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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

Application 12-04-019
(Filed April 23, 2012)

**ADMINISTRATIVE LAW JUDGE'S RULING
SETTING FORTH QUESTIONS TO BE ADDRESSED AT THE
HEARINGS ON PROPOSED SETTLEMENT AGREEMENTS**

1. Summary

As stated at the prehearing conference held on September 16, 2013, this Ruling propounds many of the questions that I will address to witnesses at the evidentiary hearings scheduled for December 2 and 3, 2013. These hearings are being convened to address the proposed Comprehensive Settlement Agreement and proposed Settlement Agreement on Plant Size and Operation (Sizing Settlement Agreement). I will ask my questions first. To the extent that my questions engender questions from other parties, they may cross examine the witnesses. However, the hearings are very narrowly structured and will address only disputed factual issues raised in the proposed Settlement Agreements, pursuant to Rule 12.3. I remind parties that they are obligated to comply fully with all Commission laws, Rules, and regulations, including the *ex parte* requirements.

2. Demand and Size of Plant

As set forth in the proposed Sizing Settlement Agreement, Cal-Am has forecast the following demand and supply for its Monterey District:

Demand (Acre Feet per year (AFY):

| | |
|--------------------------|---------------|
| System Demand | 13,291 |
| Pebble Beach entitlement | 325 |
| Tourism bounce-back | 500 |
| Lots of Record | 1,180 |
| | |
| Total | 15,296 |

Supply (AFY):

| | |
|--|-------|
| Carmel River Rights | 3,376 |
| Seaside Basin | 774 |
| ASR | 1,300 |
| Sand City Desalination | 94 |
| Remaining need (to be served by proposed desalination plant) | 9,752 |

In its application, Cal-Am states that the Monterey Peninsula Water Supply Project (MPWSP) will “serve the Monterey County District main system, and, depending on developments with the Seaside Basin Adjudication, may be used to serve the Bishop, Hidden Hills, and Ryan Ranch service areas. The

[MPWSP] will not be used to serve the Ambler, Chular, Ralph Lane, and Toro service areas.”¹

It is not clear to me how the demand quantities outlined above have been justified. For example, the five-year average (2007-2011) shows a system demand of 13,291 AFY, with an approximate 18% reduction in demand from 2007 (14,644 AFY) to 2011 (11, 989 AFY). Is it reasonable to base demand on this five-year average? Is this standard industry practice?

In Advice Letters 903, 938, and 1009, Cal-Am stated that its demand for 2010, 2011, and 2012 was 10,758 AFY, 10,595, AFY, and 10,851 AFY, respectively. Moreover, the estimate of demand in Cal-Am’s 2010 Urban Water Management Plan (UWMP) for its Monterey District (dated September 7, 2012 and submitted to the Department of Water Resources (DWR) on October 1, 2012) forecasts water deliveries for the Monterey Main System at 10,923 AFY for 2015, 11,244 AFY for 2020, 11,565 AFY for 2025, and 11,884 AFY for 2030. Even when the Bishop, Hidden Hills, and Ryan Ranch service territories are included, the forecasted demand is 11,298 AFY for 2015, 11,617 AFY for 2020, 11,935 AFY for 2025, and 12,254 for 2030. All of these projected demand figures are well under the total demand calculation for the MPWSP. How do Settling Parties reconcile the demand projections used in the proposed settlement agreement with the demand projections submitted to DWR as recently as October 1, 2012?

Parties should note that I intend to take official notice of Cal-Am’s Urban Water Management Plan for its Monterey District, which can be found at the following link:

¹ Application (A.) 12-04-019 at 9.

http://www.water.ca.gov/urbanwatermanagement/2010uwmps/Cal-Am%20Water%20-%20Monterey%20District/2010%20UWMP_Monterey%20District_Final.pdf

Parties may file and serve an objection to the official notice of this document no later than November 15, 2013.

In order to ensure that the record is complete and to ensure that the hearings are as efficient as possible, I direct Cal-Am to verify the description of the customer service area that will be served by the proposed Monterey Peninsula Water Supply Project (MPWSP) and the underlying rationale for serving this service area. In addition, I direct Cal-Am to file and serve actual monthly customer usage and production data from 2007 through 2012 for the customer service area to be served by the proposed project. The data shall include calculations of peak hourly demand and maximum monthly demand. Cal-Am shall also demonstrate and justify the difference in demand calculation for the MPWSP with its projection of demand in the 2010 UWMP for its Monterey District, dated September 7, 2012. These compliance filings shall be filed and served no later than November 19, 2013.

