BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W), California Water Service Company (U60W), Golden State Water Company (U133W), Park Water Company (U314W) and Apple Valley Ranchos Water Company (U346W) to Modify D.08-02-036, D.08-06-002, D.08-08-030, D.08-09-026, D.08-11-023, D.09-05-005, D.09-07-021, and D.10-06-038 regarding the Amortization of WRAM-related Accounts.	Application 10-09-017 (Filed September 20, 2010)

COMMENTS ON PROPOSED DECISION OF ALJ WALWYN OF APPLICANTS CALIFORNIA WATER SERVICE COMPANY (U60W), GOLDEN STATE WATER COMPANY (U133W), PARK WATER COMPANY (U314W), AND APPLE VALLEY RANCHOS WATER COMPANY (U346W)

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In accordance with Rule 14.3 of the Commission's Rules of Practice and Procedure, Applicants California Water Service Company ("Cal Water"), Golden State Water Company ("Golden State"), Park Water Company ("Park"), and Apple Valley Ranchos Water Company ("AVR"), collectively referenced as "Applicants" herein, respectfully submit their joint comments on the Proposed Decision of Administrative Law Judge ("ALJ") Walwyn , which was issued on March 19, 2012, in the above-captioned proceeding.

I.

SUMMARY OF APPLICANTS' COMMENTS

The application in this proceeding requested resolution of several technical problems impeding implementation of the Water Revenue Adjustment Mechanisms ("WRAMs") and Modified Cost Balancing Accounts ("MCBAs") authorized in prior Commission decisions. Most importantly, working closely with the Division of Ratepayer Advocates ("DRA"), Applicants proposed a solution to the key issue driving the proceeding – the conflict between financial accounting standards, and the long periods of amortization for high WRAM/MCBA balances.

Despite this promising beginning, and the eventual success of Applicants and DRA in developing a compromise on the key amortization issue, the Proposed Decision ("PD") injects

needless controversy, misstates the Commission's purpose in approving the WRAM/MCBA mechanism, and makes no attempt to address the tension between accounting and ratemaking treatment of the large revenue under-collections tracked in the WRAM/MCBA mechanism. In particular, the PD:

- Introduces an annual "7.5% Advice Letter ceiling" for recovery of each year's WRAM/MCBA balance without considering the significant repercussions on both customers and Applicants.[1] The approach now supported by both Applicants and DRA, which would allow annual recovery of WRAM/MCBA balances up to 10% of revenue requirement,[2] better balances high surcharge rates with the need for timely elimination of each surcharge, and also limits the potential for inter-generational inequity.
- Extends surcharges over a longer time (by limiting annual recovery to 7.5%), and thus increases the "pancaking"[3] effect on customer bills when amortizations of subsequent WRAM/MCBA balances require new surcharges.[4] Based on a flawed assumption that lower surcharges inherently benefit customers, the PD fails to recognize that, because there may be a continuing need to recover WRAM/MCBA balances between general rate cases, there are also customer benefits to having surcharges end quickly.
- Erroneously redefines the Commission's stated goal for the full WRAM/MCBAs, which was to remove a company's financial disincentives to encouraging conservation, thereby undermining the Coomission's purpose in adopting those mechanisms. Instead, the PD's proposal of an annual 7.5% ceiling on recovery (with the remainder of high WRAM/MCBA under-collections still to be addressed in a subsequent general rate case) unexpectedly re-introduces a level of financial risk. This may effectively relegate the full WRAM/MCBA mechanism to a tool that can only <u>reduce</u> Applicants' conservation disincentives, but not entirely <u>remove</u> them.[5]
- Appears to erroneously view this proceeding as a request for revenue increases, when in fact the issue is the timing for recovering certain revenue that the Commission has already determined to be necessary and appropriate. Rather than acknowledging that the high WRAM/MCBA under-collections are an undesirable outcome from a valid mechanism, the PD appears to blame Applicants for the outcome as a basis for a proposed solution that would be punitive to Applicants.

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[1] The 7.5% would be based on a district's last authorized revenue requirement. For purposes of this discussion, "district" refers generally to each rate area that has a WRAM/MCBA mechanism.

[2] It is Applicants' understanding that DRA believes Applicants' modification is reasonable.

[3] The "pancaking" on customer bills that the PD would exacerbate is illustrated in Attachment C to these Comments.

[4] In a district where the variance between forecasted and actual sales has created a high WRAM/MCBA, high WRAM/MCBA balances will also tend to develop in subsequent years because the variances will likely continue until sales forecasts are adjusted in a general rate case.

[5] If applied, *e.g.*, to Cal Water's 2011 WRAM/MCBA balances, the PD's annual limit of 7.5% would subject WRAM/MCBA revenues in seven rate areas to potential revenue deferral, while an annual limit of 10% would only put the revenues of three Cal Water rate areas at risk. Cal Water Information-Only Filing No. 14, March 26, 2012.

