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water

VIA HAND DELIVERY AND ELECTRONIC MAIL

July 31, 2006

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Mr. Jonathan P. Tom
Water Division
California Public Utilities Commission
505 Van Ness Avenue
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Re: Comments of California Water Association
on Rate Case Plan for Class A Water Utilities

Dear Mr. Tom:

California Water Association (“CWA”) is pleased to respond to the July 7, 2006 letter from Mr. Kevin Coughlan, Director, Water Division, regarding generic changes to the Rate Case Plan for Class A Water Utilities that the Commission adopted by D.04-06-018. Mr. Coughlan’s letter solicited comments for a forthcoming rulemaking on changes that would improve the Rate Case Plan in light of the experience gained by the Class A Water Utilities and the Commission through almost three complete rate case cycles under the new Rate Case Plan. His letter also sought input in the context of Objective No. 5 of the Water Action Plan, adopted by the Commission in December 2005 – to streamline Commission regulatory decision-making.

Based on the experience gained by the water utilities in applying the new Rate Case Plan and in the interest of helping to achieve the Commission’s goal of streamlining its regulatory decision-making, CWA offers the following proposals for changes to the Rate Case Plan (“RCP”) for Class A Water Utilities:

1. Proposed Applications and Determining Completeness of Applications.

The current practice of filing a Proposed Application and then, after deficiency letters have been issued and deficiency matters have been satisfied, re-filing the GRC application, should be revised so that only one formal filing is made. CWA sees no benefit to duplicative formal filings of a Proposed Application and a revised final GRC application. Nor is there any apparent purpose served in tendering seven sets of the Proposed Application (without

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testimony) to the Docket Office and several other complete sets (including testimony) to Commission staff and any third party who requests them, if the sole purpose of the Proposed Application is to determine its completeness.

In light of the fact that the Proposed Application will be superseded just weeks later with the filing of revised and updated materials, a significant savings of time in the RCP schedule may be achieved by eliminating formal filing of the Proposed Application. Such a significant time savings would help to achieve the Commission's goal, as specifically set forth in the Water Action Plan, of streamlining regulatory decision-making. Instead of the Proposed Application being formally filed, CWA suggests it be submitted to the appropriate Commission staff – a subject addressed below – and that the date of such submission be the event that begins the starting point for the 60-day clock toward the formal filing of the GRC application, as currently provided for in the RCP.

Whether or not the requirement of filing a Proposed Application is eliminated, the Commission should adopt more objective criteria to determine when a GRC application is complete for filing purposes. Adoption of objective criteria would help to make the process of determining completeness less controversial and more ministerial, and also would streamline the overall decision-making process for GRC applications. The Commission should also examine whether the current process for appealing deficiency letters on Proposed Applications is satisfactory. The experience of water utilities so far indicates that items outside the definition of “deficiency” in RCP footnote 4¹ have been included in deficiency letters and have unduly delayed the normal RCP schedule. CWA recommends that an Administrative Law Judge (ALJ) be assigned to each GRC application within 15 days after submission of the Proposed Application, and that the assigned ALJ be responsible for resolving any dispute that arises concerning the completeness of a Proposed Application or with respect to any deficiency letter.

Responsibility for determining the completeness of a GRC application also should be changed. Currently, an adverse party to the water utility's application – the Division of Ratepayer Advocates (“DRA”) – has the responsibility for issuing deficiency letters and for determining when a GRC application is acceptable for filing. CWA believes a neutral party (such as the Docket Office or Water Division), instead of an adverse party (DRA), should

¹ Footnote 4 to the Appendix of D.04-06-018 defines the term “deficiency”, in part, as “a material omission of a required component from the Proposed Application ... A deficiency is not a subjective determination that the Proposed Application or submitted documents, including workpapers, do not adequately support the utility's request or are non-responsive to the Rate Case Plan filing requirements ...”

have the responsibility for determining whether the GRC application is complete and acceptable for filing. This will not detract in any way from DRA's overall authority and responsibility to represent ratepayers in a utility's GRC application; DRA clearly will continue in that essential role. However, the determination of whether a GRC application is complete should be an objective decision that an adverse party should not be called upon to make.

2. Scoping Memo

In furtherance of the Water Action Plan, the RCP should be revised to specify that the Scoping Memo for every GRC application sets forth all of the issues relating to a water utility's policies, plans, programs and performance with respect to water quality, water conservation (including rate proposals related to conservation), infrastructure investment (including security for infrastructure, distribution system improvement charges, and compatibility with the company's DWR Water Management Plan), and low-income ratepayer assistance.

