluntary conservation." (D.90-07-067, p. 1.) The order contemplated full recovery of these amounts up to forecasted sales level "(i)n order to encourage regulated water utilities to promote conservation." (D.90-07-067, p. 1.)

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14 These proceedings, all of which were consolidated into I.89-03-005, were San Jose Water Company, D.89-04-041; California Water Service Co. Bear Gulch, San Carlos, San Mateo and South San Francisco Districts, D.89-04-046; Great Oaks Water Company, D.89-04-075; California Water Service Co. Los Altos Suburban District, D.89-05-069, and California American Water Co. Monterey District, D.89-06-053.

In short, our decisions have consistently called for full recovery[15] up to the adopted sales level of reasonable estimates of lost revenue and expenses caused by utilities' efforts to ration and conserve water. Ratepayers have been placed on notice that the cost of water is likely to increase, generally through a drought surcharge, and this in turn encourages ratepayers to conserve.

In D.90-08-055, we stated that while water companies could expect to recover their reasonable estimate of lost revenue and expenses due to conservation and rationing, they could not expect to recover more. Specifically, to the extent absent drought a company's water sales would fall, a company should not expect to recover those lost revenues through the memorandum account. (D.90-08-055, pp. 27-28, Finding of Fact 28b.) Lost revenue absent drought is a normal business risk and is reflected in shareholders' return on equity.

Because we recognize that lost revenue does not come neatly labeled, and that utilities in good faith are likely to capture both conservation and non-conservation shortfalls in their memorandum accounts, we urged all parties to suggest a formula by which memorandum accounts could be fairly adjusted. (D.90-08-055, Ordering Paragraph 9c.) Utilities for the most part declined the invitation and argued that no adjustment is necessary.

We have rejected this argument before.[16] We reject it again. It is intuitively obvious, and we so found in D.90-08-055, that a water company with a memorandum account that allows it to recover lost revenue that it attributes to rationing and

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15 In D.87398, dated June 1, 1977, we authorized CWS to recover projected lost revenue up to 95% of normalized sales, but our final order (D.87861, dated September 13, 1977) permitted 100% recovery.

16 Utilities raised much the same argument in their petitions for modification that were denied in D.91-04-018.

conservation clearly has less risk of lost revenue due to normal causes than a company that does not have such a memorandum account. In cross-examination, utilities acknowledged that sales losses can and do occur during warm/dry years for any number of reasons, including increased consumer awareness of the need to reduce water consumption.

We conclude, therefore, that drought memorandum accounts do include revenue losses that are not necessarily drought-related. We further conclude that it is appropriate to apply to memorandum accounts an ROE-based reduction intended to limit recovery to legitimate conservation and rationing losses and expenses.

DRA's methodology for accomplishing that objective is the only calculation before us. CWS effectively has withdrawn its proposed formula on the basis that it was intended to apply to early recovery of memorandum accounts. We note, however, that the CWS method in some respects validates the direction taken by DRA, particularly in looking to return on equity in the last rate case for the adjustment in a memorandum account.

As DRA acknowledges, its methodology is not precise. It is to an extent a best judgment approach to determining a risk factor based on normal sales variability. In the words of DRA's witness Khan, "it is the most representative method that we found to be useful." (Tr., p. 1607.) Khan acknowledged that the pure mathematical result of the method could reduce a company's ROE to a point lower than long-term debt cost, which would be unreasonable. The method would reduce SJWC's return on equity by 193 basis points, which DRA's witness acknowledged would not be fair. The recommendation of 50 basis points, therefore, was primarily a judgment call, guided by the direction charted in DRA's methodology.

Because the method is not precise, utilities attack it as flawed. Utilities have failed, however, to meet the burden of showing that DRA's method, <u>in its entirety</u>, is an unreasonable one.

Under the guidelines established by the United States Supreme Court in Hope Natural Gas,[17] it is not the components of a regulatory theory but the impact of its result, viewed in its entirety, that must be just and reasonable.

DRA's risk model is a first. Neither DRA nor the Commission has adopted any other formula to measure reduction of "normal" risk said to be part of drought risk. We accept as a given that judgment elements within such a model are subject to challenge. DRA's proposed method seeks to balance the burden of ratepayers who will pay for sales that a utility does not make (including some normal business risk sales) and the interest of stockholders who will benefit from a form of revenue guarantee.

With that said, however, we find that the utilities have demonstrated that "normal risk" revenue captured in a memorandum account is likely to be minimal. Absent drought, a water company during a warm/dry year can expect sales above the forecasted normal level. In ratemaking, these above-average earnings are balanced over time by reduced sales during cool/wet years. When rationing or conservation during drought (by definition, a warm/dry year), a water company loses the above-normal sales it could otherwise expect. The memorandum account protects it only to the level of normalized sales. Any "normal risk" loss in sales in a warm/dry year is subsumed for the most part in the above-normal sales that conservation prevents the company from earning.

DRA has not rebutted this showing. Because of our order in D.90-08-055, it has accepted the conclusion that a memorandum account reduces risk, and it has devoted itself to the formidable task of measuring risk. DRA concedes that its methodology reduces drought risk revenue as well as normal business risk revenue in the

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17 Federal Power Commission v. Hope Natural Gas Company (1943) 320 U.S. 591.

memorandum account, and to that extent its risk reduction findings are overstated. Moreover, as witness Khan explained, the formula at best can provide only direction, not answers. For answers, subjective judgment is required.

For these reasons, we find that SoCalWater's adjustment to the DRA methodology comes closer to producing the degree of risk reduction that can be supported by this record. Its reasoning, if not its stochastic computation, leads to the more reasonable calculation of from 7 to 43 basis points in reduction in return on equity, instead of the 47 to 193 basis points found by DRA. At the same time, however, since SoCalWater's reasoning stresses the midpoint of the sales variance range, we believe it is consistent in applying that reasoning to look to the midpoint (rather than the low point) of the basis point spread. Both DRA and SoCalWater agree that this final step in their calculations is one of judgment, based upon all of the data available to the decision-maker.

Accordingly, we find that each time a water company seeks recovery of its memorandum account, the recovery should be reduced by an amount equivalent to a 20-basis point reduction in return on equity in the utility's last approved rate case.

In reaching this conclusion, we note again that our objective is to account in a fair and reasonable manner for a utility's reduced risk of normal business loss represented by the memorandum account. We intend no reduction of lost revenue attributable to conservation and rationing, up to the level of normalized sales. The record as a whole persuades us that since the memorandum account is generally in effect during dry/warm years (when water use typically increases), the likelihood of lost sales for reasons other than conservation and rationing is minimal.

