Decision **DRAFT DECISION OF ALJ MCVICAR (Mailed 7/1/2004)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for an Order for Emergency Authority to Temporarily Increase Upper Block Rates for Water Service in its Monterey District to Avoid SWRCB Violations and Request for Immediate Ex Parte Relief.	Application 04-06-020 (Filed June 16, 2004)

OPINION AUTHORIZING CONSERVATION RATES

Summary

California-American Water Company (CalAm) is ordered to restructure the quantity blocks and increase certain upper-block rates in its Monterey District to promote water conservation. The revised rates are to apply to service rendered through October 31, 2004. CalAm must also file an application seeking to impose a moratorium on new water connections and expansions of existing connections in its Monterey District within 90 days. This proceeding is closed.

Background

CalAm's Monterey District

CalAm provides public utility water service to approximately 170,000 customers in various areas in San Diego, Los Angeles, Ventura, San

Mateo, Santa Cruz, Sonoma, Sacramento, Placer and Monterey counties.[1] CalAm is a California corporation and a wholly owned subsidiary of American Water Works Company, Inc., which was recently acquired by RWE Aktiengesellschaft, Thames Water Acqua Holdings GmbH.

CalAm's Monterey District provides water service to approximately 38,200 customers on the Monterey Peninsula and vicinity, encompassing the of Carmel-by-the-Sea, Pacific Grove, Monterey, Sand City, Del Rey Oaks and part of Seaside, much of the Carmel Valley, the Highway 68 corridor, and several other nearby unincorporated areas.

CalAm supplies about 85% of the Monterey Peninsula's water. It develops its supply from Carmel River surface water and wells in the Carmel Valley, Seaside basin, and along the Highway 68 corridor. It has been apparent for some time that during periods of drought there is not sufficient water to satisfy fully both environmental requirements and unrestrained municipal water demands, but various factors have prevented any permanent solution to date.

In 1995, the State Water Resources Control Board added a major new legal constraint to the Monterey Peninsula's physical water supply limitations. SWRCB, following hearings begun in 1992, acted on complaints alleging that CalAm's Carmel River water use was without valid rights and adversely impacted environmental and public trust values. In Order WR 95-10, it directed CalAm to cut its Carmel River diversions to 14,106 acre-feet annually and implement conservation measures to bring that figure down by 20% more

[1] For much of background information in this order, we take official notice of our Decision (D.) 03-02-030 in CalAm's last general rate case (GRC).

beginning with the 1997 water year. CalAm met the SWRCB-mandated cutback during the first water year ending September 30, 1996 following Order WR 95-10. It exceeded the limit in the second year, however, and the SWRCB levied a $168,000 fine on CalAm for the violation.[2] With the aid of Commission-authorized rate structures designed to provide very strong conservation incentives, CalAm has been able to meet SWRCB's limits each year thereafter.

Monterey's Current Supply Situation

CalAm continues to operate Monterey District under the terms of SWRCB Order WR-95-10 as modified by Order WR 98-04. CalAm works with Monterey Peninsula Water Management District (MPWMD) to create quarterly water production budgets and sets monthly targets that, if met, should at the end of the water year be within the SWRCB annual limit. Through April 2004, CalAm had managed to stay within its cumulative water production target for the current October through September water year. However, in mid-May 2004, CalAm recognized that May deliveries were consistently exceeding the daily targets and that the early, dry and hot weather conditions were continuing with no relief in sight. That pattern continued into June and unless immediate action is taken CalAm believes it is virtually certain that it will exceed the SWRCB limit for this water year. CalAm estimates that, depending on how SWRCB counts the number of violations, the fines SWRCB may assess for failing to meet the Order WR 95-10 water production limits for the current water year could run as high as

[2] CalAm has been authorized memorandum account treatment in three earlier Monterey District decisions (D.98-08-036, D.00-03-053 and D.03-02-030) for any SWRCB fines due to failure to meet the requirements of Order WR 95-10. Recovery in rates may be allowed provided the Commission determines that CalAm's management and operations related to those fines have been reasonable and their recovery is justified.

$3 million to $4 million. If fines are assessed, they will be booked in CalAm's previously authorized memorandum account and CalAm will seek Commission authorization to recover them from its Monterey District customers.

