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Decision 92-09-084 September 16, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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.

ORIGINAL
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 D.91-10-042 for appearances.)

INTERIM OPINION

1. Summary

This order establishes a Water Management Committee comprised of representatives of water utilities, the Commission staff, and other interested parties, intended to encourage long-term conservation and water resource planning, to protect the interests of ratepayers and to provide for continued economic health of investor-owned water companies. The order also provides for continued work on water management programs prepared by 60 water company districts and closes the applications for approval of those programs. Certain procedural requests are approved, as are two requests by utilities for modifications of prior Drought Phase decisions. While many of the procedures adopted in this Drought Investigation are likely to be reinstated when California faces its next drought, and could be authorized in a timely manner, we deny the request by utilities that we order that all procedures now in place be applied automatically to future droughts.

2. Background

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 the drought on the state's 233 regulated water utilities and their customers.¹ All water utilities subject to the Commission's jurisdiction were made parties, and all Class A, B, and C utilities

¹ The Commission recognized in Decision (D.) 90-08-055 that while it strongly encourages efforts to reduce water use and increase sources of water, 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.

I N D E X

<u>Subject</u>	<u>Page</u>
INTERIM OPINION	2
1. Summary	2
2. Background	2
2.1 Industry Workshops	4
3. Consensus on Future Direction.....	5
3.1 Positions on Working Committee	6
3.2 Establishment of Water Management Committee	7
3.3 Committee Meeting and Report Dates	8
3.4 Inclusion of Certain Expenses	9
3.5 Review of Water Management Programs	10
3.6 Closing of Program Applications	11
3.7 Continuation of Memorandum Accounts	12
3.8 Additional Requirements for Conservation Accounts ..	14
4. Contested Issues	15
4.1 Procedural Objections	15
4.2 Applicability to Future Droughts	16
4.3 Treatment of Penalty Reserves	18
4.4 Continuation of Rationing Surcharges	19
5. Comments on ALJ's Proposed Decision	21
Findings of Fact	22
Conclusions of Law	23
INTERIM ORDER	25
APPENDIX A	

INTERIM OPINION

1. Summary

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(that is, those serving more than 500 connections) were required to provide information on their water supply outlook.

Since that time, approximately 15 days of public hearings and numerous workshops have been conducted. Comprehensive plans for dealing with drought have been proposed, analyzed, and debated by the Commission's Water Utilities Branch (Branch), water utilities, the utilities' trade association, consultants, and interested ratepayers. With the benefit of this review, the Commission in three interim decisions has adopted policies proposed by the parties that can have important results in conserving water resources.

In D.90-07-067, effective July 18, 1990, we authorized all utilities to establish memorandum accounts to track expenses and revenue shortfalls caused both by mandatory rationing and by voluntary conservation programs. We reasoned that without some form of revenue protection, utilities could not be expected to launch aggressive water conservation programs.

In D.90-08-055, effective August 8, 1990, we required each Class A utility, and any other utility seeking to recover revenue from a memorandum account, to develop for Commission approval a water management program addressing long-term strategies for managing water resources. Water management programs now have been developed for 60 districts. All have been certified as complete by Branch.² Each of these programs is a comprehensive one, complete with long-range forecasts, water resource management plans, and conservation efforts that range from leak detection and

² See D.91-10-042, where 40 programs were certified as complete; D.91-12-035, where 10 additional programs were conditionally accepted as complete; and D.92-04-021, where approval as to form was granted to the 10 programs conditionally approved and to 10 additional programs.

distribution of flow restrictors to an annual "smart garden" contest and no-cost water audits for homeowners.

In D.91-10-042, effective October 23, 1991, we adopted procedures by which water companies are to reduce their memorandum accounts to reflect operating cost reductions resulting from drought and reduced regulatory risk. Additionally, the memorandum accounts are to be offset by any penalties collected from ratepayers for excess water use during rationing. A utility may file for recovery of the balance of a memorandum account through a one- or two-year surcharge. No surcharge may be imposed until Branch has reviewed memorandum account entries for reasonableness. We adopted procedures that permit small water companies (Class C and D) to begin conservation programs and establish memorandum accounts without the requirement of a formal water management program.

We also directed a third round of hearings to deal with other issues that had arisen during the course of this proceeding.