In the guise of granting a measure of relief regarding amortization, the PD actually rejects Applicants' fundamental premise: that a failure to act by the Commission is likely to cause financial markets to inappropriately penalize Applicants – not for voluntarily embarking upon the WRAM/MCBA conservation pilot programs that are groundbreaking in the water industry, but for failing to collect the portion of guaranteed WRAM revenues on a timely basis. Unfortunately, Applicants were not crying "wolf;" on February 29, 2012, an interpretation by its external auditors required Cal Water to announce a delay in recognizing $2.4 million in pretax income, in large part due to the Commission's indecision in this proceeding. Applicants urge the Commission to recognize that Applicants' concerns are legitimate, and that partial or temporary "solutions" will prolong a quandary that the Commission can in fact resolve now in a fair and balanced manner.

Applicants also propose in these comments certain exceptions to the restrictions on the timing and contents of filings that the Proposed Decision would require. Specifically, Applicants propose to allow the status of WRAM/MCBA accounts for the entire calendar year to be reflected in advice letter filings made thereafter to amortize the balances in such accounts, and to allow those advice letter filings for the 2011 balance to be made within 30 days after adoption of a decision in this proceeding or, where the company already has filed its advice letters for the 2011 balance, to allow the company to update those filings based on a final decision in this proceeding.

II.

THE PROPOSED DECISION INJECTS NEEDLESS CONTROVERSY AND RISK INTO WHAT SHOULD HAVE BEEN A ROUTINE ACCOUNTING MATTER.

Over the course of this proceeding, Applicants and the only other party in the proceeding, DRA, have largely been in accord. Most importantly, on the key disputed issue of the appropriate amortization period for high WRAM/MCBA balances, DRA and Applicants have offered modified or alternative viewpoints that are now substantially similar. The Proposed Decision, however, introduces a new formula for amortizing large WRAM/MCBA balances that is presented as more beneficial to ratepayers. The Commission and the parties have not had an opportunity to evaluate this fundamental assumption underlying the PD's amortization proposal.

By any account, and as clearly illustrated by this lengthy proceeding, the process for WRAM/MCBA amortization of large balances has now become a significant issue for those companies with full WRAM/MCBAs. In working with DRA, and filing their carefully crafted and detailed Application, Applicants have at every step attempted to facilitate the Commission's

review of these issues and, more importantly, to present a balanced proposal that takes into account ratepayer impacts over both the short- and the long-term.

The Commission and all parties agreed to the mechanisms for a very clear and specific purpose – to remove any disincentives to encouraging conservation. All parties are concerned that some WRAM/MCBA balances are uncomfortably and distressingly high. Contrary to the Proposed Decision's innuendo, there have been no facts to suggest that the companies, ratepayer advocates, or ratepayers themselves are to blame (or, indeed, that anyone must be blamed).

Pursuant to the regulatory compact between the Commission and the utilities it regulates, Applicants pursued conservation rates and programs with the Commission's commitment that certain revenues put at greater risk would be tracked and recovered by means of full WRAM/MCBA mechanisms. Ratepayer advocates supported this delicate balance, and Applicants have in good faith aggressively pursued conservation measures pursuant to the regulatory compact and the specific multi-party settlements approved by the Commission. Accordingly, Applicants have repeatedly assured internal auditors, external auditors, and the financial community that any over- or under-collection of WRAM/MCBA balances are undisputed regulatory assets and liabilities, in that the Commission would, without any doubt, authorize recovery or require surcredits for any balances that were properly tracked. Applicants have explained that the WRAM/MCBA mechanisms bear no relationship to, for example, incentive-based ratemaking where recovery is explicitly and deliberately based on activities within a company's control.

In attempting to fix an oversight caused by a disconnect between a ratemaking practice and the application of certain accounting standards, Applicants initiated this proceeding, only to spawn a Proposed Decision that now poses great danger not only to the conservation-focused balance of which the WRAM/MCBAs are a part, but to the regulatory compact itself. The PD not only proposes an amortization formula that deliberately disregards Applicants' financial concerns, but also appears to call into question whether the full amounts in the WRAM/MCBAs should even be recovered by deferring large amounts to be resolved in general rate cases ("GRCs"). The Commission's delay in addressing Applicants' need to comply with accounting standards has compelled Cal Water to announce a delay in recognizing $2.4 million of pretax income in February of this year. The spectre that the Commission may even question the appropriateness of full cost recovery, to which the Proposed Decision opens the door, is cause for much greater alarm than that

faced by Applicants prior to this proceeding. Indeed, the PD threatens to defeat the very goal of the WRAM/MCBA mechanism – the removal of any economic disincentive to conserve water.

The WRAM/MCBAs are not memorandum accounts. They are not costs that Applicants incurred with a hope of recovery and an understanding that the Commission might conclude that not all costs were prudent. No element of *post hoc* prudency review was intended. The WRAM/MCBAs are a fundamental element of a larger commitment by the Commission, utilities, and ratepayer advocates to work together to achieve greater conservation, in consideration of the commonly-understood infrastructure challenges facing all water customers, whether of public or private enterprises. To disallow recovery of any properly accounted for WRAM/MCBA balances, or to delay them into oblivion, would be a fundamental breach of the regulatory compact. Even to defer a substantial amount of a large WRAM/MCBA balance for recovery in a GRC casts inappropriate doubt on the certainty of cost recovery.