CalAm reports that it has already attempted to persuade customers to conserve voluntarily. In mid-May, the district manager began a telephone campaign to contact local golf course operators in person, and recorded a telephone message that was delivered to over 30,000 district customers. CalAm also made two postcard mailings with conservation messages to all Monterey District customers in May, and on June 1, the company began a series of television, cable and radio spot announcements to complement extensive coverage the issue has received in the local press. Despite those efforts, water consumption continued to rise through May. Even if usage should return to normal now, to avoid SWRCB fines CalAm will have to make up the earlier overusage amounts during the remaining three months of the water year, July, August and September.

Pursuant to earlier Commission orders, CalAm has long had a Water Conservation Plan, Rule 14.1, in its tariffs. Rule 14.1 is modeled on and conforms to MPWMD's Ordinance 92. Both establish a phased plan to deal with shortages. Stage One of Ordinance 92 consists of numerous water conservation activities, has been in effect since 1999, and was in effect at the time this application was filed. Largely as a result of the Stage One program, per capita consumption in Monterey District remains among the lowest in California. Stage Two is directed at landscape water usage. Stage Three, subject to Commission authorization, allows for enforcement (through fines, etc.) by MPWMD to obtain compliance with Stages One and Two, and discusses implementing increased rates as an additional conservation mechanism. According to the application, CalAm's

current request is consistent with Ordinance 92, and all further Stage 3 action to discourage excessive usage is MPWMD's responsibility. On June 23, MPWMD wrote to the Commission to convey its conditional support for CalAm's application and to report that it had implemented Stage 3, "effective immediately." We discuss MPWMD's conditional support in a section to follow.

CalAm's Application

CalAm's application seeks ex parte authorization to impose an immediate, temporary increase in its upper quantity block rates for all water service connections (Tariff MO-1) in the affected area.[3] Those increases would expire on November 1, 2004, to be replaced by the winter rates approved in CalAm's last Monterey District GRC. The increases CalAm proposes are aimed primarily at decreasing excessive outdoor water usage, and water waste. Users of normal amounts of water indoors and those who do not waste water would be largely unaffected.

Under ratemaking provisions already in effect, the increased revenues would flow automatically to CalAm's existing Water Revenue Adjustment Mechanism balancing account and eventually be applied to customers' benefit.

CalAm states that it has commissioned a cost of service study and rate design analysis for its next Monterey District GRC application to be filed February 1, 2005. In that GRC, CalAm will propose a revised rate design intended to avoid the need to file future applications such as this one.

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[3] A relatively small number of Monterey District customers are served by systems drawing from other water sources. Those customers are not on Tariff MO-1 and not affected by our order today.

Discussion

Responses to the Application

In recognition of the urgency Monterey District's water situation presents, the usual 30-day period allowed for protests to the application was shortened to four days, and CalAm's reply period shortened from ten days to one day.[4] Three replies were received in lieu of protests, from the Commission's Office of Ratepayer Advocates (ORA), from Independent Reclaimed Water Users Group (IRWUG), and from Pebble Beach Company.[5] The Commission received additional input through two Public Participation Hearing sessions held in Monterey on July 2, and from the public and others in the form of telephone calls, letters and e-mail.

Each of the three formal responders to this application characterized its document as a response rather than a protest, but only under conditions each set forth if the changes are authorized. ORA states that it does not oppose the application, subject to three conditions: (1) that CalAm file an application for authority to implement a moratorium on new hookups and expansions; (2) that the Commission provide an opportunity for public comment; and (3) that CalAm implement a two-tiered rate structure for golf course and public authority

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[4] Under the Commission's Rules of Practice and Procedure, Rule 44.1, a protest or response to an application must be filed within 30 days of the date the notice of the application's filing first appears in the Daily Calendar. This application appeared on the Commission's Daily Calendar of June 21, 2004.

[5] Under Rule 44, a protest is a document objecting to the granting in whole or in part of the authority sought in an application, while a response is a document that does not object to the authority sought but nevertheless presents information the party believes would be useful to the Commission in acting on the application.

customers. CalAm agrees to those conditions in its reply. Both the Pebble Beach Company and the IRWUG support CalAm's changes with two conditions: (1) that the Commission establish a two-tiered rate structure for golf courses; and (2) the Commission state in its decision that the increased rates should not affect the price of reclaimed water. CalAm agrees to the first condition and requests the second as well, recognizing that the rates for reclaimed water are not within CalAm's or the Commission's control. We group the respondents' conditions for discussion next.

