Decision **PROPOSED DECISION OF ALJ GRAU** **(Mailed 7/25/2006)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Suburban Water Systems (U 339-W) for Authority to Increase Rates Charged for Water Service by $5,633,937 or 12.1% in Fiscal 2006-2007; $1,640,549 or 3.1% in Fiscal 2007-2008; and by $1,364,551 or 2.5% in Fiscal 2008-2009.	Application 05-08-034 (Filed August 22, 2005)

(See Appendix B for List of Appearances.)

OPINION ADOPTING SETTLEMENT

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A. Summary

This decision adopts a settlement agreement between Suburban Water Systems (Suburban) and the Commission's Division of Ratepayer Advocates (DRA), which resolves all issues contained in Suburban's general rate case (GRC) and most policy issues identified in the Assigned Commissioner's scoping memo. The one remaining policy issue, a low-income program, will be addressed by Suburban in an application to be filed within 90 days following the issuance of this decision. The settlement provides for a revenue requirement increase of $2,973,872, or a 6.38% increase over current rates, during Test Year (TY) 2006-2007, and an estimated revenue requirement increase of $1,449,093, or 2.91%, and $1,344,888, or 2.62%, respectively, for Escalation Years (EY) 2007-2008 and 2008-2009.

This decision approves the rate consolidation of the San Jose Hills, West Covina, and Walnut service areas. DRA concurs that this ratemaking meets our guidelines for consolidating districts and would also comply with our policy of setting rates on a cost-to-serve basis. Although the consolidation proposal was opposed by William Robinson (Robinson), an appearance at the hearings, we find the consolidation proposal comports with our guidelines. The decision defers a conservation rate design to the application for a low-income program. Suburban shall true-up the interim rate increase, granted in Decision (D.) 06-06-046, with the final rates adopted in this decision.

B. Procedural Background

Suburban serves approximately 74,000 metered customers who are mostly residential in its San Jose Hills and Whitter/La Mirada districts. Communities served include Glendora, Covina, West Covina, La Puente, Valinda, Industry,

Hacienda Heights, Walnut, Whitter, La Mirada, La Habra and Buena Park, as well as unincorporated areas in Los Angeles and Orange counties.

We resolved Suburban's last GRC in D.03-05-078. Suburban filed this application pursuant to D.04-06-018, adopting the rate case plan for Class A water utilities. In this application, Suburban requests a total company increase to revenue by $5,633,937 or 12.1% in fiscal year 2006-2007, by $1,640,549 or 3.1% in fiscal year 2007-2008, and by $1,364,551 or 2.5% in fiscal year 2008-2009. DRA filed a protest on October 5, 2005. The Commission held a prehearing conference on November 1, 2005.

A scoping memo and ruling of Assigned Commissioner (ACR) was issued on December 16, 2005. The following issues were included within the scope of this proceeding:

a. Adoption of a reasonable cost of common equity and a reasonable rate design;
b. Reasonableness of proposed revenue increases;
c. Reasonableness of proposed capital structure and cost of capital;
d. Reasonableness of estimated expenses and forecasts of sales, operating, and other revenues;
e. Reasonableness of proposed additions to plant;
f. Reasonableness of consolidation of San Jose Hills, West Covina, and Walnut into a single service area;
g. Reasonableness of allocating parent company expenses for rate recovery and, if so, the correct method of allocation, including the three-factor and four-factor methods;
h. Reasonableness of methods of accounting for purchased energy; and
i. Inclusion of a low-income program.

The ACR also determined there were several key policy areas that should be used as guidance in this proceeding. The policy areas are:

(1) Ensuring safe water;
(2) Securing reliable water supplies;
(3) Encouraging and promoting water conservation; and
(4) Ensuring reasonable rates and viable utilities.

The ACR found the parties should develop the record with an eye toward explaining how the positions they take: (a) promote both reasonable rates and short and long term utility viability; (b) affect the utility's ability to ensure water quality in the short and long term; (c) increase customer and utility conservation incentives; (d) affect infrastructure development and investment; (e) moderate rate impacts on low income customers; and (f) make the Commission's regulatory and decision-making processes more timely and efficient.