We also must recognize that the risk issues we consider today can not be taken in isolation. We will consider this matter in the whole context of utility industry risk in the risk OII, I.90-11-033.

Finally, it is important that we not lose sight of our purpose in instituting this investigation. Our aim, consistently,

has been to encourage water conservation. As we have stated earlier, an undue limitation on revenues subject to recovery creates a disincentive for utilities to promote conservation. (D.90-08-055, p. 21.) Testimony at hearing suggests--and common sense dictates--that a company in the business of selling water will approach the restriction of those sales more willingly if reasonable safeguards are in place to protect the company's financial health.

7. Assessment of User Fee on Penalty Assessments

Sections 431 and 432 of the Public Utilities (PU) Code direct the Commission to establish a fee, sometimes called a user fee, to be paid by water companies based on gross intrastate revenues. This fee funds the Commission's work. (PU Code Chapter 2.5.) The fee is currently set at 1.5% and is passed on to consumers on their utility bills. (PU Code § 404.)

Branch asks that we impose this 1.5% fee on penalty amounts collected by water companies that have imposed mandatory rationing. For the reasons discussed below, we decline at this time to assess the fee on rationing penalties.

As Branch notes, a rationing penalty is not "revenue" at the time it is imposed or collected. Tariffs authorizing penalties require that penalty collections be booked to a special account for disposition as authorized by the Commission. In D.90-08-055, we authorized three water corporations to use the fines collected in suspense accounts to offset net revenue losses due to rationing and fines imposed by their water suppliers. Remaining penalty money was transferred to expense balancing accounts. The offset provided by penalties reduces the surcharge that these companies charge ratepayers to recover losses in their drought memorandum accounts. (D.90-08-055, pp. 55-56.)

Since a penalty is not revenue at the time it is collected, and since the user fee must be assessed based on revenue (PU Code §§ 432(4), 435(c)), the question is when may a utility

impose the fee on customers. Branch argues that utilities may impose the fee at the time a penalty is collected on the basis that the most likely disposition of the penalties will be conversion to revenue. That is, penalty funds become revenue if they offset memorandum account recovery or are transferred to an expense balancing account, as was ordered in D.90-08-055. However, penalty funds do not become revenue if they are refunded to customers or if they are turned over to a regional water purveyor.

The evidence shows that these "non-revenue" uses of penalty funds can be significant. SJWC in the month of March 1991 returned to customers $38,000 more than it received in penalties because conserving customers "earned back" penalties they earlier had paid. In April 1991, SJWC turned back to conserving customers $92,000 more than it received in penalties. Other water corporations collect rationing penalties from customers but turn them over in full to Metropolitan Water District or other agencies that have imposed the rationing.

CWS objects to collecting a user fee on penalties on grounds that it will be perceived by customers as imposing a fee on a fee. Cal-Am objects that customers already have paid the 1.5% fee on water usage, and imposing 1.5% on a penalty for excess water used appears to impose the user fee twice on the same usage. Branch responds correctly that the fee is not a tax on usage but is an impost on revenues. We agree with the utilities, however, that a customer who pays 1.5% on an amount of excess usage, plus another 1.5% on the penalty for that excess usage, may legitimately feel that he has paid the fee twice.

We return then to the question of how to impose a 1.5% revenue fee on funds that are not revenue. We find no authority in PU Code Chapter 2.5 permitting us to make such an assessment, and no party cites us to other authority for imposing the fee. Alternatively, Branch suggests that we require utilities to change their tariffs to state that penalty funds are revenue when

collected, thus subject to the 1.5% fee.[18] The record shows, however, that calling a penalty revenue does not make it so. Penalty refunds for later conservation, and pass-through penalty payments to water suppliers, are not revenue. If some penalty money does not become revenue, then utilities face the daunting task of determining what customer paid a fee on non-revenue and refunding that amount to him.

We conclude that rationing penalties are not revenue at the time of collection, and therefore are not susceptible to the 1.5% reimbursement fee at that time. While technically these funds may later become revenue, it is not feasible to collect a 1.5% fee retroactively. Moreover, we find no authority suggesting that the primary use of penalty funds (i.e., an offset to drought memorandum accounts, thus reducing the drought surcharge on ratepayers) is one intended to be subject to the reimbursement fee. Chapter 2.5 of the PU Code gives us discretion in establishing the rules and regulations that implement the reimbursement fee, so long as the rules are just and reasonable. (See, e.g., PU Code §§ 410, 432, 435.) Based on that authority, we find at this time that rationing penalties are not subject to the reimbursement fee.

8. Drought 'Banking' Procedure

Utilities with mandatory rationing charge a penalty per 100 cubic feet (ccf) of water over a customer's rationing allotment. If a customer uses less water than his allotment during a billing period, the amount saved is "banked" to the customer's account and is available for use in a later billing period without

18 Thus, instead of paying a $2 fine per 100 cubic feet (ccf) of excess use, the customer would pay $2.03 per ccf. Alternatively, Branch suggests that the $2 penalty could remain unchanged but be deemed to be inclusive of the 1.5% fee. In other words, the penalty would be reduced to $1.97, and 2 or 3 cents above that amount would go to the state fund supporting the work of the Commission.

incurring a penalty. This procedure is authorized by the mandatory rationing tariff rules filed by utilities.

At hearing, Branch challenged the practice of some utilities to "refund" penalties paid by a customer in one billing period if the customer in a subsequent billing period used less water than alloted. Branch argues that this refund of penalties paid is not expressly authorized in tariffs filed by the utilities. Utilities respond that, first, the tariffs contemplate a cumulative penalty, thus expressly envisioning a "refund" feature, and, second, the practice has been in place for at least three years and has proved to be a successful technique in encouraging customers to conserve water.

The tariff language in dispute is typified by that of SJWC. Relevant portions of SJWC's Rule No. 14-1 (Mandatory Water Rationing Plan) state as follows:

> "C. <u>CONSERVATION FEE</u>
>
> "1. A conservation fee of $2.00 per 100 cubic feet of water used in excess of the applicable allocation during each...billing period shall be charged by the Company on all read-month bills..., except that such conservation fee shall not apply to any customer...whose consumption is 600 cubic feet or less per billing period per dwelling unit, <u>nor to any customer whose total consumption to date during the period this rationing plan has been in effect does not exceed the total allocated usage for said period</u>.
>
> * * *
>
> "2. Any monies collected by the Company through conservation fees shall not be accounted for as income, but shall be accumulated by the Company in a separate account for disposition as directed or authorized from time to time by the California Public Utilities Commission." (Emphasis added.)