Other questions regarding demand include the following:

- a. Does the size of the proposed desalination plant factor in the additional 875 AFY discussed in Exhibit CA-12 that may be required to be delivered to Salinas Valley Ground Water Basin users to offset freshwater in the feedwater from the slant wells (if any)? In other words, is the proposed 9.6 million gallons per day (mgd) desalination plant sized to address demand of 10,627 AFY? How does this concept factor in to the proposals for reduced plant size with use of water from the Ground Water Replenishment (GWR) project?

- b. How does the concept of serving maximum monthly demand in a critically dry year fit in to the demand calculation? For example, my understanding is that the proposed sizing does not consider availability of the aquifer storage and recovery system (ASR), which would not be available in dry years. What monthly peak figure should we be considering? What about maintaining pressure on the system? What is required for daily needs? What about high demand needs? How do the Pacific Grove water projects offset demand?
- c. What is the demand calculation if all outdoor irrigation (whether for agriculture or landscaping of any kind) is required to use non-potable water? Would such a change in demand influence the size of the desalination plant?
- d. What is the size of the plant that is required if demand is restricted to only that amount required to ensure that Cal Am complies with the State Water Resource Control Board (SWRCB) Cease and Desist Order (Order 2009-060)?
- e. What public policy is being served by allowing the desalination plant to be sized to accommodate demand from a potential tourism bounceback and for lots of record that may or may not be developed?
- f. What is the basis for the lots of record demand estimate? Where are these lots of records located and how do the lots of record in each service area jurisdiction relate to the development anticipated in the jurisdiction's general plan? Are the referenced lots of record all buildable lots? What is the anticipated range of dates for development of the lots of record and when would such connections occur? How was the demand for these items derived?
- g. If the Commission approves a larger desalination plant to accommodate demand from a tourism bounce-back and development of lots of record, how would current ratepayers be compensated for intertemporal inequities?
- h. Section 1.5(c) of proposed Comprehensive Settlement refers to a process to be developed to determine an

accurate estimate of added capacity to meet general plan build-out projections for communities served by Cal-Am. How would this projection impact the demand calculation?

- i. The proposed plant will be designed to operate at nearly 100% capacity to serve demand in the initial years of operation. Is this industry standard? Is it reasonable?

3. Authority Requested in Phase 1 and Interaction of Phase 1 and Phase 2:

The Settling Parties have moved to bifurcate this proceeding to address the size of the actual plant to be built in Phase 2 when more is known about the GWR Project, and whether that project can feasibly be implemented. In the Amended Scoping Memo and Ruling, issued on September 25, 2013, President Peevey granted that motion. In Phase 1, do Settling Parties request that Commission would issue a certificate of convenience and necessity (CPCN) but would not specify the plant size at that time? Alternatively, do the Settling Parties request that the Commission grant authority to build the 9.6 mgd plant (or the smaller size plant), but that the actual sizing decision will not be made until the Phase 2 decision is issued?

If the authority requested is left open-ended as to plant size, how can the Commission determine whether the rates will be just and reasonable? If the Commission determines that it is reasonable to authorize a smaller desalination plant, how can the Commission reasonably consider the potential impact on ratepayers of the GWR Project at this time? What are the potential costs of the GWR Project (in dollars and by acre-foot), and how can the Commission assess how this project may impact revenue requirements?

The Settlement Proposal contains an approach to the GWR findings that must be in place if the Commission is to approve a smaller size desalination plant, but these findings are contemplated to be considered in Phase 2. Does

approval of the settlement imply that these are the findings that must be made? The findings that are being requested appear to require certain judgment calls and legal conclusions. However, the settlement also contemplates that if various findings cannot be made by Commission decision, information will be provided by Tier 2 advice letter. How can this process be justified?

4. Cost Caps:

As set forth in the Comprehensive Settlement Agreement, the settling parties have agreed on an approach to cost caps for the various plant sizes. As I understand it, the proposed cost caps take into account variations in costs, including intake contingencies, discharge contingencies, and site contingences, but it is not clear to me exactly how these contingencies are considered. For example, the cost cap includes a budget of \$31.83 million for potential implementation of brine diffuser and an additional pipeline to Potrero Road, if required. What, if any, other contingencies are included in the cost cap? Again, the Commission must ensure rates are just and reasonable and therefore requires a rationale to determine that these costs are reasonable.