A hearing was held on December 28, 2005. Suburban and DRA reached a settlement in principle immediately prior to the hearings. The hearing focused on the settlement. Two additional appearances, Robinson, a Director of the Upper San Gabriel Valley Municipal Water District representing Division 4 ratepayers, and Royall Brown, were taken at the hearing. We also received letters and e-mails from a number of Suburban's customers. Many of the customers opposed the size of the rate increase, and others opposed the consolidation of the service areas.

Suburban and DRA filed a joint motion for adoption of settlement agreement on February 17, 2006. The settlement agreement resolved all outstanding issues, including the policy issues identified in the December 16, 2005 scoping memo. On March 14, 2006, Suburban filed a motion for interim rate relief because the comment cycle on the proposed settlement agreement could

result in a decision after the first day of the first test year, July 1, 2006, for Suburban's GRC application. Suburban stated interim relief was warranted because (1) the delay in the proceeding was not Suburban's fault; (2) Commission case law supports granting the requested relief; and (3) the requested relief is in the public interest. No opposition was filed to the motion for interim rate relief.

Robinson submitted an opposition to the settlement agreement by e-mail on March 20, 2006. Robinson also mailed copies of the opposition with a certificate of service. However, the certificate of service was not signed. Suburban objected to the opposition being entered into the record in this proceeding in a March 27, 2006 letter. On March 28, 2006, the assigned Administrative Law Judge (ALJ) sent Robinson an e-mail asking him to contact her concerning an extension of time to file the opposition. Robinson sent a letter, dated March 28, 2006, noting that he was confused by the inclusion of the Los Angeles Docket Office on a Suburban pleading and had sent copies of his opposition to the LA Docket Office. On March 30, 2006, the ALJ sent a ruling by e-mail granting Robinson until April 5, 2006 to file the opposition and granting Suburban and DRA 15 days after the filing of the opposition to file reply comments.

Robinson filed his opposition to the settlement on April 4, 2006. Suburban filed its response to the opposition and a motion to strike portions of the opposition on April 19, 2006.

On June 29, 2006, we issued D.06-06-046, granting interim rate relief based on the rate of inflation as compared to existing rates (the rate of inflation to be calculated using the most recent Consumer Price Index maintained by the U.S. Department of Labor).

C. Terms of Settlement

The settlement between Suburban and DRA resolves all contested issues. The settlement, including tariffs and GRC tables (late-filed Appendices A-E to the settlement), is attached as Appendix A to this decision. Appendix A to the settlement includes a summary of earnings that reflects the parties' updated proposals for revenues, expenses, rate base, and rate of return and the adopted amounts at present and authorized rates.

The settlement sets a separate revenue requirement and customer rates for fiscal years 2006-2007, 2007-2008 and 2008-2009, based on agreements on the cost of capital, operating expenses, and plant in service. Specifically, the settlement provides for a revenue requirement increase of $2,973,872, or a 6.38% increase over current rates, during TY 2006-2007, and an estimated revenue requirement increase of $1,449,093, or 2.91% for EY 2007-2008, and $1,344,888, or 2.62%, for EY 2008-2009. The actual rate adjustment for the Escalation years cannot be finally determined until advice letters are filed, evaluated, and approved. The parties agree to a return on equity of 10.00% and a weighted cost of capital of 8.65% for all years.

The parties state that the settlement is an integrated document, so if the Commission rejects any portion of the settlement, each party has the right to withdraw.

D. Review of Settlement

We review this settlement pursuant to Rule 51.1(e), which provides that, prior to approval, the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest." This settlement is contested. Robinson opposes the settlement, because he alleges the rate increase is exorbitant and the settlement has weak provisions for water

conservation. Robinson also opposes the combining of the San Jose Hills, West Covina, and Walnut service areas into a single service area, because the infrastructure in the separate tariff areas was developed at different times and there are three water districts, which supply water for the areas.[1] We address these contested issues below.

