Decision **PROPOSED DECISION OF ALJ MALCOLM (Mailed 8/24/2004)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the California-American Water Company (U 210 W) for an order authorizing it to increase its rates for water service in its Los Angeles Division to increase revenues by $1,354,500 or 7.56% in the year 2004, $842,100 or 4.68% in the year 2005, and $1,052,000 or 5.22% in 2006.	Application 03-07-036 (Filed July 23, 2003)

FINAL OPINION ADOPTING RATE CHANGES FOR CALIFORNIA-AMERICAN WATER COMPANY'S LOS ANGELES DISTRICT

California-American Water Company (Cal-Am) seeks rate changes for its Los Angeles district in the service areas of San Marino, Baldwin Hills and Duarte. This decision approves all but one element of an uncontested settlement resolving all matters in this application.

1. Summary of Application and Adopted Rates

CalAm's application seeks revenue increases of 7.56% in 2004 and 4.68% in 2005. The application proposes these rates would go into effect with a one year lag (i.e., January 1, 2005), and with different rate increases by community (service area). In some communities, rates would increase substantially; in others, rates would increase slightly or decline. The proposed rate changes would be allocated to the service areas as follows:

	2004	**2005**
San Marino	21.04%	4.32%
Baldwin Hills	(8.86%)	(7.60%)

Duarte	1.23%	4.76%

Cal-Am states it needs the revenue increases to pay for operation and maintenance, and financing and capital costs resulting from growth in plant, among other things. The application presents information about all forecast expenses, sales and revenues, including those for operations and maintenance, general office expenses and financial requirements, utility plant, depreciation, rate base, revenue requirements, and the rate of return. The application also proposes rate design, which would allocate revenue requirements to various customer groups and service offerings. At the direction of the assigned Administrative Law Judge (ALJ), CalAm proposed a separate rate for low-income customers.

CalAm's application recognizes the settlement adopted in Decision (D.) .02-12-068, which deferred any rate increases through the end of 2004. Accordingly, the rate increases that would normally have gone into effect on January 1, 2004 would become effective January 1, 2005. Rate changes that would have been implemented January 1, 2005 would be effective January 1, 2006.

This decision adopts all but one element of a proposed settlement between CalAm, Office of Ratepayer Advocates (ORA), and the City of San Marino. Consistent with the settlement, the overall increase in revenues for the Los Angeles Division is 4.82% in 2004 and an additional 2.81% in 2005. These revenue changes are allocated as follows to each service area in the Los Angeles division:

	2004	**2005**
San Marino	13.46%	3.32%
Baldwin Hills	(7.6%)	2.23%
Duarte	.28%	2.39%

2. Procedural Background

The Commission held a prehearing conference in this proceeding on September 16, 2003 which ORA stated it would oppose some of CalAm's revenue requirement proposals.

On December 16 and 17, the Commission conducted public participation hearings in the communities of San Marino, Montebello, and Inglewood. About 30 local residents attended the hearing in San Marino, 23 of whom spoke in opposition to the rate increase proposal. Many raised a common concern that their neighborhood had been targeted for a rate increase because of the residents' relative affluence. Some stated a concern that CalAm might not pursue reparations from companies that had contaminated its water supply for the San Marino area, and that the cost of replacement supplies was onerous. Some raised questions about the Commission's procedures for adopting rate changes. A couple of speakers described service problems they had experienced in previous years. No one attended the public participation hearings conducted in Inglewood or Montebello.

ORA submitted testimony on January 9, 2004, and CalAm submitted rebuttal on January 20, 2004. Subsequently, ORA and CalAm met to discuss settling the case. On February 23, 2004, ORA and CalAm filed a Motion for Adoption of Settlement Agreement pursuant to Rule 51 of the Commission's Rules of Practice and Procedure (Rule). The settlement proposed resolution of all outstanding issues in the proceeding. At the time, CalAm and ORA were the only active parties to the proceeding.

After CalAm and ORA filed a motion to adopt the settlement, the City of San Marino moved to intervene. The assigned ALJ granted the City's motion over CalAm's objection. The City filed comments on the settlement March 24. San Marino's comments proposed rejecting the settlement because of (1) its

treatment of water purchases, and (2) the costs of and third party reimbursements associated with contaminated wells. The comments also addressed accounting treatment of certain plant.

CalAm, ORA, and the City of San Marino subsequently resolved their differences following negotiations. On May 7, 2004, they jointly filed a Motion to Adopt Supplemental Settlement Agreement. This new settlement would resolve all controversies among the three active parties by addressing concerns raised by the City of San Marino regarding treatment of costs and revenues related to CalAm's contaminated wells and replacement water supplies.