2.1 Industry Workshops

A prehearing conference to schedule the third round of hearings was conducted on November 13, 1991. Parties agreed that many of the remaining issues could be resolved in workshops. Accordingly, two workshops were conducted in January 1992, and a third informal meeting was held in February 1992. The workshops were chaired by Branch representative Robert E. Penny. San Jose Water Company (San Jose) prepared the workshop report. Eighteen persons, including representatives of 10 water companies and the California Water Association, participated. The workshop report was distributed to all parties in February 1992. Two days of hearings were conducted on April 2 and 3, 1992, to receive the workshop recommendations and to hear testimony on contested issues. Final briefs were filed on July 1, 1992.

3. Consensus on Future Direction

Branch has focused throughout this proceeding on the need to encourage utilities to manage their water resources efficiently, while protecting consumers from unnecessary rate increases. Water utilities support these objectives, but they also stress the need to protect their financial stability at a time when they are being asked to sell less of their product (water) to individual customers. All parties agree that effects of the drought are long term, and that ratepayers, the utilities, and the Commission will have to deal with conservation and water resource issues far into the future.

The utilities and Branch emerged from their workshops with a number of consensus recommendations. The parties urge the Commission to adopt the following measures:

- * Authorize establishment of a working committee, including representatives of the utilities, the utility association, Branch, and the Commission's Division of Ratepayer Advocates₃ (DRA), to deal with incentive programs, memorandum account procedures, standards by which to evaluate water management programs, and procedural matters.
- * Require the working committee to report and make recommendations promptly as part of this Drought Phase proceeding.
- * Provide that memorandum accounts, both for mandatory rationing and for voluntary conservation programs, remain open at the option of each utility until its next general rate case.

3 Utilities in their water management programs proposed numerous techniques by which customers can be encouraged to use water wisely. Incentive plans range from inverted rate blocks (in which rates increase as water use increases) to targeting particular users, like industry, and adjusting rates to encourage conservation.

- * Permit utilities to include in their memorandum accounts certain specified expenses (supply mix changes resulting from drought and additional labor costs attributable to drought) for later reasonableness review and recovery.

As set forth below, this order adopts all of these workshop recommendations.

3.1 Positions on Working Committee

Utilities initially proposed establishment of an incentive committee. The committee would deal with means of structuring rates to encourage long-term conservation. The utilities commented:

"The OII to date has been focused more on the short-term need to respond to the drought. Incentives, however, deal more with long-term water conservation. It was agreed that we should not be litigating those matters but rather should be trying to meet mutual goals through cooperation. It was observed that the Water Management Programs will continue long after the present drought is behind us. The drought has brought California's long-term water supply shortage into focus. It is to the solution of these shortages that the incentives should be directed." (Ex. A-2, Report on Workshops, p. 3.)

Branch responded (and utilities agree) that the committee should not be limited to incentive issues, since these relate to other conservation matters. Branch observed:

"[The committee] should be used as a collaborative process to facilitate open exchange of ideas...to develop solutions to current drought problems, with an eye to the future. [The committee should] fairly weigh the interests of all affected parties, that is, utilities and the public they serve. The committee may consider administrative problems utilities may be facing in implementing and complying with the Commission's decisions....Branch believes that consideration should be given to keeping...an on-going committee that will monitor the drought

situation in the state." (Ex. A-5, Statement of Position of the Water Utilities Branch, p. 4.)

3.2 Establishment of Water Management Committee

Our order today authorizes establishment of a Water Management Committee intended to encourage long-term conservation and water resource planning, protect the interests of ratepayers, and provide for continued economic health of public utilities. The committee will be comprised of utility representatives and representatives both of the Commission's Water Utilities Branch and DRA.

However, we cast the committee's mission in terms slightly different than those proposed by the parties.

We believe that the water management programs filed by the larger water districts offer the most promising approach to long-term conservation policies because they are tailored to the particular resources and needs of individual districts. We ask, therefore, that the Water Management Committee consider those incentives, those conservation programs, and those administrative matters that can be shown to smooth the functioning of water conservation programs. We expect the committee to be able to show how a particular incentive or rate recommendation will contribute to the effectiveness of water conservation programs in particular districts. For example, rate incentives for a district that purchases most of its water supply from the Metropolitan Water District may not fit water management plan objectives for districts supplied primarily by wells. The committee may endorse (and recommend inclusion of expenses in rates) an irrigation project described in some water management programs, while finding no value for the project in districts that have expressed no irrigation need in their water management programs.