3. Discovery/Data Requests.

The Master Data Request should be eliminated and replaced with more targeted data requests. Currently, the Master Data Request requires the submission of an enormous amount of data, most of which is not used in the GRC process. The overall efficiency of the GRC process would be improved and streamlined with the use of targeted data requests in lieu of the Master Data Request. In addition, principles of relevancy and cost effectiveness should be applied to all data requests. Since GRCs are now filed every three years, information provided in prior responses to a Master Data Request, or provided in other reports submitted to the Commission (such as the Annual Report), if unchanged, should be incorporated by reference rather than provided again. The Commission should consider whether utilities can provide general information needed by Commission staff in a timelier and more efficient manner through reports (such as the Annual Report) outside the GRC process.

The requirement that water utilities submit work papers with their application materials should apply equally to DRA and other parties in connection with their submissions. The requirement that water utilities cross-reference their reports and testimony to supporting work papers also should be applicable to DRA and to other parties. Given that the RCP schedule allows utilities only two weeks to analyze and rebut the testimony of DRA and intervenors, the absence of explicit work paper requirements (or requirements to provide underlying support for a position) for parties other than a GRC applicant hinder a more complete and better-organized response to issues raised.

4. Water Quality.

Consistent with one of the major objectives of the Water Action Plan, the RCP should require that each GRC application include a report on water quality. In 2002, in *Hartwell Corp. v. Superior Court*, the California Supreme Court reviewed the Commission's assertion of jurisdiction over water quality issues of the investor-owned water utilities and essentially confirmed the Commission's actions – because the Commission exercised “continuing jurisdiction” over such water quality issues. Requiring a separate report on water quality to be included with every GRC application will institutionalize the Commission's continuing exercise of jurisdiction and will confirm that water quality is, as it should be, one of the key areas of Commission regulation of investor-owned water utilities.

5. Determining Cost of Capital and Return on Equity.

For the multi-district utilities with three or more districts, cost of capital should be determined only once every three years. The GRC decision should specify an overall rate of return, to be implemented company-wide, for each of the three years. The multi-district companies should not need to file separate applications to revisit cost of capital for the second or third years. Allowing these companies the option of determining cost of capital only once every three years will help achieve the Water Action Plan's goal of streamlining regulatory decision-making.

6. Rates Related to General Office Expenses.

The procedure for implementing rates related to general office (“GO”) expenses should be revised. Currently, an inequality exists between single and multi-district companies due to deferred implementation of rates reflecting GO expenses for multi-district companies. Under the current RCP, GO costs are reviewed and determined only once every three years, and so are one or two years out of date by the time such costs are reflected in rates for districts of the multi-district company with later GRC Test Years. A solution would be to make rates reflecting GO expenses effective company-wide for multi-district companies in the year the GO expenses are reviewed.

7. Consolidated GRC Applications for Multi-District Companies.

The Commission should permit, but not require, a multi-district water company with three or more districts to file a single general rate case (“GRC”) application for all of its operating districts. Multi-district companies with a large number of districts file GRCs every year for different groups of their districts. For some companies, single, combined GRC applications might result in

efficiencies and contribute to the reduction of workload for both the companies and Commission staff.

Permitting large multi-district companies to file a single GRC application is consistent with one of the Water Action Plan's "action items" for streamlining regulatory decision making: "The Commission will examine the feasibility of consolidating districts in those instances where the districts are geographically adjacent and have similar rates," and of permitting those districts "to simultaneously file rate cases." While this action item refers to consolidation of "geographically adjacent" districts, efficiency and timely regulation also can be achieved by permitting a multi-district company with three or more districts to file a single GRC.

8. Interim Rates.

The procedure for implementation of interim rates should be revised. Current procedures often do not result in interim rates becoming effective by the first day of the test year as required by statute. This can happen due to a number of unforeseeable events, such as the proposed decision not being issued on schedule or the Commission unexpectedly postponing the scheduled adoption of a GRC decision. If everything goes according to the RCP schedule (a rare event), interim rates are not needed. However, a utility often does not discover that the GRC decision will be delayed until it is too late to begin the process of implementing interim rates (requiring a motion, time for responses, and a decision) in time to make them effective on the first day of the test year.

To resolve this problem, CWA proposes that if the RCP schedule is not being met for reasons not attributable to the water utility, and/or the Commission fails to act on a GRC decision within five days before the utility's test year begins, the utility should be allowed to file an advice letter implementing interim rates. Effective on five days notice, this advice letter would set interim rates at the utility's present rates, adjusted for inflation, effective on the first day of the test year and subject to subsequent true-up from that date forward. This procedure is quick and uncomplicated, and therefore will ensure that interim rates will become effective on the first day of the test year in the event that a decision on a GRC application is not going to be adopted in accordance with the RCP schedule.