Based on the proposed Settlement and my review of the testimony, I have developed a table that sets forth an overview of the proposed cost caps and approach to cost overruns:

| Plant Size | Range (CA-12, Att. 3) | Settlement Cost Cap | Cal-Am Facilities Cost Cap | Combined Cost Cap | Approach to Cost Over Runs |
|------------|---------------------------|---------------------|----------------------------|-------------------|---|
| 6.4 mgd | \$152 - \$223.5 million | \$210.62 million | \$85.04 million | \$295.65 million | If ≥ \$210.62 million but ≤ \$223.5 million, Tier 2 Advice Letter (A/L) to be filed; if ≥ \$223.5 million, pet. for mod. to be filed. |
| 6.9 mgd | ?? | \$214.08 million | \$85.04 million | \$299.12 million | If ≥ \$214.08 but ≤ \$227.81 million or \$334.69 ** million for combined facilities, Tier 2 A/L to be filed. |
| 9.6 mgd | \$188.9 - \$277.8 million | \$253.36 million | \$85.04 million | \$338.44 million | If ≥ \$253.36 million but ≤ \$277.8 million, Tier 2 A/L; if ≥ \$277.8 million, pet. for mod. to be filed. |

** See Comprehensive Settlement Agreement, Attachment A at 12, fn 5. It is not clear how this number was derived, nor is it clear whether a petition for modification is contemplated if costs are above this amount.

The proposed settlement also proposes a cost cap of \$85.04 million for the Cal-Am Only Facilities, with a Tier 2 A/L filed for costs over \$85.04 million but less than \$106.875 million, and a petition for modification filed for costs over

\$106.875. Parties shall be prepared to clarify exactly how the cost caps and cost overruns are proposed to work on the combined facilities, and it would be helpful to include examples of how this would work in practice.

In order to understand the cost caps that are proposed by the Settling Parties, I direct Cal-Am to file and serve itemized cost estimates for capital and operation and maintenance expenses for the MPWSP as currently proposed. Cal-Am shall categorize the expenses into three aspects of the Project: desalination, aquifer storage and recovery, and Cal-Am Only Facilities. Each category shall list each component and its associated number of units, unit cost, and total cost. The desalination category shall be separated into the three desalination plant options: 6.4 mgd, 6.9 mgd, and 9.6 mgd.

In addition, I have the following questions:

- a. Assume that the Commission authorizes the infrastructure for a 9.6 mgd plant, but authorizes an initial starting production capacity of 6.4 mgd. What would be the impact on total project costs? What demand could be served by this approach?
- b. If the Commission authorizes a 9.6 mgd plant and authorizes the full initial starting capacity, what happens if the GWR Project later becomes operational (*i.e.*, after the timeline for making the decision to construct the desalination plant)?
- c. Why are Cal-Am Only Facilities being considered separately from the rest of the desalination project? Since the entire project will be owned by Cal-Am, why are these facilities treated separately for both cost cap and financing purposes?
- d. Why is it appropriate to allow advice letters to be filed to increase costs above the proposed “soft” cost cap? If costs exceed these “non-absolute” cost caps, what standard should the Commission apply in reviewing costs that may

- be above proposed cost caps?² Does the contemplated approach to cost caps have any impact on financing?
- e. What is the cost per acre-foot of each of these cost cap estimates? Based on the proposed cost caps and potential for cost overruns, what is the anticipated rate base and revenue requirement (first through fifth year) for the MPWSP? What are customer bill impacts of the proposed cost caps?

5. Financing and Securitization:

Parties have proposed securitization as an approach to financing that would lower costs. What is the impact of the securitization proposal on the approach to financing? Does it add any additional uncertainty to financing this project? When would the proposed bill go to the legislature? What is the timing and how would a financing order be requested?

When will Cal Am determine whether securitization is appropriate and so seek such an approach? Provide examples of the metrics to be used to determine whether securitization is a reasonable and cost-effective course to pursue. What entity is the public agency referred to in Section 11.4 of the Proposed Comprehensive Settlement?

Have the settling parties consulted with bond counsel to determine the feasibility of pursuing such an approach? If securitization was not feasible or cost-effective, what do the public agencies recommend in terms of a public contribution to offset costs of this project?

As I understand it, the proposed approach to financing includes the following steps:

² See, e.g., Decision (D.) 10-12-016, Conclusion of Law 52 at 201.

- a. Monies accrued from Surcharge 2 would offset the cost of the MPWSP, with the first \$35.1 million of the monies accrued applied to the Cal-Am only facilities;
- b. Equity: Cal-Am has a direct investment of 27% of total cost of MPWSP facilities (desalination plant and Cal-Am only facilities)
- c. Cal-Am would obtain State Revolving Fund (SRF) financing or other long-term debt;
- d. Cal-Am would obtain short-term debt during construction to offset up to \$20 million in AFUDC, but this amount is to be repaid to Cal Am by issuance of SRF or other long-term debt).
- e. While securitization is proposed if various criteria are met, it is not clear to me how securitization fit into the financing scheme described above.

What is the range of financing costs to ratepayers, based on the proposed cost caps? Does this include “all-in” costs? (*i.e.*, attorney fees, brokerage fees, placement fees, underwriting fees, etc., etc.?) Have the parties relied on prior Commission decisions for guidance? Would this securitization proposal be considered debt for Cal-Am? Why or why not?