One of the most disconcerting aspects of the Proposed Decision is its insistence on finding some kind of culpability for high WRAM/MCBA balances. The PD appears to assume that, if something unpalatable has occurred, then something went "wrong;" and further, that someone is to blame. Absent any foundation, the PD states that "applicants appear to accept some responsibility for the large undercollections…." PD, at 19. The current sizeable WRAM/MCBA under-collections pose a problem to be addressed, as Applicants and DRA, the primary parties to the full WRAM/MCBA settlements, are treating it – as a weighty technical problem that is a challenge to both companies and ratepayers, but one that can and should be resolved by balancing parties' interests, not by misguided and inflammatory efforts to assign "responsibility."

Whether the "blame" for low consumption is due to dated and inaccurate sales forecasts that historically failed to reflect conservation, whether it is due to a confluence of undesirable economic and climatic forces, whether it is due to conservation programs or rate designs, or whether it is due to a combination of those and other factors that vary for each company's rate area, are issues to consider for future mechanisms. What is not at issue is whether Applicants have tracked consumption and billings in the WRAM/MCBA mechanisms correctly. What is not at issue is whether Applicants have found some mysterious way to "game" the system. The WRAM/MCBA balances are what they are, and in this context, no amount of speculation as to how closely reality aligns with past hopes and fears of the Commission will change those balances or will alter the fact that all the parties and the Commission developed and implemented the WRAM/MCBA settlements in good faith, and continue to do so.

III.

PROCEDURAL BACKGROUND

In the Water Action Plan adopted in December 2005, the Commission acknowledged that the recovery of costs through sales created a disincentive to demand side management. In order to help water utilities encourage their customers to conserve water, the Commission recommended various means to strengthen conservation programs and stated its intent to consider decoupling water utility sales from earnings. The WRAM/MCBA mechanism was seen as a means to facilitate changes to rate designs that would provide customers incentive to conserve, but in a way that would be "revenue-neutral" from a utility's perspective.

To further the conservation goals of the Water Action Plan, the Commission addressed conservation rates, WRAMs, and MCBAs in Investigation ("I.") 07-01-022 and in a series of decisions approving conservation rates and the new WRAM/MCBA mechanisms. Each of the decisions relating to Applicants – D.08-02-036, D.08-08-030, D.08-09-026, and D.09-05-005 (the "WRAM Decisions") – addressed aspects of the WRAM/MCBA mechanism, including the goal of decoupling revenue from sales.[6] However, the Commission did not specifically consider how to amortize the net balances of the WRAM/MCBAs in a way consistent with their purposes.

Since the WRAM/MCBA mechanism was adopted in the various WRAM Decisions, water consumption has been significantly lower than projected in the Applicants' general rate cases ("GRCs"). The result has been high net under-collections in most of their WRAM/MCBA accounts. The present Application was developed in order to address this unintended effect and to remove any resulting disincentive for encouraging water conservation. In consultation with DRA, Applicants developed the Application in order to achieve prompter amortization of the balances in Applicants' WRAM/MCBA accounts while clarifying related accounting procedures.

DRA responded constructively to the Application. DRA's witnesses agreed in their testimony with most of the proposed modifications but proposed different measures to address several of the identified issues. In the course of the evidentiary hearing, it became apparent that there was more agreement than dispute between Applicants and DRA as to how each of the issues should be resolved.

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[6] D.08-02-036, at 28 (noting that the Water Action Plan "concluded water utilities had a financial disincentive to conserve water and full decoupling of sales and revenues was necessary to remove that disincentive").

There was testimony at hearing that the authorized WRAM mechanism "is doing exactly what it was designed to do." Tr. 35:23-25 (Jordan/Park). It is capturing the variation in actual revenues from adopted revenue requirements due to differences between adopted and actual sales. To the extent there are problems with the WRAM's operation the most important problem is the inadequacy of the sales forecasts adopted in the utilities' GRCs. There is also a problem, which this Application addresses, with the lengthy amortization periods that currently apply for substantial under-collections of revenue, which may be so long that accounting rules prevent booking of sales revenues on a timely basis. This creates a financial disincentive to promote sales reductions exceeding a certain percent, tending to defeat the original purpose of decoupling water utility revenues from sales. Tr. 37:20-38:2 (Garon/Golden State). These long amortization periods also create an inequity in that customers who benefit from reduced usage may not be the same customers who have to pay the resultant WRAM/MCBA surcharges. This Application sought relatively modest changes and clarifications to the timing of annual reports and the way WRAM/MCBA balances are amortized in order to improve the efficiency of the annual reporting and advice letter process and to eliminate both the utilities' disincentive to promote water conservation and the intergenerational inequity of lengthy amortization periods.

IV.

THE PROPOSED DECISION MISSTATES THE COMMISSION'S INTENTIONS IN AUTHORIZING THE WRAM/MCBA MECHANISMS AND RELIES ON THAT FAULTY BASIS TO LIMIT AMORTIZATION OF WRAM/MCBA BALANCES.

The Proposed Decision would impose a limit on amortization of large WRAM/MCBA account balances stricter than any party has proposed, based on a view that "the mechanisms are not working as intended." According to the Proposed Decision, "[t]he goal of these mechanisms is to ensure utility and customer neutrality regarding the implementation of conservation rate design and utility conservation programs." PD, at 3. This is not an accurate summary of the Commission's intentions as expressed in its decisions that authorized Applicants to implement the WRAM/MCBA mechanisms.