The Commission held a brief evidentiary hearing on April 27, 2004. During the hearing, CalAm described briefly the settlement and parties made minor changes to testimony. The matter was submitted at the end of the hearing.

3. The Settlement

The settlement resolves several major differences between ORA's position and CalAm's position including the following:

- The cost of purchased power is reduced from CalAm's original request of about $2.5 million to $1.95 million;
- Reduction in general overhead expenses from CalAm's original request of $336,000 to $292,000;
- Deferral of changes to irrigation rates in Duarte that could cause major rate increases for certain customers;
- Reduction in the cost of capital from CalAm's proposed 10.7% to 10.04%; and
- Reductions to costs to reflect updated information regarding payroll, chemical costs, equipment costs, and miscellaneous expenses.

The settlement also defers the resolution of how to treat the replacement of the irrigation system serving the Duarte area. Cal-Am agrees to address this in a

separate application because of its potentially substantial rate impacts on a handful of customers.

The settlement is modified by the supplement filed May 7, 2004. The supplement provides that all costs and revenues associated with recovery of contaminated well water costs will flow through to CalAm's ratepayers. This contamination by third parties has required CalAm to purchase more expensive water supplies for the residents of San Marino. The supplement documents CalAm's agreement to pursue recovery of costs related to contaminated wells or potentially face sanctions by the Commission.

The application and settlement would defer the 2004 rate increase until January 1, 2005 and the 2005 rate increase to January 1, 2006. This rate deferral is required by D.02-12-068 as a condition of the merger of CalAm with RWE Aktiengesellschaft. Attachment A presents a summary of earnings for CalAm's Los Angeles Division, and compares CalAm's proposed revenue requirements, ORA's recommendations and the adopted settlement amounts. Attachment B presents the new rates for each customer class in each service area. Attachment C compares customer bills at current and adopted rates. Attachment D shows adopted water consumption for each service in each community.

4. Low Income Discount Rates

Pub. Util. Code § 739.8 requires the Commission to consider low-income discount rates for water customers. Accordingly, the assigned ALJ directed CalAm to propose a low-income residential water rate.[1] CalAm proposed an

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[1] Pub. Util. Code § 739.8 provides in pertinent part:

> "(b) The commission shall consider and may implement programs to provide rate relief for low-income ratepayers.

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inverted rate with a bill discount of up to $15. In its testimony, ORA proposed instead to provide a 15% discount to the bills of customers whose incomes are less than 175% of the federal poverty level. The settlement would incorporate this ORA proposal.

The matter of low-income discount rates has been under consideration in several water company rate cases over the years. For example, D.02-10-058, a rate case decision for San Gabriel Water Company, addressed this issue in some detail. In that case like here, ORA and the company filed a settlement that included a low-income discount rate. There, we considered whether the rate would be fair and efficient and ultimately rejected the rate partly because it created a problem it could not or did not cure. Specifically, the rate would not be offered to users living in master-metered facilities, that is, individuals and families living in apartment buildings and mobile home parks. These tenants would not receive the rate because they are not customers of the utilities but instead pay for utilities as part of the rent or lease amount. Because many low-income individuals and families live in buildings or facilities with master meters, CalAm's low-income rate would presumably not be available to a significant portion of its low-income customers.

The settlement does not address how the shortfall from the low income discount would be allocated to other customers, deferring the issue and

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"(c) The commission shall consider and may implement programs to assist low-income ratepayers in order to provide appropriate incentives and capabilities to achieve water conservation goals.

"(d) In establishing the feasibility of rate relief and conservation incentives for low-income ratepayers, the commission may take into account variations in water needs caused by geography, climate and the ability of communities to support these programs."

permitting the shortfall to be tracked in a memorandum account. The uncertainty regarding how the shortfall would be recovered imposes an additional risk on low income individuals and families who are tenants living in master-metered buildings or facilities. Those tenants may ultimately pay higher rates because of the low income discount if the shortfall from the discount is allocated to master meter customers and those customers may pass along the higher utility rate to their low-income tenants.

We also share CalAm's concern that providing discounts to any customer merits consideration of more aggressive water conservation efforts. In fact, the ability to conserve water – and thereby reduce utility bills – without compromising the quality of life should be one element of a program to meet the needs of low-income customers. Although we applaud the parties' efforts to settle the case, these types of issues are not addressed in ways that satisfy our interest in promoting the interests of those who are similarly-situated, in this case individuals and families on limited incomes.

These issues relating to low-income rate discounts for master meter customers and conservation programs have been raised in other water company general rate cases, and we are considering whether to pursue their resolution in a rulemaking or individual rate cases. In the meantime, we decline to adopt the low-income rate. This change to the settlement would not affect the rates it proposes because the shortfall from the rate was not allocated to other classes of customers, and would have been included in future rates.