In other words, we will expect the Water Management Committee to be able to show how any recommendation it makes will

contribute to the success of conservation objectives in utilities' water management programs. Utilities that cannot or do not show how a rate incentive will advance the objectives of their water management programs should not expect the incentive (if adopted) to be applicable to them.

We agree with the parties that the Water Management Committee should consider all drought-related matters. We anticipate that many administrative, reporting, and compliance matters can be resolved at the committee level, without the need for further action by the Commission. We do not preclude recommendations by the committee that have general applicability (for example, Branch's promulgation of a generic Rule 14.1 to permit a utility to implement rationing in emergency situations). Programs designed to be generic, on the other hand, too often give the appearance of progress while actually affecting few districts.

We want to state as clearly as we can that the committee should use the water management programs, updated and amended as necessary, as the basis for its work. These water programs are district-specific blueprints for meeting the needs of consumers now and in the future. The committee's efforts can help assure that the water management programs are working documents, frequently consulted, rather than reports that are filed away and dusted off every three years during general rate cases.

3.3 Committee Meeting and Report Dates

At the request of all parties, we direct Branch to schedule the first meeting⁴ of the Water Management Committee within 30 days of the effective date of this decision. The meeting will be open to all utilities, the utility association, staff, and any other interested person. The first report of the committee,

⁴ We take official notice that Branch and utilities have had informal meetings on drought matters in advance of this decision.

including recommendations, shall be distributed to parties and to the assigned commissioner and administrative law judge within 90 days of the first meeting. We suggest, but do not require, that the Water Utilities Branch prepare the first report, and that this report be circulated in advance to all attendees so that they have the opportunity to attach supplementary comments to the final distributed report. This method of preparing the report was used for the initial workshops and appeared to work well.

3.4 Inclusion of Certain Expenses

Branch recommends that the Commission authorize utilities to include in their memorandum accounts those expenses caused by supply mix changes, provided that (1) the expenses are caused by the drought, and (2) the expenses are not included in present rates or are otherwise recoverable. Branch also recommends that we permit utilities to book to their memorandum accounts those legal fees attributable to these Drought Phase proceedings and supervisor overtime costs directly related to drought and to voluntary conservation programs. Like all other costs in the memorandum accounts, expenses for supply mix changes, legal fees, and supervisor overtime will be subject to reasonableness review at the time the utility seeks to recover the memorandum account expenses in rates.

We adopt the proposal. Our decisions have made it clear that water companies should be permitted to recover in rates reasonable lost revenue and reasonable costs caused by drought.⁵ The recovery is made through increased rates or surcharges reflecting these losses, less cost savings, up to a utility's normalized sales level. So long as expenses are directly drought-related, are not otherwise recoverable, and are subject to review

⁵ See, e.g., D.91-10-042, pp. 18-24.

by staff to be certain that they are reasonable, we agree that they may properly be booked to the memorandum account.

3.5 Review of Water Management Programs

Branch and the utilities agree that the water management programs now on file with the Commission should be formally updated and reviewed as part of the general rate case process.⁶ Because the programs were only recently filed, the parties suggest an initial grace period before these reviews become mandatory. They urge that utilities not be required to update water management programs in general rate cases filed before January 1, 1994. After January 1, 1994, it would be mandatory for a utility with a water management program to (1) file an updated water management program as part of its rate case, and (2) evaluate the performance of the water management program as part of the rate case.

Branch's position was explained at hearing by Fassil Fenikile, associate utilities engineer. Asked if a utility would be expected to put on a witness at its general rate case to report on each project in a water management program, he replied:

"We did not contemplate that a witness will necessarily have to do that. But we expect a utility to inform the Commission...by updating its water management plan and asking for approval to implement specific programs from that water management plan.

"[There is an even] more important aspect of the review process. The utility also will have a chance to consider alternatives to some of the programs it has in the water management plan. The plan being a long-term document, it needs updating, revision, corrections or amendments, and that is the purpose of [the review]."
(Tr. p. 2085.)

⁶ See D.90-08-045, dated August 8, 1990, adopting a revised rate case plan for processing general rate case applications of Class A water utilities. In general, Class A water utilities are authorized to seek rate increases every three years.

Utilities join in Branch's proposal. We adopt it. A utility's water management program shall be reviewed as part of that utility's general rate case. Review will be required for rate cases filed on or after January 1, 1994. A utility may initiate a review during rate cases filed prior to that time.⁷

3.6 Closing of Program Applications

In D.90-08-055, we directed each Class A water utility to develop a water management program with long-term objectives and to file an application for approval of the completed program.⁸ In D.91-10-042, we approved as complete those water management programs so certified by Branch. We did not approve expenditures for projects contained in the programs, commenting:

"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." (D.91-10-042, p. 8.)