Branch argues that a "refund" of a penalty to a customer who uses too much water in one billing period but uses less than his allotment in a later period constitutes a "disposition" of penalty fees not authorized by the Commission pursuant to Paragraph C(2) of the rationing plan tariff. Utilities argue that the highlighted section of Paragraph C(1) contemplates a running or cumulative allotment by stating that the penalty does not apply to those whose water use "does not exceed the total allocated usage" for the period that the rationing plan has been in effect.

We agree with Branch that the tariff does not allow for refunds of penalty moneies. The tariff contemplates water usage, not penalty monies. The utility is mixing apples with oranges, or in this case, gallons and dollars. The portion of the tariff which applies to penalty monies is found in subpart (2) which clearly states that any disposition of money is to be directed by the Commission.

While we find these actions inconsistent with the tariffs, we do not believe that these activities were an intentional violation. We note that SJWC did not profit by these actions. Further, as noted by CWS witness Ferraro, the possibility of refund has tended to increase future compliance. Because of the good faith by the utilities we do not believe any penalties are appropriate at this time.

We expect the utilities to file to clarify the meaning of their tariffs if they believe ambiguity remains.

9. Other Matters

With some exceptions, the parties generally agree on other matters presented to the Commission in this part of the Drought Phase proceeding. Our examination of these matters, discussed below, persuades us that recommendations of the parties are just and reasonable.

9.1 Water Management Program Requirements for Small Utilities

The Commission in D.90-07-067 authorized all utilities to establish memorandum accounts to track expenses and revenue losses attributable to rationing and to conservation. In D.90-08-055, the Commission made recovery of amounts in the memorandum accounts subject to approval of a water management program and a risk reduction adjustment. A total of 59 such programs were filed by Class A utilities, and one was filed by a Class B utility. While they were authorized to do so on a voluntary basis, none of the 176 Class D water companies (fewer than 500 customers) and none of the 30 Class C companies (500 to 1,999 customers) elected to do so. This is not surprising. As Branch noted:

> "A Water Management Program is intended to be a comprehensive document for long-term (20-year) planning and scheduling of water supply and conservation projects. It covers the projected water demand for that period, the development of new supply sources, the economic effects and demand-reducing effects of specific conservation measures, and the proposed scheduling of those measures...
>
> "Preparing a WMP can be a major effort. An adequate WMP can require several months to prepare, and may involve a large amount of coordination with public agencies and suppliers. Several Class A utilities hired additional personnel or engaged consultants to assist in the preparation of their WMPs. Some Class A utilities will take more than 10 months to complete their filings." (Exhibit 100, p. 6.)

Branch states that some Class B, C, and D utilities did not foresee continued drought in 1991, but now must ration water and are subject to conservation-related expenses and reduced revenue. While these companies are authorized to establish memorandum accounts to record such expenses and lost revenue, they

have no way of filing for recovery under our rulings because they did not prepare water management programs.

To deal with this, Branch recommends that Class B utilities be permitted to file water management programs for Commission approval at any time prior to filing for recovery of monies tracked in a drought memorandum account. Branch recommends that the requirement of a water management program be waived as a condition for Class C and D companies to file for recovery of a drought memorandum account. The smaller water companies have neither the personnel nor resources to develop such comprehensive programs.

In short, Branch would permit any water company to establish a memorandum account to track rationing or conservation expenses and lost revenue. A company then by advice letter or application may (subject to the trigger mechanism discussed below) file for recovery of amounts in the memorandum account. Class A and B utilities would be required as a condition for recovery to have filed and obtained Commission approval of a water management program. Class C and D utilities would not have to file such a program, but their requests for recovery of drought memorandum account would be reviewed for reasonableness and would be subject to the risk reduction formula.

No utility objects to Branch's proposal. CWS asks whether, as a practical matter, small water companies are likely to take advantage of the memorandum account procedure. Branch responds that it will advise these utilities that the procedure is available for rationing and conservation costs, and it will answer any questions that the small utilities have. The drought memorandum account will be a financial and conservation tool available to these companies if they elect to use it.

Branch's proposal is a reasonable one. The record in this and our companion investigation, I.90-11-033, investigating financial and operational risks of small water utilities, makes it

clear that Class C and D water companies that establish conservation programs may have need for a memorandum account in order to recover costs, yet may lack resources to prepare a water management program. Class B utilities, on the other hand, should be encouraged to develop such programs to meet the continuing need for water resource management.

9.2 Generic Rule 14.1

The drought has created an unprecedented water shortage. The Metropolitan Water District and other regional agencies and cities have required rationing on short notice. Regulated water utilities are required to obtain Commission approval of rationing plans before implementing rationing. (Water Code § 357.) The regulated utilities also must obtain Commission approval before discontinuing a rationing plan.

To meet the urgency of these rationing requirements, the Commission in D.90-08-055 directed Branch to process rationing requests for the earliest Commission agenda on which they can be calendared. Utilities seeking approval for rationing must file what has come to be known as Tariff Rule 14.1, and an accompanying tariff schedule, setting forth rates and conditions of the rationing plan.

To further speed this process, Branch has distributed a "generic" Rule 14.1 that it recommends for Commission approval and for adoption as part of the tariffs of all regulated water utilities that are now or may in the future be subject to rationing. With the pre-approved rule in its tariffs, a utility need only file an accompanying tariff schedule to implement rationing. Once its Schedule 14.1 is approved, a utility may comply with rationing mandated by a water supplier. Similarly, a utility may implement its own rationing program by filing for approval of a Schedule 14.1 to implement its pre-approved Rule 14.1, after it has complied with all other applicable state laws.

Branch's proposed generic Rule 14.1 is attached to this order as Appendix B. Section A of the rule sets forth voluntary conservation techniques that a utility may call upon customers to observe. Section B of the rule authorizes mandatory rationing, pursuant to a Tariff Schedule 14.1. Section C of the rule states penalties and other sanctions for violation of rationing.

During examination, Branch witness Martin R. Bragen further explained how the proposed rule would be used:

> Q. (W)ould generic Rule 14.1 apply in the case where a utility wished to impose voluntary conservation on its ratepayers?
>
> A. It could be used as a guide, but it wouldn't be in effect unless a Schedule 14.1 required mandatory conservation or rationing. In other words, these could be considered as guides for voluntary conservation, but they wouldn't really require the customers to do anything unless there was a Schedule 14.1 in effect.
>
> Q. So Generic 14.1 would go into effect when a utility was either required to implement rationing by, say, Metropolitan Water District, or when the utility on its own judgment decided to impose mandatory rationing, is that correct?
>
> A. Yes. And the mode that it would go into effect would be for Tariff Schedule 14.1 to be approved to activate the Rule 14.1.
>
> Q. That is, the generic rule would be in place and the utility would submit a new Schedule 14.1 in line with its rationing plan?
>
> A. That is correct. (Tr., p. 480.)