5. Conclusion

We adopt the settlement and supplement presented in this proceeding with the exception of the low income discount. The rate changes in the settlement are very small with the exception of those for San Marino residents. The increases in San Marino are higher in part as a result of costs associated with

water purchases in San Marino that are necessary because of contamination in traditional supply sources. The settlement protects San Marino residents from unreasonable costs of such water purchases by documenting CalAm's intent to seek remuneration from parties responsible for water supply contamination. Moreover, even with a 13.97% rate increase, San Marino rates are comparable to rates in Duarte and remain substantially lower than CalAm's rates in Baldwin Hills. The settlement and supplement thereby address the main concerns articulated at the public participation hearing.

We reject a low income discount at this time because of our concern that it cannot be offered to tenants in master metered facilities and buildings, many of whom would otherwise be likely to qualify for the rate. We do appreciate the parties' willingness to address the issue at the request of the assigned ALJ and urge them in future proceedings to consider ways CalAm may resolve the concerns we raise here.

The settlement is unopposed and appears consistent with existing Commission policy. The settlement would implement a reasonable rate of return and reflects most recent information on various operational costs. We concur with the settlement provision deferring resolution of changes to irrigation infrastructure and rates because of the potentially substantial impact of those changes and the need to consider them in more depth.

The parties followed the procedural requirements for settlements, as set forth in Rule 51, et seq. The settlement is signed by representatives of consumers and the utility and is uncontested.

Consistent with Rule 51.1(e), the settlement is consistent with and reasonable in light of the record in this proceeding, lawful and in the public interest. We therefore we adopt it with the exception stated herein rejecting the low income discount.

6. Comments on Proposed Decision

The proposed decision (PD) of the ALJ in this matter was mailed to the parties in accordance with Pub. Util Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. ORA filed comments on the PD objecting to the Commission adopting the settlement without the provision for a low-income rate. ORA observes that the Commission has adopted rate design in other cases where it did not have good information about the impacts on other customers. It argues that the Commission should not deny rate relief to one deserving customer group on the basis that it cannot provide rate relief to all.

While ORA makes reasonable points on procedural issues, it does not dispute the view of the PD that the implementation of a low-income rate could be costly to similarly-situated citizens in master-metered facilities, and it does not offer a cure for this potential problem. We therefore decline to modify the PD to adopt a low-income rate for CalAm's Los Angeles District for the reasons discussed herein.

7. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Kim Malcolm is the assigned ALJ in this proceeding.

Findings of Fact

1. No party objects to the settlement as modified by supplemental agreement among all the active parties.

2. The modified settlement would resolve all outstanding issues in this proceeding and set a revenue requirement and rate of return for CalAm's Los Angeles division for the years 2005 and 2006.

3. The modified settlement proposed by CalAm, ORA, and the City of San Marino is reasonable in light of the whole record.

4. The low income discount, as proposed in the settlement, could not be provided to individuals and families who are tenants of master metered facilities and buildings.

Conclusions of Law

1. The settlement as modified by the supplement is consistent with Commission policy and D.02-12-068 with the exception of the low income discount.

2. The exhibits identified in this proceeding at the April 27, 2004 hearing should be entered into the record of this proceeding.

3. Consistent with D.02-12-068, the rate increases adopted in this decision for test year 2004 should be deferred until January 1, 2005 and the rate increases adopted in this decision for test year 2005 should be deferred until January 1, 2006.

4. The settlement, as supplemented and with the exception of the low income discount, meets the Commission's criteria for approval of proposed settlements.

5. Today's order should be made effective immediately.

FINAL ORDER

IT IS ORDERED that:

1. The settlement proposed in a motion filed on February 23, 2004 by California-American Water Company (CalAm) and Office of Ratepayer Advocates (ORA), as modified by a motion and supplemental settlement filed on May 7, 2004 by CalAm, ORA, and the City of San Marino, is adopted as set forth herein with the exception that the low income discount is not adopted.

2. The rates adopted herein for 2004 shall go into effect January 1, 2005 and the rates adopted herein for 2005 shall go into effect January 1, 2006.

3. The exhibits identified in this proceeding in an evidentiary hearing on April 27, 2004 are hereby entered into the record of this proceeding.

4. CalAm is authorized to file in accordance with General Order 96-A, and to make effective on not less than five days' notice, tariffs containing the rate changes authorized in this decision for the Los Angeles Division and consistent with Attachment B.

5. CalAm is authorized to establish a memorandum account to track the costs and revenues associated with contaminated wells in the Los Angeles Division, as described in Section 2 of the Supplemental Settlement Agreement filed May 7, 2004 in this proceeding.

6. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.