New Connection Moratorium

To address ORA's first condition, CalAm is in the process of preparing a Commission application seeking a moratorium on all new or expanded water service connections in Monterey District. Pursuant to California Water Code §§ 350 et seq., before CalAm may impose a moratorium it must conduct a public hearing on the water shortage emergency and the Board of Directors must pass a resolution declaring the existence of a water shortage emergency. CalAm is in the process of complying with those conditions and commits to filing shortly the application ORA seeks. While we withhold judgment today on whether such a moratorium is justified, we agree that it is an appropriate measure to consider. We will order the application be filed.

Public Participation Hearings

ORA's response to the application recommended the Commission provide an immediate opportunity for public comment. On the day CalAm held its informal meeting with ORA, CalAm made such a request to the Commission's Administrative Law Judge Division, and the ALJ Division the following day calendared a formal, two-session Public Participation Hearing to be held in Monterey on July 2. ORA's response acknowledges and supports that outcome.

Public Authority Rates

ORA's response also raised the issue of a two-tiered rate structure for public authority customers. CalAm's application notes that it limited its proposed increases to the upper blocks in an effort to induce conservation in outdoor water usage. Rates for the lower blocks were left unchanged so as to permit continued, normal indoor usage levels without penalty. In meetings with ORA, CalAm discussed the fact that public authority customers purchase water for both indoor and outdoor uses. So as not to unfairly penalize public authority customers for their necessary indoor water use, CalAm agrees that a two-tiered rate structure should be established. In its reply, CalAm includes such a rate structure based on average monthly winter use for public authority customers as a group. This should allow public authority customers to continue most of their existing usage at the present lower block rate. We agree that this is a reasonable adjustment to the original proposal and will require its adoption.

Golf Course Rates

ORA, Pebble Beach Company and IRWUG all raised the issue of a two-tiered rate structure for golf courses. As the Pebble Beach Company and the IRWUG discuss in their comments, they are participants in the Monterey Reclamation Project. As such, they have voluntarily agreed to accept reclaimed (recycled) water from MPWMD in lieu of potable water previously supplied by CalAm. Their contracts with MPWMD provide that to the extent reclaimed water is insufficient in either quality or quantity, it will be supplemented by potable water from CalAm. High salinity in reclaimed water results in salt concentration buildup which, if not flushed, can severely damage or even destroy golf course greens. To prevent that damage, the golf courses flush with

potable water over a five-day period once a month during the March through November irrigation season.

In its reply, CalAm agrees with ORA, Pebble Beach Company and IRWUG that golf courses should not be charged the proposed higher conservation rates for water used to flush accumulated salts from reclaimed water use. Golf courses not using reclaimed water should be similarly treated. CalAm therefore proposed in its reply a two-tiered rate structure for all golf courses under which it would establish a monthly allotment (first tier) sufficient to allow for monthly flushing, and as of the date its reply was filed had already begun to determine those allotments. The existing rate for all golf courses would remain unchanged for usage up to the allotment and only additional usage would be at the increased, second-tier rate. Again, we agree that this is a reasonable outcome – it balances the need for conservation with the need to minimize the adverse impact on a golf course industry that is one of the major drivers in the Monterey Peninsula's economy.

Reclaimed Water Rates

As Pebble Beach Company and IRWUG explain, the price MPWMD charges for reclaimed water under the Monterey Reclamation Project is tied by their contracts to CalAm's rate for potable water. Their responses to the application ask the Commission to order a separate tariff rate for their golf courses (which we have agreed above to do for all golf courses), make a finding that golf courses using potable water for flushing are not similarly situated to other potable water users, and make clear that the increased rate for the second-tier water use is an extraordinary charge and therefore not appropriately considered a driver for the price of reclaimed water.

As all parties implicitly agree, only MPWMD, not the Commission, has the ability to interpret or modify the contracts to include or exclude as reclaimed water price drivers the extraordinary conservation rate increments we approve in this application. Given that caveat, CalAm and we do agree with Pebble Beach Company and IRWUG's position. Substitution of reclaimed water for potable water in golf course irrigation has been a major factor in holding down potable water usage in CalAm's system over the past decade. The second-tier golf course rates we establish today are indeed extraordinary, temporary, and intended only for purposes of promoting much needed conservation. We will make our finding to that effect.

MPWMD's Conditions

MPWMD did not file a formal protest or response to the application. It did, however, through a June 23, 2004 letter inform the Commission that it had implemented Stage 3 conservation effective immediately and make its views on the application known. Lacking a formal filing, CalAm did not comment on MPWMD's views in its formal reply. We nonetheless note MPWMD's views here because it is a key participant in the issues involved.