7 The approval of this recommendation goes to required updates and evaluations. However, as noted earlier (Section 3.2), we expect utilities that want to benefit from Water Management Committee recommendations to regularly implement and amend their water management programs as necessary to achieve conservation and resource management goals.

8 Water management programs originally were due on November 8, 1990. Only San Jose 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.)

Today's order requires that water management programs be formally reviewed and revised as necessary during general rate cases that are filed after January 1, 1994. It also contemplates that these programs will be the focus for the work of the Water Management Committee.

We have decided sua sponte, therefore, that we now may close the 60 applications seeking approval of the water management programs.⁹ The programs have been approved as to form and general content, and their evolution in the future will be directed by individual utilities, subject to review as part of general rate cases.

3.7 Continuation of Memorandum Accounts

The Commission's decisions have established two kinds of memorandum accounts to deal with the drought. The first, responding to mandatory rationing imposed by water suppliers, permits water companies to track losses and costs attributable to rationing. In D.90-08-055, we authorized utilities to file for a surcharge to recover funds tracked in these memorandum accounts until August 8, 1990, as offset by any penalty funds collected in mandatory rationing.

In D.91-10-042, we established additional requirements for recovery of memorandum account funds after August 8, 1990. To recover, a Class A or a Class B utility must have an approved water management plan on file with the Commission, must apply a risk reduction offset to the account, and must offset net revenue losses with penalty funds collected as part of mandatory rationing.

The second type of memorandum account is one that tracks losses and costs attributable to a voluntary conservation program

⁹ Pursuant to Rule 55 of the Rules of Practice and Procedure, the water management plan applications were consolidated into this proceeding. See, D.91-10-042, Ordering Paragraph 2.

sponsored by a utility. Again, recovery is by filing of an advice letter setting forth a surcharge of the approved amount in the account. In this case, however, there is no offset for penalty dollars because no penalties are imposed on ratepayers during voluntary conservation.

The surcharge procedures adopted in D.90-08-055 and D.91-10-042 provide for the recovery of both recorded (past) and estimated (future) lost revenue. As such, surcharges are likely to have two components, one for recorded losses and a second for projected losses. We require that any surcharge for recovery of revenue losses due to rationing must end when rationing ends, and any overcollection or undercollection in the memorandum account at the end of mandatory rationing then is to be transferred to a utility's expense balancing account.¹⁰

As a result of their workshop discussions, Branch and utilities propose that our order today provide that when a rationing surcharge ends and the rationing memorandum account effectively is closed out (through transfer of any balance to the expense balancing account), we nonetheless permit the memorandum account to remain open to continue tracking lost sales due to residual conservation.¹¹ Branch explains that it would permit memorandum accounts to remain open until a utility's next general rate case, at which time, presumably, the accounts would be closed and the balances accounted for in rates adopted for that utility. Branch states that, without this accommodation, utilities that incur lost sales because of residual conservation may be unable to

10 D.90-08-055, Conclusions of Law 3 and 4.

11 Residual conservation refers to sales losses following the end of rationing that are caused because consumers continue to practice the conservation techniques they employed during rationing.

recover that revenue because of the rule against retroactive ratemaking.

A memorandum account opened to track losses incurred during mandatory rationing is limited to costs and losses incurred during the period of mandatory rationing. We therefore decline to allow a utility to keep open a mandatory rationing memorandum account after the end of mandatory rationing.

All parties agree that residual conservation exists. If consumers install low-flow showerheads and take other steps to conserve during rationing, their reduced water use will continue when rationing ends. Utilities cannot be expected to encourage water conservation if they are obliged to incur losses because of lost sales due to residual conservation. We will therefore allow a utility to open (as discussed below) or maintain a voluntary conservation memorandum account in which lost sales associated with residual conservation may be tracked until the next general rate case. We will expect Branch to challenge recovery of any amounts not attributable to conservation.