1. Conservation

Robinson recommends that the Commission delay granting the requested rate increase until Suburban completes a rate study and implements an increasing block rate pricing structure for residential, industrial, and commercial ratepayers. Suburban states that an increasing block rate structure will be considered in Suburban's next GRC and the record in this proceeding is not adequate to address the issue of rate design to encourage conservation. The Water Action Plan and scoping memo, encouraging water conservation and efficiency rate designs, did not issue until testimony already had been served in this proceeding.

We support conservation and understand that appropriate rate designs promote conservation. Our Water Action Plan encourages the implementation of rate designs such as increasing block rates to encourage conservation, but also recognizes the need to address the impact of efficiency rate designs on low income ratepayers. However, we issued the Water Action Plan months after Suburban had filed this application in conformance with the rate case plan adopted in D.04-06-018, and Suburban does not have a low-income program.

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[1] We will not strike portions of Robinson's opposition, as requested by Suburban. Robinson in principle complied with the Administrative Law Judge (ALJ) directive to attach relevant portions of documents supporting his opposition to the pleading.

It is reasonable to delay consideration of efficiency rate designs such as increasing block rates for Suburban. Suburban assures us it will address the issue of encouraging conservation through rate design in its next GRC application. Suburban also notes that rates under the settlement will increase conservation incentives since they will reflect costs to serve. The settlement also includes a provision for $32,448 to be spent for water conservation in 2006-2007. Although these steps support our policy objectives, they do not substitute for conservation pricing. Therefore, Suburban shall file a conservation rate design proposal with its low-income program application. We concur that Suburban can propose an increasing block rate design and that this proposal shall be limited to residential customers. As Suburban points out, we are considering California-American Water Company's (Cal-Am) proposal for a residential conservation rate design in Application (A.) 06-01-005. Additionally, Suburban believes DRA has agreed to defer non-residential conservation rate designs in A.06-07-017. We will not indefinitely defer consideration of a conservation rate design proposal for all other customer classes. It would be counter to the goal of increasing conservation to limit increasing block rates to residential customers. Suburban shall propose a conservation rate design for all other customer classes in its next GRC.

If Suburban's conservation rate design proposal is adopted, Suburban shall use a Water Revenue Adjustment Mechanism (WRAM), consistent with the WRAM adopted for Cal-Am in D.96-12-005, to track revenue changes associated with the adoption of its increasing block rate proposal. Suburban shall address details of the WRAM in its conservation rate design proposal. The WRAM shall be in effect at least through this GRC cycle. Any recovery of the WRAM, or its further extension, shall be addressed in Suburban's next GRC.

2. Consolidation of Rates

Suburban requested a rate consolidation for the separate San Jose Hills, West Covina, and Walnut service areas. Suburban stated that the combination would reduce regulatory effort and expense with little impact on customers. Each of the three service areas has three tariff zones, as part of Suburban's tariff structure, for a total of nine tariff zones. Combining the service areas will result in three zones. Most customers will remain in their current tariff area zone; however, approximately 475 customers in Zone 2 would be reclassified to Zone 3.

Suburban and DRA agree that Suburban's proposal meets the "Guidelines for Combining Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes" developed by representatives of Class A water utilities and Commission staff in 1992. The four criteria to be considered in evaluating consolidations are proximity, rate comparability, water supply, and operation. Robinson states the consolidation does not meet most of these standards.

DRA states the proximity criterion is met, because all three systems are within a radius of approximately 10 miles. Interconnections among the three systems have been built to allow the same water supply to be used and shared by the three systems. There is no disagreement that the service areas are in close proximity; thus, we find the rate consolidation proposal meets the proximity criterion.

DRA states that the consolidation meets the water supply standard, because the three service areas share the same source of both pumped and purchased water as a result of the interconnections among the systems.