Bragen stressed that utilities need not file the generic Rule 14.1 if they do not wish to do so. Similarly, they may file variations of the generic rule to fit their system requirements. (That is, in the words of one utility, the generic rule is not intended to become generic cement.) The aim is simply to have a

pre-approved rule in place to reduce the time required for processing a rationing plan request.

Branch also recommends that utilities be authorized to discontinue mandatory conservation and rationing on five days' notice by filing an advice letter. Without that procedure, utilities have sometimes been unable to lift rationing restrictions for several weeks because of the time required for Commission approval.

Utilities support Branch's recommendations for a generic Rule 14.1 and for authorization to discontinue rationing on five days' notice through advice letter filings. These are sensible proposals and will further enable utilities and the Commission to act promptly in meeting drought emergency. Utilities are authorized to file the "generic" Rule 14.1 (Appendix B), or a variation thereof, by advice letter. Utilities are authorized to discontinue rationing on five days' notice upon approval of an advice letter filing.

9.3 Trigger for Voluntary Conservation Memorandum Account

In D.90-08-055, we authorized CWS, SJWC, Cal-Am, and Great Oaks Water Company (Great Oaks) to file advice letters to implement a surcharge to recover revenue losses incurred due to imposition of mandatory rationing. In doing so, we accepted the argument of water companies that lost revenues (for purposes of a drought memorandum account) be defined as the difference between revenues at 100% of the adopted sales and actual sales. Further, we adopted the recommendation of water companies that the utility surcharge be based on annualized sales. We directed that the surcharge could remain in effect until the end of the mandatory rationing period, and that any over- or under-collections be transferred to a utility's expense balancing account. This procedure prevents ratepayers from being overcharged and also provides utilities with a reasonable opportunity to recover their

revenue losses. The order limited recovery of memorandum accounts to those funds tracked to the effective date of D.90-08-055 (August 8, 1990).

Our order today authorizes each Class A and Class B water utility to file an advice letter for recovery of the adjusted amount in its memorandum account at any time after approval of the utility's water management program and the determination of the adjustment for risk reduction. Class C and D utilities may file for recovery of memorandum account funds without the necessity of a water management program. The net lost recorded funds (before risk adjustment) shall be calculated in the manner authorized in D.90-08-055.

Pursuant to our order in D.90-07-067, utilities with voluntary conservation programs (that is, a conservation program not required because of mandatory rationing) also are entitled to establish drought memorandum accounts and to recover net lost revenues and conservation expenses in the same manner as that applicable to mandatory rationing.

SCWC correctly notes that our earlier decisions, which concentrated on rationing, did not set forth a triggering mechanism for utilities to recover memorandum accounts tracking voluntary conservation programs. Branch proposes, and SCWC endorses, a relatively simple advice letter procedure.

First, a utility with a voluntary conservation program may file an advice letter for recovery of the adjusted amount in its memorandum account. Second, the utility will calculate an annualized surcharge to be recovered in 12 months. The surcharge will be calculated to recover accumulated net revenues in the account, plus the amount estimated to be accumulated in the subsequent 12 months.

Third, when the surcharge has been in effect for 10 months, the utility will file an advice letter to reduce or otherwise adjust the surcharge for the 12-month period following

the first year of the surcharge. Finally, when voluntary conservation ends, a utility may by advice letter seek to transfer its memorandum account balance to its expense balancing account. Alternatively, if the utility files a general rate case, the surcharge and any amounts in the memorandum account would be incorporated into rates.

Class C and D water companies that have launched conservation programs can and should establish drought memorandum accounts to recover some of their lost revenue and expenses attributable to the drought. Branch has been directed to assist these small operators in tracking conservation costs.

Branch's proposal for dealing with voluntary conservation memorandum accounts is supported by SCWC, CalWater, and other utilities. We believe that the proposal is a reasonable one and that it will encourage regulated utilities to implement conservation programs during the drought.

9.4 Great Oaks Water Company

Great Oaks has served its customers since 1959 without seeking a rate increase through a general rate proceeding. Since it has no adopted normalized sales level or adopted return on equity, it argues that no risk reduction offset can or should be applied to its recovery of memorandum account revenue. Branch responds that the memorandum account of Great Oaks is as likely as that of any other utility to contain some amount representing protection against normal business risk. Branch recommends that, in the absence of a rate case, calculation of the risk offset for Great Oaks be the same percentage reduction as that applied to the memorandum account for SJWC. Great Oaks objects that it is one-tenth the size of SJWC and has a different capital structure. Assuming as we do in this decision that normal business risk is captured in memorandum accounts, Branch obviously is correct that the account benefits Great Oaks as much as it does utilities with adopted rate bases. In D.90-08-055, we applied pro forma

workpapers prepared by Branch (Exhibit 15 in that proceeding) for Great Oaks ratemaking issues. (D.90-08-055, pp. 16-17.) We will permit Great Oaks to calculate its risk reduction offset either through the use of those pro forma workpapers or through adoption of the percentage reduction applicable to SJWC.

9.5 Subsequent Proceedings

Branch and utilities agree and jointly propose to the Commission that a third round of hearings be scheduled following today's order to take evidence on remaining Drought Phase issues. These issues include utility incentives for conservation included in water management programs, compensation for expenses incurred due to changes in supply mix, a proposal for balancing accounts to mitigate effects of rationing, and accounting clarifications with respect to memorandum accounts. A prehearing conference to schedule the third round of hearings has been set for 10:00 a.m. Wednesday, November 13, 1991, in the Commission Courtroom in San Francisco. By ruling, it has been directed that each party that advocates further issues in this proceeding serve upon other parties no later than October 28, 1991, a statement setting forth the issues that the party advocates, along with a brief explanation of the issues and the position of the party. A party that is not an advocate for any further issue in this proceeding need not serve a prehearing statement.

10. Comments on ALJ's Proposed Decision

In accordance with PU Code § 311 and Rule 77.1 of the Rules of Practice and Procedure, the draft decision prepared by the assigned administrative law judge was issued on September 20, 1991. Timely comments were filed by Cal-Am, SoCalWater, SJWC, CWS, Branch and DRA. We will accept the comments of Branch and DRA and of SJWC, although these parties have not set forth findings of fact and conclusions of law to support proposed changes, as required by Rule 77.4. Timely reply comments were filed by Branch and DRA.

CWS filed a reply and a motion for leave to file late; for good cause shown, the motion is granted.

All of the comments and replies have been carefully considered by the Commission, and we have made corrections in the text where warranted.