3.8 Additional Requirements for Conservation Accounts

Our order today also adds a notification requirement to the establishment of a memorandum account for a voluntary conservation program. Testimony at hearing suggests that there is confusion on this subject. At least one utility appears to be under the impression that it may book lost revenue and costs to such an account without having a defined conservation program in place. This is not our intent. As a matter of clarification, therefore, our order provides that, effective immediately, any water utility that opens a memorandum account for a voluntary conservation program must (1) notify the Commission's Water Utilities Branch by letter of the date that it intends to open such an account; (2) describe briefly the supply problem and the goals and objectives of its conservation program (i.e., a 10% reduction in water consumption from a stated period in the past); and

(3) state briefly how it intends to notify ratepayers and encourage them to participate in the conservation effort.

4. Contested Issues

While utilities and Branch reached agreement on many issues in their workshops, they brought to hearing three contested matters. Utilities ask the the Commission in this order do the following:

- * Provide that the procedures developed in this Drought Phase proceeding will apply to future droughts unless specifically changed by Commission order.
- * Provide that utilities will be protected if, following mandatory rationing, the reserve account for penalty funds is insufficient to cover credits to ratepayers under banking provisions intended to encourage water conservation.
- * Provide that the surcharge for recovery of a rationing memorandum account be permitted, under certain conditions, to continue in effect for a period of time after rationing ends. D.90-08-055 now requires that such a surcharge be terminated at the end of rationing.

4.1 Procedural Objections

Branch urges that the contested issues be dismissed because they were not set forth in prehearing statements as required by rulings in this proceeding, and that utilities actually are seeking to relitigate matters already decided by the Commission. We decline to dismiss on that basis. While we agree that these matters were not specifically identified in prehearing submissions, we believe that the rulings of the administrative law judge were sufficiently broad to permit consideration of questions

dealing with future droughts, penalty credits, and surcharges.¹² Branch does not claim that it has been prejudiced or that it has had insufficient time to respond to the issues raised by utilities.

4.2 Applicability to Future Droughts

San Jose and Southern California Water Company argue that the Commission must make it clear that the procedures and rules adopted in this proceeding will apply in the future. San Jose states:

"That the decisions resulting from I.89-03-005 would apply to future droughts had been intuitively assumed by all the water utilities....It is incomprehensible to SJWC that all parties including staff could have spent weeks of testimony and thousands of hours developing a Commission drought response...and then conclude it would not apply to a future drought!...The financial consequences are too awful to contemplate if we enter the next drought believing we have recovery mechanisms only to find out staff was correct and the rules do not apply to the next drought."
(Ex. A-1, p. 6.)

Branch responds that procedures adopted in this proceeding may indeed be appropriate in future droughts. It simply does not believe that now is the time to make that decision. It comments:

"[A]dopting any of the current procedures on a generic basis for future drought conditions at this time would be premature. Many of the programs and procedures...have not completed their full course yet....Moreover, conditions in the future may be different from those

¹² For example, the administrative law judge ruling of September 5, 1991, states: "[Issues in the third round of hearings] 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 drought memorandum accounts."

presently faced by the state....[T]he level of water shortage may be different, and better ways of dealing with revenue losses may also be developed."

We doubt that the parties are as far apart on this subject as it might appear. Certainly, no one questions that the water management programs developed by the utilities will continue to play a role for years to come in dealing with drought and management of water resources. Incentive plans and costs of particular conservation programs will be brought to the Commission for review and approval. Many of the plans that we approve will continue in place through and beyond the current drought.

We are not prepared, however, to state at this time that the procedures now in place for establishment and recovery of memorandum accounts (which presumably is the main concern of utilities) will automatically apply when the current drought ends and another drought begins. In the first place, as Branch points out, utilities continue to seek changes in these procedures.¹³ More importantly, new methods of dealing with water resources may be developed before California faces another drought.

The Commission approved a number of programs for dealing with the drought of 1976-77. Those were the first programs examined, and most of them (i.e., distribution of water conservation kits) were quickly approved when we began a decade later to deal with the current drought. We did not make the 1976-77 techniques mandatory for later droughts, but those techniques that worked in the past were adopted without objection in dealing with the current drought. Similarly, we expect

¹³ In stating changes proposed in this proceeding, San Jose comments that it "does not mean to imply there are only three issues remaining. There may be other issues which will surface as time tests the omniscience of the existing orders." (Brief on Remaining Issues, Phase III, p. 2.)

precedent to be on the side of those that seek similar approaches to similar problems when the next drought occurs, but proponents will have the burden of showing that their proposals are still reasonable, and they must respond to any challenge at that time that conditions have changed and prior solutions are no longer applicable.