Robinson disputes that the areas share the same source of supply, because they straddle three water districts. Robinson fears there will be no accountability for serving the area and that rates could be fraudulently inflated.

We have no evidence to support Robinson's concerns. Suburban notes that the service area has long been split between two districts and numerous water sources jointly serve the fully integrated service areas. Suburban also responds that DRA will have access to invoices supporting water purchases in future rate cases and will be able to verify Suburban's identified sources of supply and analyses of its supply mix. Because the service area is now fully integrated, we find the consolidation proposal meets the water supply criterion.

DRA agrees that the consolidation meets the operation criterion. A single management, operation and maintenance crews presently oversee and operate the three systems. Robinson states the areas were developed at different times, have different maintenance histories and cannot be compared. Because the operation of the systems has been combined, we find the consolidation proposal meets the operation criterion.

DRA agrees that the consolidation meets the rate compatibility criterion. The maximum difference in current rates for average usage is 20%. If the services areas were combined, the San Jose Hills area customers' current rates in Tariff Area 1 with 25 Ccf monthly usage would be 5% lower, the Walnut area about 4% lower, and the West Covina area about 7% higher. The overall effect is to bring West Covina's rates into line with San Jose Hills and Walnut. Robinson characterizes that shift as West Covina subsidizing the other two service areas. Although West Covina will receive a larger rate increase as a result of the proposed consolidation, the net effect is to establish rates for the three districts

that reflect an integrated supply and combined operations. We find that the consolidation proposal meets the rate compatibility criterion.

Suburban's proposed rate consolidation meets our guidelines and should be approved.

3. Adoption of Settlement

We find the settlement is reasonable in light of the whole record. The parties to the settlement state that the settlement is in their best interests because of the significant savings in time, resources, and expense. The parties have avoided considerable litigation costs and uncertainty by entering a settlement. The parties engaged in discovery on Suburban's proposals and conducted extensive settlement negotiations. The parties' testimony was received into the record at the hearing. Suburban responded to cross examination on the terms of the settlement. The settlement was opposed and we have addressed the contested issues. On balance, we have determined those provisions of the settlement should be adopted.

We find the settlement is consistent with the law. In accord with Commission case law, the settlement specifically states that the settlement should not be construed as a precedent or statement of policy of any kind. No term of the settlement contravenes statutory provisions or prior Commission decisions.

We find that the settlement is in the public interest as it represents a reasonable compromise of the settlement parties' respective positions on individual issues and, taken as a whole, is fair and reasonable. The parties also state the settlement proposes rates that will allow Suburban to recover a reasonable amount of increased costs and will promote operational efficiency, infrastructure development, and investment, while avoiding rate shock and

keeping rates as low as possible. The rate increase for 2006-2007 is considerably less than originally proposed by Suburban.

The settlement addresses the policy issues in the scoping memo by promoting efficient operations, authorizing reasonable and necessary capital improvements, providing adequate resources to provide reliable water service, bringing rates into line with costs to serve, and devoting resources for water conservation measures. Suburban will file a separate application for a low-income program within 90 days of a final decision in this proceeding.

Based on the discussion above, we find the settlement to be reasonable in light of the whole record, consistent with the law, and in the public interest. Therefore, we shall adopt the settlement.

E. Low-Income Program

Suburban and DRA agree that it is necessary to have a separate proceeding for the low-income program. Suburban needs additional time to obtain data from Southern California Edison in order to estimate the number of Suburban customers who will participate in the low-income program. Suburban had been unable to obtain the information before the settlement was filed.

We recognize the need for a reliable estimate of customers who will participate in a low-income program. The scoping memo encouraged the parties to develop low-income proposals, but there was insufficient time to do so. The parties' proposal for a separate proceeding is reasonable. Suburban shall file an application for a low-income program within 90 days following the issuance of our decision approving this settlement.

F. True-up of Interim Rates Adopted in D.06-06-046

In D.06-06-046, the Commission granted interim rate relief to Suburban effective July 1, 2006. This interim increase was based on the rate of inflation as compared to existing rates, and should be adjusted upward or downward, back to the effective date, with the final rates adopted here.