On a more substantive level, SoCalWater, SJWC, and CWS argue that the evidence does not support a 20-basis point reduction in return on equity applied to recovery of memorandum accounts, while Branch and DRA argue that a reduction of 50 basis points or more is justified on this record. The comments for the most part reargue positions taken in briefs and, to that extent, are accorded no weight. (Rule 77.3.) To the extent that the comments address purported factual, legal or technical errors, we find that the decision adequately addresses points raised by the parties.

As to our finding in Section 8 on "refunds" of rationing penalties, Branch and DRA assert that PU Code $$ 491 and 494 require that customer refunds be approved by the Commission. We believe that the decision is clear in framing the issue to inquire whether certain tariff language approved by the Commission may be construed to contemplate a cumulative penalty, subject to adjustments. Nevertheless, because both SJWC and CWS agree that the tariff language should be more precise, we have modified Ordering Paragraph 11 to require clarification of these tariffs.

<u>Findings of Fact</u>

1. California is in its fifth year of drought.

2. Of 17 Class A water utilities, 10 were required to implement mandatory rationing in some or all of their districts in 1990 and 1991.

3. Many of the state's 233 regulated water companies have on their own or at the urging of public agencies introduced programs to encourage voluntary water conservation.

4. On March 8, 1989, the Commission instituted I.89-03-005 into measures to mitigate the effects of drought on regulated water utilities and their customers.

5. All water companies were authorized by D.90-07-067 to establish memorandum accounts to track expenses and revenue losses caused both by mandatory rationing and by voluntary conservation.

6. Recovery of memorandum account revenue was made contingent in D.90-08-055 on (i) approval of a formal water management program, and (ii) adjustment of the memorandum account to recognize reduced risk of normal sales losses.

7. A total of 60 water management programs have been submitted for approval by the Commission.

8. Branch has certified 38 water management programs as complete and recommends their approval.

9. Branch recommends that projects within water management programs be approved when implemented or when a utility seeks to recover costs for such programs.

10. DRA and utilities dispute whether drought memorandum accounts reduce utility risk by protecting the utility against normal business risk losses.

11. DRA believes that a mathematical model can identify protection against business risk by an amount representing a 50-basis point reduction in return on equity in a company's last rate case.

12. Normalized sales level is developed using a 30-year average of rainfall and temperature data, and such data excludes periods of drought.

13. Water sales normally increase during periods of warm/dry weather and decrease during periods of cool/wet weather.

14. Utilities believe that because the drought memorandum account is limited to the normalized sales level, the memorandum account already excludes non-drought sales losses.

15. SoCalWater is joined by other party utilities in an alternative argument that if memorandum accounts are reduced to recognize protection against normal business risk, the reduction should be no more than 10 basis points.

16. Reduction of return on equity is one way to measure normal business risk of lost sales.

17. The Commission has consistently directed that water companies should be permitted to recover reasonable lost revenue and expenses caused by drought, up to normalized sales level.

18. Commission decisions in this proceeding contemplate full recovery of drought losses up to forecasted sales levels in order to encourage conservation.

19. Ratepayers have been placed on notice that the cost of water is likely to increase because of rationing and conservation.

20. Non-drought revenue captured in a memorandum account is likely to be minimal because the account is capped at normalized sales levels and the account is only in effect at times when above-normal sales would be likely but for conservation restraints.

21. DRA's risk reduction formula is intended to provide direction for policy decisions rather than precise mathematical conclusions.

22. Branch and utilities disagree on whether a 1.5% utility fee may be imposed upon penalties paid by consumers who exceed their water allotment during rationing.

23. PU Code $$ 431 and 432 direct the Commission to establish a utility fee based on gross intrastate revenues of water companies.

24. By tariff definition, rationing penalties paid by customers who exceed their water allotment are not revenue at the time of collection.

25. Penalty funds do not become revenue if they are refunded to customers or if they are turned over to a regional water purveyor.

26. Penalty funds become revenue if, upon Commission order, they offset memorandum account revenue or are transferred to an expense balancing account.

27. Branch and utilities disagree on whether consumer penalties imposed during rationing are intended to be cumulative under governing tariffs.

28. Branch believes that a "refund" of a penalty to a customer who uses too much water in one billing period but uses less than his allotment in a later period constitutes a disposition of penalty fees not authorized by tariff.

29. Water companies believe that applicable tariffs contemplate a cumulative penalty, thus justifying "refunds."

30. Permitting customers to "earn back" penalties by later conservation is a popular feature of rationing programs.

31. Some Class B, C, and D utilities did not foresee continued drought in 1991 and now must ration or otherwise conserve water.

32. Class B utilities are capable of developing and filing water management programs.

33. Because of their smaller size, many Class C and Class D utilities do not have the resources to readily develop and file water management programs.

34. No utility objects to a Branch recommendation that Class B utilities be permitted to file water management programs at any time, and that the requirement of a water management program be waived for Class C and D water companies.

35. The Metropolitan Water District and other wholesale water suppliers have required rationing on short notice.

36. No utility objects to a Branch recommendation for a generic Rule 14.1 that would permit water companies to more quickly implement rationing when required.

37. No utility objects to a Branch recommendation that utilities be permitted to discontinue rationing on five days' notice through advice letter filings.

38. Water companies with voluntary conservation programs are entitled to establish drought memorandum accounts to recover net lost revenue in the same manner as that applicable to mandatory rationing.

39. No utility objects to a Branch recommendation that a utility with voluntary conservation be permitted to file an advice letter for recovery of memorandum account revenue calculated as an annualized surcharge to be recovered in 12 months.

40. Branch and Great Oaks disagree on whether the risk reduction calculation should apply to a water company that has no adopted normalized sales level or adopted return on equity.

41. Great Oaks has served its customers since 1959 without seeking a rate increase through a general rate proceeding.

42. Branch and all party utilities agree that a third round of hearings is necessary to take evidence on remaining Drought Phase issues.

Conclusions of Law

1. Water management programs certified as complete by Branch should be approved by the Commission.

2. Conservation projects in the water management programs should be subject to review during a rate case or at the time a utility seeks to recover costs and lost revenue attributable to the conservation projects.

3. Drought memorandum accounts authorized by the Commission reduce utility risk by protecting the utility against normal business risk losses.

4. Drought memorandum accounts are intended to permit full recovery of reasonable lost revenue and expenses caused by drought, up to the level of a utility's normalized sales.

5. Utilities have failed to meet the burden of showing that DRA's risk reduction methodology, in its entirety, is an unreasonable one.

6. Utilities have shown that "normal risk" revenue captured in a memorandum account is likely to be minimal.

7. SoCalWater's recalculation of the DRA methodology leads to a calculation of ROE reduction that is supported by this record.