Also, when settlements on rates are reached between a water utility and DRA, the Commission should allow the utility to implement those settlement rates on an interim basis instead of providing for interim rates reflecting only general inflation. Doing so would help avoid the impact on ratepayers that may result from significant delay in the issuance of a final GRC decision.

9. Earnings Test.

As a condition for allowing escalation year rate adjustments, the RCP requires the application of an earnings test. The Commission should eliminate this earnings test altogether. Earnings tests are not applicable to energy utilities, and there is no logical reason to treat the water industry differently. Moreover, there is no sound basis for applying an earnings test to water utilities in connection with escalation-year rate adjustments. Adopted rates of return are sometimes achieved, and sometimes not achieved, due to a number of factors, including experienced weather conditions, Commission rate design policy, and routine differences between estimates and actual results. The earnings test sets an upper limit on a water utility's return – an upper limit not applicable to energy utilities – but provides no lower limit on what its return, if any, can be. Since GRC applications are now required to be filed every three years, utility earnings are less likely to deviate from adopted levels for an extended period, thus protecting both the utility and its customers.

If the earnings test is not eliminated, the Commission should replace it with a more focused type of earnings test – a “rate base test”. This test would measure whether a water utility has implemented forecasted rate base additions before escalation year rate increases are applied.

There also exists an inequality between single and multi-district companies with respect to the application of an earnings test that should be eliminated. While the Rate Case Plan does not require it, the general rule practiced by Water Division staff, and often written into the Ordering Paragraphs of the GRC decision, in administering the earnings test for multi-district companies is to use either the most recent rate of return adopted for any district of the company, or the rate of return adopted for the district for which the escalation year rate adjustments are being considered, *whichever is lower*. Use of the rate of return adopted for the district for which the escalation year rate adjustments are being considered will place multi-district companies on an equal footing with single district companies with respect to the application of the earnings test.

10. Escalation Year Rate Issues.

Consideration also must be given to escalation year issues related to adjustments for health care insurance and all other types of insurance. Increases in health care costs and the costs of other types of insurance for the past decade or more have far exceeded any of the indices used to forecast increases in other types of operating costs. The Rate Case Plan should either allow for the tracking and recovery of cost increases in health care and other types of insurance more than once every three years, adopt an index specific to or more compatible with health care and other types of insurance costs for purposes of forecasting these cost

increases, or allow utilities to make separate forecasts of the costs of health care and other types of insurance for years 2 and 3.

11. Alternative Dispute Resolution.

In furtherance of its objective of streamlining regulatory decision-making, the Water Action Plan proposes consideration of the use of Alternate Dispute Resolution (“ADR”) “in place of more time-consuming regulatory procedures wherever a fair and efficient regulatory result can be accomplished.” However, a major hindrance to the use of ADR procedures in the GRC process is the RCP’s failure to provide timely or adequate opportunities for settlement negotiations and informal discussion of disputed issues.

In general, CWA supports the concept of alternatives to resource-intensive and time-consuming traditional regulatory procedures. One such area in the Rate Case Plan that could benefit from the ADR concept involves the issuance of the staff report on a utility’s rate case. CWA urges that there should be a mandatory meet-and-confer session prior to issuance of a staff report. Prior to and at such a meet-and-confer session, water utilities would be given opportunity to review and respond to the draft staff report before it is issued (in a manner similar to the Proposed Application procedure), in order to allow discussion of perceived inaccuracies in the report and to resolve as many issues as possible before staff formalizes its recommendations. While time for this process is not currently built into the GRC time frame, significant time could be available if the Proposed Application process were simplified as discussed above. The Commission may choose to appoint an objective facilitator or mediator to provide form and direction to the “meet and confer” and ADR process.

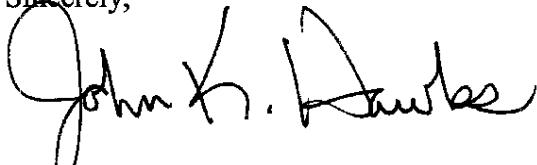
12. Workshops.

Finally, Mr. Coughlan’s letter seeks comment on whether workshops would facilitate the process of evaluating changes to the existing Rate Case Plan. Based on its experience in Phase I, CWA does not believe workshops would be particularly helpful in this process. Utilities, Water Division personnel and representatives of DRA are always free to meet and confer on their own initiative. CWA suggests that a process of comments and reply comments be used. However, if workshops are held, they should be focused on the resolution of a limited number of specific issues set forth in a workshop notice.

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CWA appreciates this opportunity to comment on potential improvements to the Rate Case Plan for Class A Water Utilities and looks forward to participating further in this process.

Sincerely,



John K. Hawks

cc: Mr. Kevin P. Coughlan (by hand delivery and electronic mail)
Service Lists in R.03-09-005 and R.06-04-010 (by electronic mail)