The methodology Suburban should use in calculating the surcharge should be based on the actual loss or gain in revenue, which is determined by applying the rate differential to the actual quantities of water sales and the actual number of customers. The surcharge will be fully recovered over the remaining period of 2006-2007.

G. Assignment of Proceeding

John A. Bohn is the Assigned Commissioner and Janice L. Grau is the assigned ALJ in this proceeding.

H. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with § 311(d) of the Pub. Util. Code and Rule 77.1 of the Rules of Practice and Procedure.

Opening comments were filed by Suburban and DRA on August 14, 2006, and reply comments were filed by Suburban on August 21, 2006.

Findings of Fact

1. On February 17, 2006, Suburban and DRA filed a Joint Motion for Adoption of Settlement Agreement. On May 1, 2006, DRA filed a Motion to Submit Appendices and Tariff Schedules in Support of the Parties' Proposed Settlement. The settlement, appendices, and tariff schedules are attached as Appendix A.

2. Robinson filed an opposition to the settlement on April 4, 2006.

3. The December 16, 2005, Assigned Commissioner Ruling and Scoping Memo ordered the parties to develop the record to explain how their proposals increased customer and utility conservation incentives. The Commission's December 15, 2005 Water Action Plan encourages increasing conservation and efficiency rate designs such as increasing block rates.

4. The 1992 "Guidelines for Combining Water Utility Districts for Ratemaking and Public Utilities Commission Reporting Purposes" are used to evaluate a proposed consolidation.

5. The settlement resolves all general rate case issues except a low-income program. Suburban was unable to obtain data from Southern California Edison in order to estimate the number of Suburban customers who will participate in the low-income program prior to the filing of the settlement.

6. The testimony and hearing record provide a comprehensive record for consideration of the settlement.

7. The settlement by its terms should not be construed as a precedent or statement of policy of any kind.

8. The settlement is a compromise of the parties' respective positions on individual issues. The increase over current rates for TY 2006-2007, 6.38%, is considerably less than originally proposed by Suburban.

9. D.06-06-046 granted Suburban an interim rate increase based on the rate of inflation as compared to existing rates.

Conclusions of Law

1. It is reasonable to permit Suburban to file an application proposing an increasing block rate design for residential customers with its low-income program application. It is reasonable to use a WRAM to track revenue changes

associated with the adoption of Suburban's proposal. It is reasonable for Suburban to submit a conservation rate design proposal for other customer classes in its next GRC.

2. Suburban's proposal to consolidate rates for its San Jose Hills, West Covina, and Walnut Service areas meets the guidelines we have relied on generally in ruling on rate consolidation proposals.

3. The proposed settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

4. Pursuant to Rule 51.1(e) of the Commission's Rules of Practice and Procedure, we should adopt the settlement and its accompanying tariffs.

5. It is reasonable to permit Suburban to file an application for a low-income program within 90 days of the issuance of this decision.

6. Suburban should true-up the interim rate increase granted in D.06-06-046 with the final rates adopted here by calculating the surcharge based on the actual loss or gain in revenue, determined by applying the rate differential to the actual quantities of water sales and the actual number of customers. The surcharge should be fully recovered over the remaining period of 2006-2007.

7. In order to provide rates in conformance with approval of the settlement, this decision should be effective immediately.

8. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement including its attached tariffs and general rate case tables, attached to this decision as Appendix A, is approved and adopted.

2. Suburban Water Systems (Suburban) shall file an application within 90 days of the issuance of this decision for a low-income program and for an increasing block rate design for residential customers, as set forth herein.

3. Suburban shall file within 15 days of the effective date of this decision a compliance filing containing the tariffs necessary to implement the surcharge methodology approved here to true-up the interim rates adopted in Decision 06-06-046.

4. Application 05-08-034 is closed.

This order is effective today.

Dated _____, at San Francisco, California.