A. The Proposed Decision Redefines the Goals of the WRAM/MCBA

The PD states that the WRAM/MCBAs are intended to ensure that Applicants and their customers are proportionately affected when conservation rates are implemented so that

neither party suffers or benefits from their implementation. PD, at 2, citing D.08-02-036, at 25.[7] Then, with no further attribution, the PD states "The goal of these mechanisms is to ensure utility and customer neutrality regarding the implementation of conservation rate design and utility conservation programs. We re-affirm this goal." PD, at 3.

What the Commission actually said in D.08-02-036 as to goals was quite different:

> The goals for both CalWater's and Park's WRAMs and MCBAs are to sever the relationship between sales and revenue to remove the disincentive to implement conservation rates and conservation programs, to ensure cost savings are passed on to ratepayers, and to reduce overall water consumption. The parties agree that the WRAMs and MCBAs are designed to ensure that the utilities and ratepayers are proportionally affected when conservation rates are implemented, so that neither party is harmed nor benefits.

Id. at 25-26. The Proposed Decision misleadingly paraphrases the "design to ensure that utilities and ratepayers are proportionally affected" as a goal of "utility and customer neutrality," in place of the goals previously stated by the Commission.

DRA agrees that the Commission's stated goals for the WRAM/MCBA are as set forth above from D.08-02-036 (DRA Report, page 17, 14-20) and DRA states that these goals have been met. Exhibit 3 (DRA Report), at 17, lines 14-20, and 18, lines 3-6. The exception is that, when under-collections reach a certain size, revenues are not fully decoupled from sales because the previously existing surcharge schedules do not allow for timely enough recovery to permit the balances to be booked as revenue; so the disincentive to promote conservation has not been fully removed. That is why this application was filed.

B. The Proposed Decision's Contention that Applicants' WRAM/MCBAs Are Not Working as Intended Is Manufactured and Is Not Supported By the Record.

The Proposed Decision states that "[w]e have examined the underlying decisions adopting the WRAM/MCBA mechanisms. These decisions contain no indication the Commission expected such high under-collections." PD, at 11-12. The PD goes on to state:

> In fact, we expected lower levels of undercollections, and a balance of under-and over-collections, similar to our experience over the last 20 years with revenue adjustment mechanisms for California's electric utilities. DRA has well documented this shared understanding of how the WRAM/MCBA mechanisms were expected to work. The applicants had similar expectations.[11] (PD, at 12.)

[7] D.08-02-036 adopted WRAM/MCBAs for Cal Water and Park.

In the footnote, Note 11, to that statement, the PD refers to language in the settlements adopted by D.08-02-036 to the effect that the WRAM/MCBAs for Cal Water and Park were designed to ensure that utilities and ratepayers are "proportionately affected." The PD suggests this result is synonymous with lower levels of under-collection, so that the occurrence of high under-collections violates what the PD has now re-defined as the goal of the WRAM/MCBAs.

In fact, except for a reference to D.08-06-002, a decision for California American Water Company, which is no longer a part of this proceeding, also written by ALJ Walwyn, none of the references cited in Note 11 have anything to do with the size of under-collections:

1) The settlements for Park (and by extension AVR) and Cal Water adopted in D.08-02-036 include the definition that "In the context of this agreement, a proportionate impact means that, if consumption is over or under the forecasted level, the costs or savings resulting from the changes in consumption should be accounted for such that neither the utility nor the ratepayers (as a whole) are harmed or benefited at the expense of the other party." This definition requires that the mechanism will accurately account for revenues and cost savings in a symmetrical way and has nothing to do with the size or frequency of under-collections.

2) The reference to Cal Water's testimony in I.07-01-022 that energy companies have operated with a similar decoupling mechanism without increased cost to customers has no bearing on this issue. The MCBA's design ensures that the WRAM/MCBA does not increase costs to customers. Further, absent reference to any decision in the Conservation OII, the notion that this testimony had any impact on the Commission's expectation as to the size of under-collections is pure speculation.

3) Golden State's settlements in D.08-08-030 and D.09-05- 005 state that "[i]f implementation of the proposed Pilot Program results in a disparate impact on ratepayers or shareholders, the Parties agree to meet to discuss adjustments to the proposed Pilot Program." Settlements, Section III.C. However, there is no definition of "disparate impact" in those settlements and no language linking disparate impact to the size of WRAM/MCBA balances. Since these mechanisms are symmetrical and proportional, the only factor that would cause disparate results is a systematic bias in the sales forecasting, which supports Applicants' position that sales forecasting is the problem that needs correction.

In fact, the underlying decisions approving Applicants' settlements do not express any expectations regarding the size of under-collections in the WRAM/MCBAs of the Applicants See, Exhibit 2 (Joint Rebuttal Testimony of Applicants), at 16. The PD's statement that these decisions contain no indication the Commission expected such high under-collections

does not support a claim that the Commission expected them to be lower.[8] In short, the Proposed Decision's contentions about the Commission's expectations and goals do not justify barring timely collection of legitimate WRAM/MCBA balances.

The Proposed Decision asserts that the Commission expected the WRAM/MCBA mechanisms "to operate in a similar manner to our electric utilities' revenue adjustment mechanism" and expected "lower levels of undercollections, and a balance of under- and over-collections, similar to our experience over the last 20 years with revenue adjustment mechanisms for California's electric utilities." PD, at 12. The Proposed Decision concludes that "the WRAM/MCBA mechanisms have behaved differently than (1) the energy revenue mechanisms and (2) our stated expectations." PD, at 15.