8. Memorandum account recovery should be reduced by an amount equivalent to a 20-basis point reduction in return on equity in a utility's last approved rate case.

9. Fines collected from consumers for exceeding their water allotment under mandatory rationing are not revenue at the time of collection.

10. The 1.5% utility fee authorized by PU Code Chapter 2.5 should not be assessed on fines collected from consumers for exceeding their water allotment under mandatory rationing.

11. Tariffs filed with the Commission have the force and effect of law.

12. Tariffs should be construed applying rules of statutory construction.

13. SJWC Tariff Rule 14.1 (Mandatory Water Rationing Plan) contemplates a cumulative customer penalty for exceeding the customer's water use allotment under mandatory rationing.

14. Under tariff language substantially similar to that of SJWC Tariff Rule 14.1, utilities should not be permitted to adjust customer penalties on a cumulative basis and "refund" past penalties based on later under-utilization of a customer's water use allotment. However, tariffs should be revised to more clearly state the cumulative basis of the penalty provisions.

15. Class B utilities should be permitted to file water management programs at any time prior to seeking recovery of memorandum account revenue.

16. Class C and Class D water companies should be permitted to file for recovery of drought memorandum account revenue without the requirement of filing a water management program.

17. A generic Tariff Rule 14.1 proposed by Branch and intended to permit water companies to more quickly implement rationing when required should be approved by the Commission.

18. Utilities should be permitted to seek approval to discontinue rationing on five days' notice through advice letter filings.

19. A water company with a voluntary conservation program should be permitted to file an advice letter for recovery of memorandum account revenue calculated as an annualized surcharge to be recovered in 12 months.

20. The risk reduction calculation should be applied to the drought memorandum account of Great Oaks even though it does not have an adopted normalized sales level or an adopted return on equity.

21. Great Oaks should be permitted to apply a memorandum account risk reduction factor computed either through a pro forma ratemaking developed by Branch or through adoption of the percentage reduction applicable to SJWC.

22. Because of the continuing drought, this order should be effective immediately in order to help mitigate effects of the drought on regulated water utilities, their customers and the general public.

23. When a utility is applying to recover net revenue losses tracked in the memorandum account, the utility should first offset the net revenue losses recorded in the memorandum account by applying the risk reduction factor. The utility should then offset the remaining memorandum account balance with penalty funds. If there remains a balance in the memorandum account, the utility is authorized to file an advice letter setting forth a surcharge for recovery of that balance. However, if penalty funds remain after

the second offset, such funds should be incorporated in the utility's expense balancing account.

INTERIM ORDER

IT IS ORDERED that:

1. Water management programs certified as complete by the Water Utilities Branch of the Commission Advisory and Compliance Division (Branch) are accepted and approved. Specific proposals set forth in each water management program are subject to further review and approval during a utility's rate case or at the time a utility seeks to recover costs of such proposals.

2. Water management program applications set forth in Appendix A are consolidated into this proceeding pursuant to Rule 55 of the Rules of Practice and Procedure.

3. Utilities that have established drought memorandum accounts pursuant to Commission order in Decision (D.) 90-07-067 and D.90-08-055 are authorized to file advice letters to implement a surcharge, pursuant to Commission guidelines in D.90-08-055 and this order, to recover reasonable revenue losses and expenses recorded in the memorandum account. Implementation of a surcharge is contingent upon (i) approval of the utility's water management program; (ii) reduction of the memorandum account balance pursuant to the risk reduction adjustment set forth in this order, and (iii) offset of the memorandum account balance, where applicable, by water rationing fines collected in a utility's suspense account.

4. California Water Service Company, San Jose Water Company, California-American Water Company, and Great Oaks Water Company are authorized to use water rationing fines collected in suspense accounts since August 9, 1990, to offset the net revenue losses due to rationing and fines imposed by their water suppliers after retaining sufficient penalty funds to provide for estimated penalty refunds over the next year. Remaining funds in the suspense

account, if any, shall be transferred to the corporate or district expense balancing accounts pursuant to the method and guidelines set forth in D.90-08-055.

5. Before seeking recovery of a drought memorandum account balance, a utility shall reduce such balance by an amount equal to a 20-basis point reduction in the utility's most recently adopted return on equity, pursuant to the guidelines set forth in this order. Before seeking recovery of such drought memorandum account balance, the utility shall reduce the amount to be recovered to a level sufficient to ensure that such recovery shall not cause the utility to exceed the authorized rate of return for the utility district for the period covered by the memorandum account.

6. A Class B water company is authorized to file a water management program at any time prior to seeking recovery of a drought memorandum account.

7. The requirement of filing a water management program prior to recovery of a drought memorandum account is waived for Class C and Class D water companies.

8. Water companies are authorized to file, by advice letter, for approval of a generic Tariff Rule 14.1, set forth in Appendix B, or a variation of that generic rule.

9. Water companies are authorized to file, by advice letter on five days' notice, for approval to discontinue rationing.

10. Water companies that have established drought memorandum accounts in connection with voluntary conservation plans are authorized to file, by advice letter, for approval to recover the memorandum account balance. Recovery shall be through a 12-month surcharge to recover the adjusted balance and an amount estimated to be accumulated in the subsequent 12 months. When the surcharge has been in effect for 10 months, the water company will file an advice letter for approval to adjust the surcharge for the 12-month period following the first year of the surcharge.

11. Utilities that intend during a period of rationing to adjust penalties to reflect cumulative use during rationing shall amend their tariffs to state that penalties will be assessed on a cumulative use basis, and that a customer penalized in one billing period may "earn back" the amount of the penalty by using less than the customer's allotment in a subsequent billing period. Such modification may be by advice letter and shall be completed within 90 days of this order.

12. The proceeding in Order Instituting Investigation 89-03-005 and the proceedings in water management applications (Appendix A) shall remain open to address further issues.

This order is effective today.

Dated October 23, 1991, at San Francisco, California.

JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I will file a written dissent.

/s/ PATRICIA M. ECKERT
Commissioner

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

NEAL J. SHULMAN, Executive Director

APPENDIX A
Page 1

WATER MANAGEMENT PROGRAMS

Certified as Complete by Water Utilities Branch

A.90-11-038 San Jose Water Company

A.91-01-035 Elk Grove Water Works

A.91-01-038 Great Oaks Water Company

A.91-02-026 Del Este Water Company

A.91-02-017 California Water Service Company (San Mateo District)

A.91-02-027 California-American Water Company (Coronado District)

A.91-02-028 California-American Water Company (Village District)

A.91-02-031 Park Water Company

A.91-02-033 Citizens Utilities Company of California (Sacramento District)

A.91-02-034 Citizens Utilities Company of California (Montara District)

A.91-02-035 Citizen Utilities Company of California (Guerneville District)

A.91-02-036 California-American Water Company (Baldwin Hills District)

A.91-02-037 California-American Water Company (Monterey District)

A.91-02-038 Santa Paula Water Works, Ltd.