In its application, Cal-Am states that “[b]ased on discussions with SWRCB, it is [Cal-Am’s] understanding that it is eligible for a SWRCB State Revolving fund Loan for the entire project, including [Cal-Am] only facilities. . .”³ What updated information can Cal-Am provide to verify this statement? Is accounting for SRF funding according to D.05-01-048 the correct approach? What about D.10-10-018 and D.10-12-058? Do these decisions provide guidance? Are there

³ A.12-04-019 at 13.

other cases that provide guidance here? If Cal Am cannot obtain SRF financing, what public agency will it work with to obtain such financing?

In order to ensure that the record is complete, Cal-Am shall file and serve a chart showing the anticipated financing approach for each proposed plant size, the impact of financing on the cost per acre foot, revenue requirements, and anticipated bill impacts. Cal-Am shall also provide a net present value comparison of the various financing approaches, assuming that the time frame is the life of the plant and using cost of funds as the discount rate.

6. Ratemaking

In order to understand the ratemaking approach that is proposed and the workings of the various memorandum accounts and subaccounts that are proposed, Cal Am shall provide a detailed description of the ratemaking implications of the proposed Settlement Agreements. For example, the Settling Parties propose that a new memorandum account be established to track \$71.5 million that will be accrued through Surcharge 2, with a subaccount established to track and credit the first \$35.1 million in accrued monies to Cal-Am Only facilities. How will the short-term debt proposed to be issued by Cal Am be recorded and tracked to offset the calculation of AFUDC? Is Phase 3 required to address ratemaking, rate design, and potential water conservation or curtailment approaches?

7. Governance

While there are few factual issues to address in the proposed Governance Agreement, certain language in the proposed agreement appears to impede Commission jurisdiction and transfer such authority from the Commission to the Governance Committee. Parties must brief jurisdictional issues in the opening

and reply briefs on the proposed Settlement Agreements, due on January 20, 2014 and February 14, 2014, respectively.

IT IS RULED that:

1. In order to ensure that the hearings are as efficient as possible, California American Water Company shall file and serve the following information as compliance filings no later than November 19, 2013:

- a. Describe the customer service area that will be served by the proposed Monterey Peninsula Water Supply Project (MPWSP) and the rationale for this service area for this Project.
- b. Provide actual monthly customer usage and production data from 2007 through 2012 for the customer service area to be served by the proposed project. The data shall include calculations of peak hourly demand and maximum monthly demand.
- c. Provide the calculation of and reconcile and justify the difference in demand calculation for the MPWSP with its projection of demand in the 2010 Urban Water Management Plan for the Monterey District, dated September 7, 2012.
- d. Provide itemized cost estimates for capital and operation and maintenance expenses for the Monterey Peninsula Water Supply Project as currently proposed. Categorize the expenses into three aspects of the Project: desalination, aquifer storage and recovery, and "Cal-Am Only" Facilities. Each category shall list each component and its associated number of units, unit cost, and total cost. The desalination category shall be separated into the three desalination plant options: 6.4 million gallons per day (mgd), 6.9 mgd, and 9.6 mgd.
- e. Provide a table showing the anticipated financing approach for each proposed plant size, the impact of financing on the cost per acre-foot of each proposed plant size and financing approach, the associated rate base,

revenue requirements, and anticipated bill impacts. Cal-Am shall also provide a net present value comparison of the various financing approaches, assuming that the time frame is the life of the plant and using cost of funds as the discount rate.

2. Parties who wish to file and serve an objection to the official notice of Cal-Am's 2010 Urban Water Management Plan for its Monterey District, dated September 7, 2012 shall do so no later than November 15, 2013.

3. Witnesses shall be available to respond to the questions outlined above at the evidentiary hearings scheduled for December 2 and 3, 2013 on the proposed Settlement Agreements.

4. I anticipate that responding to my questions can be done in one day. However, because my questions may engender questions from other parties, I have provided for an additional day of hearing time. These hearings are narrow and will only address the proposed Settlement Agreements, pursuant to Rule 12.3.

5. Parties have an obligation to understand and comply with the Commission's laws, rules, and procedures. *Ex parte* contacts are subject to several restrictions in proceedings that are categorized as ratesetting, as is this matter. Pub. Util. Code § 1701.2 and Rules 8.1, 8.2, 8.3(c) and 8.4 address the *ex parte* requirements in ratesetting matters. Parties must comply with these requirements. Prospective violations of the *ex parte* rules may be considered a violation of Rule 1 and may lead to sanctions.

6. To the extent that parties use the updated service list in this proceeding to confer by e-mail, decision-makers at the Commission (defined in Rules 8.1(b) and 8.2) must be removed from the email address list. The Public Advisor can assist parties with questions in this matter.

Dated November 4, 2013, at San Francisco, California.

/s/ ANGELA K. MINKIN

Angela K. Minkin
Administrative Law Judge