The Proposed Decision ignores the fact that the WRAM/MCBA mechanisms have been in place for only about three years, not allowing the time for fluctuations between under- and over-collections experienced by the electric utilities over a span of two decades and more. While agreeing with Applicants that "adopted sales forecasts may have played a significant role in the high undercollections," the PD finds that "the WRAM/MCBA mechanisms may provide applicants an incentive to make or to agree to high GRC sales forecasts." PD, at 16. There is no basis and no logical support for this "finding." Having already provided its customers notice of a rate increase of a particular magnitude, it is of no benefit to the utility to accept a high sales estimate that results in a lesser rate increase – although DRA might have an incentive to achieve that result. In any event, the present proceeding makes clear that excessive sales forecasts have repeatedly occurred in recent GRCs, despite good faith efforts by both DRA and Applicants to achieve the best sales forecast available, and have caused problems for all concerned. Indeed, in recent GRCs for all Applicants,[9] adopted or proposed settlements have reflected the lowest sales forecasts proposed by any party in the case or reflect substantial conservation sales adjustments proposed by the

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[8] The absence of a positive does not prove the negative. Moreover, considering the expectation – and intention – that conservation rates would lead to reduced sales, the concurrent ramp-up of utility-sponsored conservation programs, and the State's mandate to reduce usage by 20% by 2020, coupled with a reluctance to depart from the New Committee Method mandated by the Rate Case Plan for projecting sales, it was not surprising that large WRAM/MCBA balances would occur.

[9] See Attachment B, consisting of excerpts from settlement agreements adopted in D.10-12-017 (Cal Water), D.10-11-035 and D.10-12-059 (Golden State), and D.09-12-001 (Park) and pending approval in A.11-01-001 (AVR). For example, in Cal Water's recent GRC, while the parties' original sales estimates varied from district to district, the parties settled on a sales forecast that was, in aggregate, on the low end of the range between the parties. *See* D.10-12-017, Attachment D (Further Amended Settlement Agreement) at 8.

Applicant. Even with all parties to the GRC proceedings working constructively to adopt low sales forecasts, actual sales have been even lower.

V.

THE PROPOSED DECISION UNJUSTIFIABLY LIMITS ANNUAL SURCHARGES TO AMORTIZE WRAM/MCBA UNDER-COLLECTIONS BEYOND THE LIMITS ACCEPTABLE TO APPLICANTS AND DRA.

As noted above, the most important proposal addressed by the Proposed Decision relates to the amortization periods for under-collections reflected in the WRAM/MCBA accounts. Since adoption of the WRAM/MCBA Decisions, Applicants' water sales generally have been significantly lower than the sales levels adopted in GRC decisions, resulting in high net WRAM/MCBA under-collections. As a result, Applicants' annual advice letter filings pursuant to the WRAM/MCBA Decisions have had to provide for substantial billing surcharges to accomplish the WRAM/MCBA Decisions' goal of revenue neutrality. The long amortization periods required by existing Commission procedures have caused significant cash flow and accounting problems.

Lengthy amortization periods also present problems for customers. With 3-year amortization, recovery actually takes four years because the advice letter filing to implement a surcharge only comes in the year after the under-collection accrues. As a result, there are "intergenerational inequities." In the short term, customers have bills lower than what the Commission anticipated for a period of time, but once an under-collection has accrued, "customers who had that benefit of the lower bill may now be gone and other customers [are] making up the shortfall." Tr. 43:15-44:1 (Garon/Golden State). In addition, amortizing under-collections over periods longer than 12 months causes a "pancaking" of multiple surcharges that is difficult for customers to understand. Many of those surcharges remain in place even after base rates are increased to better reflect sales patterns in the next GRC. As shown on Attachment C, a ratemaking area with a sales forecast consistently exceeding experience by 20% would see a 42.5% increase in rates for nearly a year after a new rate case and would continue amortizing throughout the next rate case cycle due to this "pancake" effect under the PD's proposal. Under Applicants' proposal, surcharges after the next GRC would be lower and would be in place for a shorter period. In short, amortization within 18 months "takes away a lot of problems for the customers as well as for the utility." Tr. 44:17-24 (Garon/Golden State).

In response to DRA's concern about authorizing a surcharge exceeding 10% of a utility's revenue, Applicants presented a counter-proposal in their rebuttal testimony, premised on a 10% ceiling. Applicants' alternative proposal was that WRAM/MCBA balances above 15% should be recovered through surcharges equal to or less than 10% of the last authorized revenue requirement by setting the amortization period between 19 and 36 months, but at the smallest duration consistent with the 10% limit.

In testimony at hearing, DRA's witness acknowledged that a 10% surcharge would be reasonable to amortize a large WRAM under-collection. Tr. 199:17-200:19 (Rasmussen/DRA). Asked about Applicants' counter-proposal to amortize WRAM under-collection balances 15% to 30% over the least number of months consistent with having the surcharge not exceed 10% of revenue requirement, DRA's witness considered that "the proposal is reasonable." Tr. 200:20-202:3 (Rasmussen/DRA).