4.3 Treatment of Penalty Reserves

San Jose, on behalf of itself and other utilities with "banking" procedures¹⁴ in their rationing tariffs, seeks a change in penalty reserve provisions now in effect.¹⁵ In calculating a surcharge to recover funds in its rationing memorandum account, a utility first must reduce the amount by a risk reduction factor, then by the amount of penalties it has collected from ratepayers. However, a utility may retain sufficient penalty funds to provide for estimated penalty refunds to ratepayers over the next 12 months stemming from a cumulative banking program. San Jose urges that if a utility fails to retain sufficient penalty funds to provide for refunds, and if its reserve account then goes negative, the Commission should provide some mechanism to make up the loss. Otherwise, San Jose states, utilities are likely to retain a greater penalty fund reserve than necessary to protect themselves, thus postponing application of penalty funds to reduce the surcharge.

Branch responds that no utility to date has reported a negative balance in its reserve account, that the utility is in the

14 San Jose and others provide in their tariffs that if ratepayers pay a penalty by using more than their allotment of water during rationing, they can obtain a refund of that penalty by using cumulatively less water than their allotment in subsequent months.

15 See, D.91-10-042, Findings of Fact 25 and 26 and Conclusion of Law 23, and D.91-10-042, Ordering Paragraph 4.

best position to estimate an appropriate penalty reserve, and that much of San Jose's concern stems from the wording that it has elected to put in its rationing tariffs. It adds that if a utility has reasonably administered its penalty account and still encounters a shortfall, it can seek relief from the Commission at that time.

We agree with utilities. Without some assurance that they will be protected, utilities will be compelled to overestimate their penalty reserve account, thus delaying the time when penalties are returned to ratepayers in the form of reduced rates. Our order today adopts the modification proposed by San Jose.

4.4 Continuation of Rationing Surcharges

California Water Service Company (Cal Water) and San Jose ask that we modify D.90-08-055 to provide that the surcharge established during mandatory rationing need not be terminated at the end of rationing. If a utility still has a large, uncollected balance in its memorandum account because of rationing, it may be in the awkward position of terminating the rationing surcharge and a few months later implementing a new surcharge to recover the uncollected balance as part of its balancing account. Similarly, if rationing is followed by a voluntary conservation program, a surcharge for the latter could be imposed two or three months after the rationing surcharge. Cal Water and San Jose state that this can create a "yo-yo effect" in rates that is likely to confuse and irritate ratepayers.

Branch responds that the Commission in D.90-08-055 adopted the proposal urged by water utilities for implementing and terminating the drought surcharge, and utilities have failed to show why their own proposal should now be changed. In explaining why we favored the utilities' proposal (as opposed to a six-month surcharge proposed by Branch), we stated:

"Since Water Companies' proposal would establish a surcharge based on annualized sales, it would result in a lower surcharge. The surcharge

would remain in effect until the end of mandatory rationing and any over or undercollections would be transferred to the utility's expense balancing account. This procedure will prevent ratepayers from being overcharged and also provide utilities a reasonable opportunity to recover their revenue losses." (D.90-08-055, p. 23.)

Branch warns that continuing the drought surcharge beyond the end of drought rationing is an effort by utilities to convert short-term memorandum accounts (subject to full reasonableness review) into long-term balancing accounts (which are subject to review for accuracy of established increases in power, purchased water, postage, and the like). Cal Water denies this aim, although it believes that the difference between balancing accounts and memorandum accounts in this case is illusory.

It is not necessary for us to address the question of memorandum accounts versus balancing accounts. Instead, we find on this record that Cal Water and San Jose have not shown sufficient reason for the Commission to change the surcharge procedure adopted in D.90-08-055. Utilities through their filings determine the timing of surcharges, and we are not convinced that they cannot find means to avoid a yo-yo effect in rates. For that matter, we are not convinced that ratepayers will storm the utility moat if rates are slightly lower for two or three months between the time that one surcharge ends and another is imposed. Again, we are asked to adopt a general rule applicable to all water utilities when the record shows little more than speculation that a surcharge timing problem could occur in three or four utility districts. We decline in this proceeding to adopt such a rule.

5. 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 August 7, 1992. Timely comments were filed by San Jose, California-American Water Company (Cal-Am), Southern California Water Company, and by Branch. Reply comments were filed by Branch.

We agree with utilities that conservation will be encouraged if we modify our earlier decisions to permit a voluntary conservation memorandum account to remain open until a utility's next general rate case. The account would then track lost sales due to residual conservation. The account would be closed as part of the utility's next general rate case.