MPWMD's mission is to "manage, augment, and protect water resources for the benefit of the community and the environment" of the greater Monterey Peninsula area, and MPWMD has taken an active role in each of CalAm's last three Monterey District GRCs and in other Commission proceedings, particularly in the areas of water supply, rate design and conservation. MPWMD's charges include managing and regulating water use, reuse, reclamation and conservation, and financing water public works projects. Almost all of CalAm's

Monterey District water system lies within MPWMD's 170 square mile jurisdiction.[6] We previously expressed our strong preference that CalAm work cooperatively to develop mandatory conservation and rationing plans consistent with complementary measures to be developed by MPWMD. MPWMD enacted Ordinance 92 establishing an expanded water conservation and standby rationing plan, and we authorized CalAm to adopt Ordinance 92 as its conservation and standby rationing plan.

MPWMD's letter describes CalAm's obligations under its Ordinance 92 Expanded Water Conservation and Standby Rationing Plan, and offers conditional support for CalAm's proposed conservation rates. MPWMD asks the Commission to require Cal Am to reduce its unaccounted for water use by a date certain, and to facilitate that goal, to require CalAm to devise and implement an expedited main replacement program. MPWMD also expresses its willingness to work with CalAm to complete landscape water audits required under Ordinance 92 and to monitor water budgets for users, but requires funding assistance to complete those tasks. MPWMD also notes that CalAm has not provided water use records or budgets to it on request.

We appreciate MPWMD's input and offer of cooperation. CalAm will be filing its next GRC for Monterey District in February 2005 for test year 2006, and it is in such GRCs that we typically examine water utilities' unaccounted for water usage levels and main replacement programs. Because those considerations are major drivers in establishing water utilities' revenue requirements and setting rates, we intend to continue that practice in CalAm's

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[6] For this background, see D.03-02-030, our order in CalAm's last GRC.

case. Accordingly, we urge CalAm and MPWMD to coordinate their efforts to the extent they can do so and present and support their position(s) in CalAm's GRC proceeding next year.

Conclusion

The description CalAm's application presents of its water supply situation, the parties' responses, and CalAm's reply are compelling. No party has filed a protest to the application. No formally filed response has suggested that the water supply situation in CalAm's Monterey District is not both as critical and as urgent as CalAm contends, nor are we aware of any offer of facts to prove that it is not. CalAm has made a prima facie case that extraordinary measures to promote water conservation for the remainder of this water year are warranted.

Where parties have posed objections to the specific rate structure set forth in the application, CalAm has agreed to, and we will adopt, changes to address their concerns. Considering that CalAm will have at most less than three months before the end of the water year to accrue sufficient conservation savings to offset the year's earlier cumulative overusage, and that if it does not do so it will be in violation of a lawful order, SWRCB Order 95-10, and subject to possibly severe fines, time is of the essence. Under the circumstances, we conclude that the relief we authorize in this order is necessary and reasonable, and no evidentiary hearing is needed.

Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and James C. McVicar is the assigned Administrative Law Judge in this proceeding.

Comments on Draft Decision

Pursuant to Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, we determine that the public necessity requires a reduction in the

30-day period for public review and comment. Comments on the Draft Decision were due on July 6, 2004, and no reply comments were permitted.

CalAm, Pebble Beach Company, and IRWUG filed comments supporting the draft decision and suggesting wording changes to clarify our intent with respect to golf course customers and reclaimed water rates. We have made those changes. IRWUG also requests we fix the amount of water golf courses would receive in the first tier at 30 acre-feet per month. As CalAm noted in its earlier reply, CalAm will establish a monthly allotment for golf course customers and is currently in the process of doing so. We decline to assume that amount should be 30 acre feet per month, or that it is identical for all Monterey Peninsula courses, so we have not made the change.

Findings of Fact

1. Absent significant reductions in its customers' Monterey District water usage during the months of July, August and September 2004, CalAm is likely to exceed its SWRCB-imposed water production limits and be in violation of SWRCB's Order 95-10 for the water year ending September 30, 2004.

2. Violation of SWRCB Order 95-10 could expose CalAm to significant fines that CalAm would likely seek to pass through to its Monterey District water customers.

3. CalAm's compliance with SWRCB-imposed water production limits established in SWRCB's Order 95-10 is in the public interest.

4. Increasing upper block quantity rates is an effective method for promoting water conservation.

5. The modified rate structures and increases CalAm proposes are aimed primarily at decreasing excessive outdoor water usage and water waste. Users of

normal amounts of water indoors and those who do not waste water would be largely unaffected.