The Proposed Decision would focus the Commission's attention on "mitigating the customer bill impacts that have resulted from the Commission's implementation of the WRAM/MCBA mechanisms." PD, at 17. Applicants respectfully submit that this is not the appropriate focus for the Commission's attention. As noted above, applying "business as usual" amortization rules to the WRAM/MCBA accounts in a period of sharply declining sales has created windfalls for customers in the near term that will have to be made up for by higher rates in the future. A focus on "customer bill impacts" that denies more rapid amortization of under-collections will only exacerbate the burden on future ratepayers for costs incurred in past years.

The Proposed Decision would impose a more restrictive surcharge cap than the 10% limit proposed by Applicants and deemed reasonable by DRA. The Proposed Decision would provide that for WRAM/MCBA under-collections over 10% of the last authorized revenue requirement, "rate recovery through the Advice Letter process" would be limited to up to 7.5% a year, with additional review and recovery to be done in each Applicant's GRC "for any remaining balance requiring amortization beyond 36 months." According to the Proposed Decision, this will limit surcharges to no more than a cumulative 22% in the 3-year period between GRCs. PD, at 3-4, 22-23. The PD fails to note that this 22% surcharge collection would be occurring after base rates are adjusted in the next GRC, leading those later customers to pay 22% on top of increased base rates. By saving current customers a few percent, the PD massively penalizes future ratepayers who may have no connection to the current period.

The difference between a cap of 10% and a cap of 7.5% on annual amortization surcharges is a significant one. For example, under a 10% cap, a 15% under-collection will be amortized over 18 months and a 20% under-collection over 24 months, while under a 7.5% cap, the amortization periods would be 24 months and 32 months, respectively. Such long amortization periods are precisely the problem that has complicated the utilities' financial accounting and has created an "intergenerational equity" problem for ratepayers.

The Commission should avoid undermining the conservation goals that motivated the Commission to develop and approve the WRAM/MCBA mechanism for water utilities. The WRAM is doing what it was supposed to do, except for the unanticipated problems presented by long amortization periods. The present Application seeks to address these problems and the financial disincentive to promote sales reductions exceeding a certain percentage that it creates.

Amortization periods for WRAM/MCBA under-collections should be shortened. Applicants continue to request 12-month amortization for balances up to 5% of a ratemaking unit's last adopted revenue requirement, 18 month amortization for balances up to 15% of such revenue requirement, and for WRAM/MCBA under-collections above 15%, amortization periods set between 19 and 36 months, at the smallest duration consistent with the 10% limit but not exceeding 36 months.

VI.

CERTAIN EXCEPTIONS SHOULD BE MADE TO THE PROPOSED DECISION'S RESTRICTIONS ON TIMING AND CONTENTS OF REPORTING AND ADVICE LETTERS.

The unexpectedly long duration of this proceeding has caused complications, most significantly the continuing accumulation of under-collections due to multiple surcharges based on lengthy amortization periods. The Proposed Decision would deny Applicants' proposal to increase the existing surcharges to recover prior years' WRAM/MCBA under-collections in order to achieve amortization of those balances by the end of 2012. PD, at 28-30. Recognizing that this proposal was made expecting an earlier resolution of the application, Applicants do not seek to change the Proposed Decision in this regard as little time remains to collect such balances.

In another respect, however, the extended time-frame of this proceeding requires adjustments to the conclusions and ordering paragraphs of the Proposed Decision. Specifically, the Proposed Decision would grant Applicants' proposal to have Applicants submit annual reports by November 30 of each year, reporting the status of their WRAM/MCBA accounts as of

September 30, while making their annual advice letter filings to amortize WRAM/MCBA account balances by March 31 of the succeeding year. However, due to the extended duration of this proceeding, the March 31 filing date will have passed prior to adoption of a decision. Therefore, the relevant conclusion of law and ordering paragraph should be modified to allow the advice letter filings for 2011 (reflecting balances as of December 31, 2011) to be filed within 30 days after the date of the pending decision or, where the company already has filed its advice letters for 2011, to allow the company to update those filings based on the final decision in this proceeding.

A related problem with the Proposed Decision is that Ordering Paragraph 8 would bar any "additional items" that were not included in the Annual Report filed November 30 from being included in an advice letter filed in the following March. This formulation fails to reflect the intention of Applicants and DRA that the March advice letter should reflect WRAM/MCBA balances as of December 31 of the previous year – with the November 30 report reflecting the status of those accounts as of September 30. Thus, the decision should allow WRAM/MCBA advice letters to address WRAM/MCBA balances through December 31 of the preceding calendar year.

VII.

THERE IS NO BASIS FOR THE PROPOSED DECISION'S DIRECTIVE THAT THE RISK CONSEQUENCES OF THE WRAM/MCBA MECHANISMS BE FURTHER EVALUATED.

The Proposed Decision notes that:

> when we adopted the WRAM/MCBA mechanisms, we decided not to adopt a downward adjustment to the applicants' return on equity to reflect the risk reductions provided by these mechanisms. We were persuaded at that time by utility testimony that "a well-designed revenue adjustment mechanism should merely remove the increased risk that resulted from the adoption of policies that promote conservation." Due to the unexpected high undercollections that have occurred since implementation of the WRAM/MCBA mechanisms, we affirm here the Scoping Memo's directive that the risk consequences of the mechanisms should be further evaluated in the applicants' consolidated cost of capital proceedings. (PD, at 12-13.)