Similarly, we agree that utilities should be afforded protection if they underestimate their rationing penalty reserve account.

The proposed decision has been changed to reflect these modifications.

San Jose, Southern California Water Company, and Cal-Am continue to argue that all procedures adopted in this Drought OII should be made applicable automatically to future droughts. Neither at hearing nor in the comments does any utility explain which of the adopted procedures and rulings it would have us etch in stone. When the current drought ends and another drought begins, these utilities would have the Commission sift through prior rulings to identify which procedures, if any, should not apply. The justification for this approach is fuzzy. The need for it is not shown. Long-range water management programs are in place for each Class A utility; a Water Management Committee has been charged with developing further conservation and resource management techniques. More to the point, as Branch notes, the decision does not preclude application of current drought

procedures to future droughts; it merely denies a request that such application occur automatically.

San Jose expresses concern that the ordering paragraph denying the proposal for automatic application of procedures in a future drought could be read to suggest that all current procedures are to be discontinued. While we do not agree that such a reading is likely, we have modified Ordering Paragraph 10 to make it clear that our order simply denies the recommendation stated at hearing by San Jose and Southern California Water Company.

We have carefully considered the comments of the parties. Except as noted above, we find that no other changes are merited.

Findings of Fact

1. California is in its sixth year of drought.
2. 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.
3. 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 programs.
4. 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.
5. A total of 60 water management programs have been approved as complete by the Commission.
6. D.91-10-042 further defined procedures for recovery of memorandum account revenue and authorized Class C and Class D water companies to begin conservation programs and establish memorandum accounts without the requirement of a formal water management program.
7. Branch and utilities agreed at workshops conducted in January 1992 to recommend that the Commission appoint a working

committee to further deal with incentive programs set forth in the water management programs and other matters related to the drought.

8. Branch and utilities also recommend that (i) the working committee should make recommendations promptly as part of this proceeding; (ii) memorandum accounts should remain open at the option of each utility until its next general rate case; and (iii) supply mix changes and additional labor costs attributable to drought should be included in utility memorandum accounts.

9. Utilities recommend that procedures developed in this Drought Phase proceeding be made applicable to future droughts unless specifically changed by Commission order. Branch opposes this recommendation.

10. Utilities recommend that they be protected if, following mandatory rationing, the reserve account for penalty funds is insufficient to cover credits to ratepayers. Branch opposes this recommendation.

11. Utilities recommend that the surcharge for recovery of a rationing memorandum account be permitted to continue in effect after rationing ends. Branch opposes this recommendation.

Conclusions of Law

1. The Commission should authorize establishment of a Water Management Committee chaired by the Water Utilities Branch to encourage long-term conservation and water resource planning, protect the interests of ratepayers, and provide for continued economic health of public utilities.

2. The Water Management Committee should focus on those incentives, those conservation programs and those administrative matters that can be shown to further the goals and objectives of utility water management programs.

3. Branch should be directed to schedule the first meeting of the Water Management Committee within 30 days of the effective date of this decision.

4. The first report of the committee, including recommendations, should be distributed to parties, the assigned commissioner, and the administrative law judge within 90 days of the first meeting.

5. Utilities should be authorized to include in their memorandum accounts those expenses caused by supply mix changes that (i) are attributable to the drought, and (ii) are not included in present rates or otherwise recoverable.

6. Utilities should be authorized to include in their memorandum accounts those legal fees attributable to the Drought Phase proceedings and supervisor overtime costs directly related to drought and to voluntary conservation programs.

7. Each Class A water utility should be required to (i) file an updated water management program as part of its general rate case, and (ii) evaluate the performance of the water management program as part of the rate case, provided, however, that these requirements will apply to general rate cases filed on or after January 1, 1994.

8. Class B water utilities that elect to file water management programs shall be subject to the same update and evaluation requirements as Class A water utilities, but these requirements will not apply to Class B water utilities that do not have rationing or conservation memorandum accounts in place.

9. The applications for the 60 water management programs approved as complete by the Commission should now be closed.

10. A memorandum account opened to track losses during mandatory rationing should be limited to costs and losses incurred during the period of mandatory rationing.

11. A memorandum account opened to track losses during a voluntary conservation program should be limited to costs and losses incurred during the period the voluntary conservation program is actively pursued; but a utility should be permitted to keep such an account open until its next general rate case to also track losses attributable to residual conservation.