6. No party has filed a formal protest to the application. Where parties' responses have posed objections to the specific rate structure set forth in the application, CalAm has agreed to changes to address their concerns.

7. The rates we establish today are extraordinary, temporary, and intended only for promoting conservation. Any increased revenues CalAm receives as a result of the rate increases authorized in this order will automatically accrue to CalAm's previously-authorized WRAM account and eventually be applied to customers' benefit.

8. Substituting reclaimed water for potable water under the Monterey Reclamation Project has been and continues to be helpful to CalAm in achieving its potable water conservation goals.

9. Golf courses using potable water for flushing away the salts from reclaimed water have little flexibility to reduce their base potable water usage, and are thus not similarly situated to other potable water users.

10. The rates MPWMD charges users for reclaimed water under the Monterey Reclamation Project are tied by contract to CalAm's rates for potable water. Whether to revise those reclaimed water charges based on the temporary conservation rates authorized in this order is not a determination to be made by the Commission. This order is not intended to affect charges for reclaimed water.

11. CalAm should be required to file an application seeking to impose a moratorium on new water connections and expansion of existing water connections in the shortage-affected areas of its Monterey District.

12. Water utilities' unaccounted for water usage levels and main replacement programs are major drivers in establishing their revenue requirements and setting rates. The Commission typically examines those items in water utilities' GRCs.

13. No hearing is required.

Conclusions of Law

1. The rate increases authorized in this order are justified and the resulting rates are reasonable.

2. The modified conservation rate design and resulting rates proposed by CalAm and set forth in Appendix A to this order are in the public interest and should be approved.

3. Public necessity requires that the 30-day comment period of Pub. Util. Code § 311(g) be reduced so that CalAm can implement its new rates and begin achieving their conservation benefit as soon as possible. We have balanced the public interest in avoiding harm to the public welfare resulting from delay in considering this decision against the public interest in having the full 30-day period for review and comment required by Section 311(g). We conclude that the public interest in adopting the former outweighs the latter. Accordingly, we should reduce the comment period.

4. This decision should be made effective immediately to begin reducing Monterey District water usage as soon as possible.

O R D E R

IT IS ORDERED that:

1. California American Water Company (CalAm) shall file in accordance with General Order 96 and make effective on the date of filing the revised Tariff Schedule MO-1 sheet included as Appendix A to this order. The revised

schedule shall apply to service rendered between its effective date and October 31, 2004, unless sooner revised, extended or canceled. On November 1, 2004, CalAm shall return to the rate structure and rates that would otherwise have been in effect absent this change.

2. CalAm shall within 90 days of the date this decision is mailed file an application seeking to impose a moratorium on new water connections and expansion of existing water connections in the shortage-affected areas of its Monterey District.

3. CalAm's requests in Application (A.) 04-06-020 are granted as set forth above, and in all other respects are denied.

4. A.04-06-020 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A

Schedule No. MO-1
Monterey District Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all water furnished on a metered basis.

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, Sand City, a portion of Seaside, and certain unincorporated areas in the County of Monterey.

RATES

Quantity Rates:

	Per Ccf	
Elevation Zone Surcharge:		
Elevation Zone 1, per 100 cu. ft., ...	$0.2461	
Elevation Zone 2, per 100 cu. ft., ...	0.4280	
Residential, Multi-Residential, and PAR Customers:		
For the first 100 cu. ft. x Customer ECU	1.5264	
For the second 100 cu. ft. x Customer ECU	3.0528	
For the third 100 cu. ft. x Customer ECU.....	4.5792	
For the fourth 100 cu. ft. x Customer ECU.	12.2112	(I)
All Water over 400 cu. ft. x Customer ECU.	24.4224	(I)
Service Charge	0.9948	
Golf Course Customers:		
For all water delivered up to monthly allotment, per 100 cu. ft.	3.0528	(n)
For all water delivered over monthly allotment, per 100 cu. ft.	9.1584	(n)(I)
Public Authority Customers:		
For the first 40 ccf's, per 100 cu. ft.	3.0528	(n)
For all water delivered over 40 ccf's, per 100 cu. ft.	6.1056	(n)(I)
Special Use Customers:		
For all water delivered, per 100 cu. ft.....	6.1056	(I)
All Other Customers:		
For all water delivered up to monthly allotment, per 100 cu. ft.	3.0528	
For all water delivered over monthly allotment, per 100 cu. ft.	18.3168	(I)

(END OF APPENDIX A)