A.91-02-039 Santa Clarita Water Company

A.91-02-040 San Gabriel Valley Water Company

A.91-02-042 Apple Valley Ranchos Water Company

A.91-02-043 Valencia Water Company

A.91-02-044 Dominguez Water Corporation

A.91-02-047 Azusa Valley Water Company

A.91-02-048 Southern California Water Company (Los Osos District)

A.91-02-052 California-American Water Company (Duarte District)

A.91-02-053 Southern California Water Company (Simi Valley District)

APPENDIX A
Page 2

A.91-02-054 Southern California Water Company (San Gabriel Valley District)

A.91-02-055 Southern California Water Company (Bay District)

A.91-02-056 Southern California Water Company (Pomona Valley District)

A.91-02-057 Southern California Water Company (Ojai District)

A.91-02-058 Southern California Water Company (Metropolitan District)

A.91-02-059 Southern California Water Comapny (Orange County District)

A.91-02-060 Southern California Water Company (Desert District)

A.91-02-061 Southern California Water Comapny (Wrightwood District)

A.91-02-062 Southern California Water Company (Clearlake District)

A.91-02-063 Southern California Water Comapny (San Dimas District)

A.91-02-064 Southern California Water Company (Arden-Cordova District)

A.91-02-065 Southern California Water Company (Barstow District)

A.91-02-066 Southern California Water Company (Calipatria-Niland District)

A.91-02-067 Southern California Water Company (Santa Maria District)

A.91-02-068 California-American Water Company (San Marino District)

A.91-03-003 Suburban Water Systems

A.91-05-034 Citizens Utilities Company of California (Felton District)

<u>Not Certified as Complete by Water Utilities Branch</u>

A.91-02-001 California Water Service Company (Westlake District)

A.91-02-002 California Water Service Company (Visalia District)

A.91-02-003 California Water Service Company (South San Francisco District)

A.91-02-004 California Water Service Company (Oroville District)

A.91-02-008 California Water Service Company (Willows District)

A.91-02-009 California Water Service Company (East Los Angeles District)

APPENDIX A
Page 3

A.91-02-010 California Water Service Company (Hermosa-Redondo District)

A.91-02-012 California Water Service Company (Stockton District)

A.91-02-013 California Water Service Company (Bear Gulch District)

A.91-02-014 California Water Service Company (Bakersfield District)

A.91-02-015 California Water Service Company (Salinas District)

A.91-02-016 California Water Service Company (Livermore District)

A.91-02-018 California Water Service Company (Los Altos-Suburban District)

A.91-02-019 California Water Service Company (San Carlos District)

A.91-02-020 California Water Service Company (Selma District)

A.91-02-021 California Water Service Company (King City District)

A.91-02-022 California Water Service Company (Dixon District)

A.91-02-023 California Water Service Company (Chico/Hamilton City District)

A.91-02-024 California Water Service Company (Palos Verdes District)

A.91-02-025 California Water Service Company (Marysville District)

(END OF APPENDIX A)

Cal. P.U.C. Sheet No.

Canceling Cal. P.U.C. Sheet No.

RULE NO. 14.1

MANDATORY WATER CONSERVATION AND RATIONING PLAN

GENERAL INFORMATION

If water supplies are projected to be insufficient to meet normal customer demand, the utility may elect to implement voluntary conservation using the portion of this plan set forth in Section A of this Rule after notifying the Commission's Water Utilities Branch of its intent. If in the opinion of the utility more stringent water conservation measures are required, the utility shall request Commission authorization to implement the mandatory conservation and rationing measures set forth in Section B.

The Commission shall authorize mandatory conservation and rationing by approving Tariff SCHEDULE NO. 14.1, MANDATORY WATER CONSERVATION AND RATIONING. When Tariff Schedule No. 14.1 has expired or is not in effect, mandatory conservation and rationing measures will not be in force. Tariff Schedule No. 14.1 will set forth water use allocations, excess water use penalties, charges for removal of flow restrictors, and the period during which mandatory conservation and rationing measures will be in effect.

When Tariff Schedule No. 14.1 is in effect and the utility determines that water supplies are again sufficient to meet normal demands and mandatory conservation and rationing measures are no longer necessary, the utility shall seek Commission approval to rescind Tariff Schedule No. 14.1 to discontinue rationing.

In the event of a water supply shortage requiring a voluntary or mandatory program, the utility shall make available to its customers water conservation kits as required by Rule No. 20. The utility shall notify all customers of the availability of conservation kits.

(continued)

Cal. P.U.C. Sheet No.

Canceling Cal. P.U.C. Sheet No.

RULE NO. 14.1
(continued)

A. CONSERVATION - NONESSENTIAL OR UNAUTHORIZED WATER USE

No customer shall use utility-supplied water for nonessential or unauthorized uses as defined below:

1. Use of water through any connection when the utility has notified the customer in writing to repair a broken or defective plumbing, sprinkler, watering or irrigation system and the customer has failed to make such repairs within 5 days after receipt of such notice.

2. Use of water which results in flooding or run-off in gutters, waterways, patios, driveways, or streets.

3. Use of water for washing aircraft, cars, buses, boats, trailers or other vehicles without a positive shutoff nozzle on the outlet end of the hose, except for the washing of vehicles at commercial or fleet vehicle washing facilities operated at fixed locations where equipment using water is properly maintained to avoid wasteful use.

4. Use of water through a hose for washing buildings, structures, sidewalks, walkways, driveways, patios, parking lots, tennis courts, or other hard-surfaced areas in a manner which results in excessive run-off or waste.

5. Use of water for watering streets with trucks, except for initial wash-down for construction purposes (if street sweeping is not feasible), or to protect the health and safety of the public.

6. Use of water for construction purposes, such as consolidation of backfill, dust control, or other uses unless no other source of water or other method can be used.

7. Use of water for more than minimal landscaping in connection with any new construction.

(continued)

JUL 90

(To be inserted by utility) Issued by (To be inserted by Cal. P.U.C.)

Advice Letter No. _____ NAME _____ Date Filed _____

Decision No. _____ TITLE _____ Effective _____

Resolution No. _____

Cal. P.U.C. Sheet No.

Canceling Cal. P.U.C. Sheet No.

RULE NO. 14.1
(continued)

A. 8. Use of water for outside plants, lawn, landscape and turf areas more often than every other day, with even numbered addresses watering on even numbered days of the month and odd numbered addresses watering on the odd numbered days of the month, except that this provision shall not apply to commercial nurseries, golf courses and other water-dependent industries.