12. The recommendation that rationing and voluntary conservation memorandum accounts be kept open beyond the periods of rationing or mandatory conservation should be rejected.

13. A water utility that opens a memorandum account for a voluntary conservation program should be required to (i) notify Branch by letter of the date the account will open; (ii) describe briefly the goals and objectives of the conservation program; and (iii) state briefly how ratepayers will be notified and encouraged to participate in the conservation goals.

14. The request, as stated in this proceeding by San Jose and Southern California Water Company, that procedures developed in this investigation be made applicable automatically to future droughts should be denied.

15. The request that the Commission establish a mechanism to protect utilities' penalty reserve accounts should be granted.

16. The request that D.90-08-055 be modified to permit continuation of the rationing surcharge after rationing ends should be denied.

INTERIM ORDER

IT IS ORDERED that:

1. The Commission's Water Utilities Branch (Branch) is directed to establish a Water Management Committee comprised of representatives of water utilities, the utilities' trade association, interested ratepayers and their representatives, Branch, and the Commission's Division of Ratepayer Advocates.

2. The Water Management Committee is directed to analyze, review, and make recommendations to the Commission on those matters that will support utilities' water management programs, encourage long-term conservation and water resource planning, protect the interests of ratepayers, and provide for continued economic health of water utilities.

3. Branch shall schedule the first meeting of the Water Management Committee within 30 days of the effective date of this order.

4. The first report of the Water Management Committee, including recommendations, if any, will be distributed to parties, to the assigned commissioner, and to the administrative law judge within 90 days of the committee's first meeting.

5. Utilities are authorized to include in their rationing or voluntary conservation memorandum accounts those expenses caused by supply mix changes that (i) are attributable to the drought or to voluntary conservation programs, and (ii) are not included in present rates or are not otherwise recoverable.

6. Utilities are authorized to include in their memorandum accounts those legal fees attributable to the proceedings in Order Instituting Investigation (I.) 89-03-005, and those supervisor overtime costs directly related to the drought or to voluntary conservation programs.

7. Effective January 1, 1994, each Class A water company shall as part of its next general rate case (i) file an updated water management program, and (ii) evaluate the performance of its water management program. The same requirements shall apply to Class B water utilities that elect to file water management programs and that have a rationing or voluntary conservation memorandum account in place.

8. Any water utility that opens a memorandum account for a voluntary conservation program shall (i) notify Branch by letter of the date that the account will open; (ii) describe briefly the

supply, problem and the goals and objectives of the conservation program; and (iii) state briefly how ratepayers will be notified and encouraged to participate in the voluntary conservation program.

9. Decision (D.) 90-08-055 and D.91-10-042 are modified to permit a utility to open or maintain its voluntary conservation memorandum account following termination of mandatory rationing in order to track lost sales attributable to residual conservation, and such account may remain open, at a utility's option, until its next general rate case.

10. The request, as stated in this proceeding by San Jose Water Company and Southern California Water Company, that procedures developed in I.89-03-005 be applicable automatically to future droughts is denied.

11. D.90-08-055 and D.91-10-042 are modified to provide that any negative balance in a penalty reserve account be restored through the purchased power or purchased water balancing account amortization procedure for future recovery.

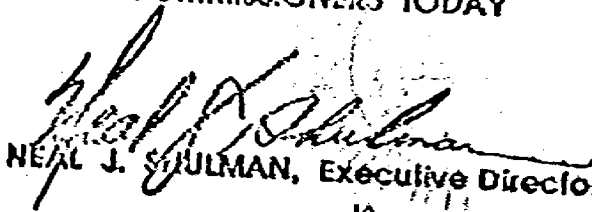
12. The request that D.90-08-055 be modified to permit continuation of a rationing surcharge after rationing ends is denied.

13. The applications set forth in Appendix A are closed. This order becomes effective 30 days from today.

Dated September 16, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

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


NEAL J. SULMAN, Executive Director

I.89-03-005 et al.

APPENDIX A

Page 1

WATER MANAGEMENT PROGRAMS

- A.90-11-038 San José 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 Citizens 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)

I.89-03-005 et al.

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 Company (Orange County District)
- A.91-02-060 Southern California Water Company (Desert District)
- A.91-02-061 Southern California Water Company (Wrightwood District)
- A.91-02-062 Southern California Water Company (Clearlake District)
- A.91-02-063 Southern California Water Company (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)
- 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)

I.89-03-005 et al.

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)