These statements mischaracterize the Commission's actions and decisions. While the PD is correct that the Commission decided not to adopt a downward adjustment to Applicants' Return on Equity ("ROE") in Phase 1B of I.07-01-022, the PD gives the erroneous impression that the Commission did so because it was persuaded that the WRAM did not reduce risk and

that no reduction was necessary and, further, that the Commission has never subsequently addressed the risk impact of the WRAM/MCBA in its Cost of Capital determinations. The PD implies that the existence of under-collections provides a basis for reducing ROE that the Commission has not addressed. These inferences are not correct.

In D.08-08-030, the Commission merely decided to defer consideration of an ROE adjustment at that time until it could be reviewed comprehensively with other risk changes in a cost of capital proceeding. *Id.* at 36-37, 41 (Conclusions of Law 3, 4). By now, the impact of the WRAM/MCBA has been taken into account in the determination of Applicants' ROE in past Cost of Capital proceedings. In D.09-05-019, the Commission took the impact of WRAM into account in determining the ROE forCal Water and Golden State, even though it declined to specifically quantify the impact. *Id.* at 38-39. In D.10-10-035, the Commission took the impact of WRAM into account in setting the ROE for Park and AVR, eliminating the previously adopted 30 basis point ROE premium for those companies above the publicly-traded proxy group due to allowance of the WRAM. *Id.* at 56-57,

Thus, the Proposed Decision misconceives that the Commission has not previously considered the authorization of WRAM/MCBA mechanisms in setting Applicants' ROEs. The need to address amortization of WRAM/MCBA under-collections provides no basis for differently evaluating the risk consequences of the WRAM/MCBA mechanisms, unless it be to reconsider whether the WRAM/MCBA in fact mitigates risk to the extent that has been assumed.

VIII.

CONCLUSION

For the reasons stated in the foregoing comments, Applicants respectfully urge the Commission to correct the Proposed Decision's inaccurate portrayal of the Commission's intentions in authorizing Applicants' WRAM/MCBA mechanisms, to allow for amortization of WRAM/MCBA account balances on the terms stated in Applicants' "counter-proposal," and to allow exceptions to the filing requirements stated in the Proposed Decision with respect to timing and contents as proposed above.

Respectfully submitted,

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April 6, 2012

ATTACHMENT A

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PROPOSED FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDERING PARAGRAPHS

Findings of Fact

. . .

5. The WRAM/MCBA mechanisms are part of pilot programs to promote water conservation. The mechanisms were designed to ensure that applicants and their customers are proportionally affected when conservation rates are implemented, so that neither party suffers nor benefits from the implementation of those rates.

. . .

7. ~~A GRC proceeding is the forum in which the Commission is best able to address high rate increase impacts.~~[DELETE AS IRRELEVANT.]

8. ~~The existing amortization schedule for net WRAM/MCBA account balances is the same as adopted by the Commission for all water balancing accounts in R.01-12-009, and reflected in DWA's Standard Practice U-27W.~~ The Commission did not provide an ~~different~~ amortization schedule when it authorized the WRAM/MCBA balancing account mechanisms. Absent Commission guidance, the Commission staff has enforced an amortization schedule in line with that adopted by the Commission for water cost balancing accounts in R.01-12-009 despite a clear distinction between WRAM/MCBA accounts that may be amortized only once per year and water cost balancing accounts that may be amortized as frequently as practicable.

9. The adopted sales forecasts may have played a significant role in causing the high WRAM/MCBA undercollections. These forecasts were typically included as part of settlements in ~~the~~ GRCs. However, the adopted settlements all reflect the lowest proposed sales forecasts by any party in the case. Even with all parties to the GRC proceedings working constructively to adopt low sales forecasts, the actual sales have been even lower~~With a WRAM/MCBA mechanism in place, the applicants would have an incentive to agree to a settlement that included a high sales forecast. If actual sales revenue fell below authorized revenue requirement (which is likely to happen given a high sales forecast), applicant would return the following year(s) of the GRC cycle to seek surcharges through the Advice Letter process~~.

10. In adopting the WRAM/MCBA mechanisms, the Commission did not anticipate ~~the~~ continuously high undercollections ~~that have occurred~~. Rather, the Commission ~~expected~~ expected, over the course of time,~~lower levels of undercollections, and~~ approximately a balance of under- and over-collections, similar to the Commission's experience over the last 20 years with revenue adjustment mechanisms for California's electric utilities.

11. Applicants' proposals to shorten the amortization period for net WRAM/MCBA undercollections would result in customers more contemporaneously paying the cost of service as adopted by the Commission. Surcharges to collect large balances are a substitute for revisions to align sales forecasts with actual experience~~could expose customers to substantial rate increases without any notice or opportunity to be heard. For example, under these proposals, the WRAM/MCBA amortization period could in some circumstances double the associated surcharge on a customer's bill~~.

. . .

Conclusions of Law

. . .

2. The scope of this proceeding is limited to the nine amortization schedule and process issues set forth in the application. Further review of the WRAM/MCBA mechanisms should be undertaken in each applicant's GRC proceeding, and the risk consequences of the mechanisms should continue to be evaluated along with other risk factors in applicants' consolidated cost of capital proceedings.