9. Use of water for outside plants, lawn, landscape and turf areas during certain hours if and when specified in Tariff Schedule No. 14.1 when the schedule is in effect.

10. Use of water for watering outside plants and turf areas using a hand held hose without a positive shut-off valve.

11. Use of water for decorative fountains or the filling or topping off of decorative lakes or ponds. Exceptions are made for those decorative fountains, lakes, or ponds which utilize recycled water.

12. Use of water for the filling or refilling of swimming pools.

13. Service of water by any restaurant except upon the request of a patron.

B. RATIONING OF WATER USAGE

In the event the conservation measures required by Section A are insufficient to control the water shortage, the utility shall, upon Commission approval, impose mandatory conservation and rationing. The water allocated for each customer, the time period during which rationing shall be in effect, and any additional conditions, will be set forth in Tariff Schedule No. 14.1, which shall be filed for this purpose at the time such rationing is approved by the Commission.

Before rationing is authorized by the Commission the utility shall hold public meetings and take all other applicable steps required by Sections 350 through 358 of the California Water Code.

(continued)

JUL 90

(To be inserted by utility) Issued by (To be inserted by Cal. P.U.C.)

Advice Letter No. _____ _____ NAME Date Filed _____

Decision No. _____ _____ TITLE Effective _____

Resolution No. _____

Cal. P.U.C. Sheet No.

Canceling Cal. P.U.C. Sheet No.

RULE NO. 14.1
(continued)

C. ENFORCEMENT OF MANDATORY CONSERVATION AND RATIONING

1. The water use restrictions of the conservation program in Section A of this rule become mandatory when the rationing program goes into effect. These restrictions are applicable whether or not the customer exceeds the monthly water allocation.

2. Upon inception of the mandatory provisions of this Rule the utility may, after one verbal and two written warnings, install a flow-restricting device on the service line of any premises where utility personnel observe water being used for any nonessential or unauthorized use as defined in Section A.

3. A flow restrictor shall not restrict water delivery by greater than 50% of normal flow and shall provide the premises with a minimum of 6 Ccf/month. The restrictor may be removed only by the utility, after a three-day period has elapsed, and upon payment of the appropriate removal charge as set forth in Tariff Schedule No. 14.1.

4. After the removal of a restricting device, if any nonessential or unauthorized use of water continues, the utility may install another flow-restricting device. This device shall remain in place until rationing is no longer in effect and until the appropriate charge for removal has been paid to the utility.

5. Each customer's water allocation shall be shown on the water bill. Water allocations may be appealed in writing as provided in Section D of this Rule. If a customer uses water in excess of the allocated amount, the utility may charge the excess usage penalty shown in Tariff Schedule No. 14.1.

6. Any monies collected by the utility through excess usage penalties shall not be accounted for as income, but shall be accumulated by the utility in a separate account for disposition as directed or authorized from time to time by the Commission.

7. The charge for removal of a flow-restricting device shall be in accordance with Tariff Schedule No. 14.1.

(continued)

JUL 90

Cal. P.U.C. Sheet No.

Canceling Cal. P.U.C. Sheet No.

RULE NO. 14.1
(continued)

D. APPEAL PROCEDURE

Any customer who seeks a variance from any of the provisions of this mandatory water conservation and rationing plan or a change in water allocation shall notify the utility in writing, explaining in detail the reasons for such a variation. The utility shall respond to each such request.

Any customer not satisfied with the utility's response may file an appeal with the staff of the Commission. The customer and the utility will be notified of the disposition of such appeal by letter from the Executive Director of the Commission.

If the customer disagrees with such disposition, the customer shall have the right to file a formal complaint with the Commission. Except as set forth in this Section, no person shall have any right or claim in law or in equity, against the utility because of, or as a result of, any matter or thing done or threatened to be done pursuant to the provisions of this mandatory water conservation and rationing plan.

E. PUBLICITY

In the event the utility finds it necessary to implement this plan, it shall notify customers and hold public hearings concerning the water supply situation, in accordance with Chapter 3, Water Shortage Emergencies, Sections 350 through 358, of the California Water Code. The utility shall also provide each customer with a copy of this plan by means of billing inserts or special mailings; notifications shall take place prior to imposing any fines associated with this plan. In addition, the utility shall provide customers with periodic updates regarding its water supply status and the results of customers' conservation efforts. Updates may be by bill insert, special mailing, poster, flyer, newspaper, television or radio spot/ advertisement, community bulletin board, or other appropriate method(s).

JUL 90

(To be inserted by utility) Issued by (To be inserted by Cal. P.U.C.)

Advice Letter No. _____ _____ NAME Date Filed _____

Effective _____

Decision No. _____ _____ Resolution No. _____

(END OF APPENDIX B)

MASTER LIST
I.89-03-005
(DROUGHT PHASE)
REVISED: 09/16/91
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****
INFORMATION ONLY:
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INVESTIGATION "I" 89-03-005

DECISION NO. _____
NO. OF PAGES _____
BILLING CODE _____
DEC. SIGNED _____
(CONFERENCE DATE/SPECIAL DECISION)

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(END OF APPENDIX C)

I.89-03-005, I.90-11-033
D.91-10-042

PATRICIA M. ECKERT, President, Dissenting

One year ago, in Decision 90-08-055, the Commission allowed water utilities to recover 100% of the revenues lost due to mandatory rationing. The Commission adopted a policy of full revenue recovery stating in D. 90-08-055 that "...if we impose any limitation on the revenues subject to recovery we create a disincentive for the utilities to promote conservation."

This policy was supported by the projected water shortages and the then present shortages water utilities were experiencing.

Not much has changed with regard to shortages and drought conditions in the last year.

Our policy one year ago was to encourage utilities to promote conservation by removing any conservation disincentive. At that time we did not want to put utilities in the precarious position of promoting conservation to their financial detriment.

Apparently with today's decision that policy has changed.

I cannot support that change - not as we enter what may be our sixth year of drought - and not as we continue to order the utilities to promote conservation.

Conservation is good. Ordering the water utilities to promote and encourage conservation is good.

Penalizing the utilities for promoting and encouraging conservation is wrong.

Reducing the utilities memorandum account recovery by an amount equivalent to a 20-basis point reduction in return on equity in a utility's last approved rate case is bad policy.

It is a direct disincentive to utilities to promote or encourage conservation.

It is a policy that is bad for the water utilities, bad for the public interest, and bad for the integrity of the water supply in California.

For these reasons I dissent from today's order.

PATRICIA M. ECKERT, PRESIDENT

October 23, 1991
San Francisco, California