3. ~~We should reject as unreasonable parties'~~It is reasonable to approve applicants' counter-proposal~~s~~ to pass-through~~,s~~ via a Tier 1 Advice Letter, WRAM/MCBA surcharge increases ~~of 10% or more in a calendar year~~ between GRC proceedings. Advice Letter pass throughs should be limited to not more than ~~7.5~~10% per year~~s~~, except that any under-collection should be amortized in not more than 36 months. This limit allows ~~a maximum cumulative rate impact of 22.5% by the third year following a GRC proceeding~~more timely collection of WRAM/MCBA account balances and allows the Commission to notice, analyze, and properly address any remaining undercollections in the next GRC proceeding.

. . .

6. We should adopt he following amortization schedule for net WRAM/MCBA balances for Cal Water, Golden State, Apple Valley, and Park:

- All surcredit balances be amortized to return money to ratepayers "as soon as possible;"

- Surcharge balances less than 2% of last authorized revenue requirement may, at the utility's option, be amortized over 12 months or be addressed in the next GRC;

- Surcharge balances between 2% and 5% of last authorized revenue requirement are amortized over 12 months;

- Surcharge balances between 5% and 1~~0~~5% of last authorized revenue requirement are amortized over 18 months; and

- Surcharge balances over 10~~5~~% of last authorized revenue requirement are amortized ~~at up to 7.5% per calendar year~~over a period between 19 and 36 months, but at the smallest duration consistent with having the surcharge recover annually no more than 10% of the utility 's last authorized annual revenue requirement. Any remaining balance requiring amortization beyond 36 months should be addressed in the next GRC.

. . .

8. A Tier 1 Advice Letter is reasonable for annual requests to amortize net WRAM/MCBA account balances because pursuant to General Rule 7.5.3, if DWA finds a defect in the Advice Letter after it has become effective, the utility must promptly submit an Advice Letter setting forth a remedial plan both to make prospective adjustments and correct for past errors. ~~If a utility fails to submit a timely or satisfactory revision after notice by DWA, the Commission may impose a penalty and/or take such other actions as may be appropriate to protect consumers and ensure compliance with the law.~~

. . .

10. Annual requests to amortize net WRAM/MCBA balances accumulated during the previous calendar year should be filed by Tier 1 Advice Letter on or before March 31st, except that such filing for the year 2012 should be filed no later than 30 days after the date of this decision. If an applicant already has filed its advice letters for 2011, it should be permitted to update those filings within 30 days of this decision.

11. It is reasonable to allow applicants the option to include in each annual Advice Letter any remaining amounts that have been under-or-over amortized, provided that the ~~7.5~~10% annual ceiling, as a percentage of the last authorized revenue requirement, is not exceeded, except that any under-collection should be amortized in not more than 36 months. The ongoing surcharges or surcredits already adopted should run until the end of their originally intended amortization term.

. . .

13. No additional items should be included in the Tier 1 Advice Letters that were not included in the Annual Report, except that the Advice Letters should address WRAM/MCBA balances through December 31 of the preceding calendar yearand should be permitted to include under- or over-amortized amounts referenced in Conclusion of Law 11.

. . .

ORDER

IT IS ORDERED that:

. . .

3. The following amortization schedule for the net Water Revenue Adjustment Mechanism/Modified Cost Balancing Account balances is adopted for California Water Service Company, Golden State Water Company, Apple Valley Ranchos Water Company, and Park Water Company as follows:

- All surcredit balances be amortized to return money to ratepayers "as soon as possible;"

- Surcharge balances less than 2% of last authorized revenue requirement may, at the utility's option, be amortized over 12 months or be addressed in the next General Rate Case;

- Surcharge balances between 2% and 5% of last authorized revenue are amortized over 12 months;

- Surcharge balances between 5% and ~~10~~15% of last authorized revenue requirement are amortized over 18 months; and

- Surcharge balances over ~~10~~15% of last authorized revenue requirement are amortized over a period between 19 and 36 months, but at the smallest duration consistent with having the surcharge recover annually no more than 10% of the utility 's last authorized annual revenue requirement~~at up to 7.5% per calendar year~~. Any remaining balance requiring amortization beyond 36 months should be addressed in the next General Rate Case.

. . .

5. Applicants must submit their annual requests for amortization of net Water Revenue Adjustment Mechanism/Modified Cost Balancing Account balances by a Tier 1 Advice Letter on or before March 31st, except that such filing for the year 2012 must be filed no later than 30 days after the date of this decision. If an applicant already has filed its advice letters for 2011, it may update those filings within 30 days of this decision.

6. Applicants may include in each annual Advice Letter any remaining amounts that have been under-or-over-amortized, provided that the ~~7.5~~10% annual Advice Letter ceiling, calculated as a percentage of the last authorized revenue requirement, is not exceeded, except that any under-collection should be amortized in not more than 36 months. The ongoing surcharges or surcredits already adopted shall run until the end of their originally intended amortization term.

. . .

8. Applicants can not include any items in the Tier 1 Advice Letters that were not included in their Annual Report, except that their Advice Letters should address their WRAM/MCBA balances through December 31 of the preceding calendar year and may include under- or over-amortized amounts permitted by Ordering Paragraph 6.