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# The Weekly Wrap



**June 29, 2012**

**No. 2012-26**

TO: CWA Member Companies  
FROM: Jack Hawks, Executive Director  
SUBJECT: Highlights for the Week Ending June 26, 2012

**Cost-of-Capital Proposed Decision Preserves IOWC-DRA Settlement**—After months of inactivity and speculation, Administrative Law Judge (ALJ) Karl Bemserderfer issued a long-awaited Proposed Decision (PD) in the 2012 Cost-of-Capital proceeding involving California American Water (CAW), California Water Service (CWS), Golden State Water (GSW) and San Jose Water (SJW) on June 25th. Although the lack of a timely PD created concerns over the proposed returns on equity (ROEs) under which the three investor-owned water companies (IOWCs) would operate for 2012, 2013 and 2014, in the end, ALJ Bemserderfer's PD accepted an October 2011 settlement between the four applicants and the Division of Ratepayer Advocates (DRA).

The settlement agreement: (1) establishes the costs of capital (both debt and equity); (2) establishes the capital structures; (3) establishes the rates of return on rate base; (4) eliminates the Temporary Interest Rate Balancing Accounts that were previously authorized for CAW, CWS and GSW; and (5) continues the Water Cost of Capital [Adjustment] Mechanism. Here are the results:

<u>Company</u>	<u>Cost of Equity</u>	<u>Cost of Debt</u>	<u>Capital Structure</u>	<u>Rate of Return</u>
CAW	9.99 percent	6.63 percent	47.0% debt/ 53.0% equity	8.41 percent
CWS	9.99 percent	6.24 percent	46.6% debt/ 53.4% equity	8.24 percent
GSW	9.99 percent	6.99 percent	45.0% debt/ 55.0% equity	8.64 percent
SJW	9.99 percent	6.68 percent	48.65% debt/ 51.35% equity	8.38 percent

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As you can see, the main issue (as always) is the ROE. The companies' settlement with DRA called for a 9.99% ROE in 2012-2014, down slightly from the 10.2% ROE that prevailed from 2009-2011. In his discussion, ALJ Bemserderfer said, "The Parties assume that all [four] Class A water companies face identical costs of equity, and agree that this cost is 9.99 percent." He went on to note the compromise between the Applicants' proposed costs of equity range (11.25% to 11.50%) and DRA's proposed costs of equity (which ranged from 8.75% to 9.00% for the individual companies).

ALJ Bemserderfer also expressed some skepticism in approving the settlement, saying that "Overall, we find that the record to support the Agreement is thinner than we would like. However, the record is not insufficient enough to warrant reopening the proceeding or to reject the Agreement. In future cost of capital proceedings, parties should be prepared to address the concerns we raise in this discussion." The concerns to which he referred were the rather ominous questions posed by Assigned Commissioner Mark Ferron last fall, which prompted a second round of testimony.

His first question was most significant: What is the effect on the utility bill of the average customer of a 100-basis-point change in the return on equity? Fortunately, the answers for all four companies were in the relatively small range of 91 cents to \$1.24 per month. Further, he acknowledged the companies' position that this relatively small short-term savings would be more than offset by much larger long-term costs in the form of higher capital costs and less cost-effective investment should the reduction to 8.99 percent occur. Finally, he noted that the settlement agreement was "the product of good-faith, arms-length negotiation" between the Parties and that it reflected all the affected interests. Accordingly, he concluded, "The Agreement is reasonable in light of the record as a whole," and that it should be approved.

The financial community breathed a sigh of relief in their next-day research notes on the PD. Baird Equity Research headlined its report with "CA ALJ Supports COC Settlement; In Line with Our Expectations," and said "We believe the ALJ's proposed cost of capital decision supports our view that the regulatory risk for California water utilities has been overdone; we maintain our 'Generally Constructive-Declining' assessment of the California regulatory climate."

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Bank of America Merrill Lynch (BAML) opined that the water COC PD was a “positive datapoint” for California’s energy utilities. BAML analyst Steve Fleishman said, “Assuming PUC approval, we view this [PD] as a positive datapoint for the California utilities, as we believe this sets a floor for electric ROEs to be at least in the low 10% area. The cost of capital case has been a major overhang for the CA utilities, and while we do not think it goes away entirely, it should ease investor concerns.”

The PD is scheduled for the California PUC’s July 12<sup>th</sup> Open Meeting agenda.

**Fourth Recycled Water OIR Workshop Highlights NRC Report**—The California PUC hosted the fourth of what will likely be five workshops on June 27<sup>th</sup> associated with the ongoing Order Instituting Rulemaking (R.10-11-014) on recycled water policy for California’s regulated water utilities. This workshop focused on four agenda items: (1) a presentation by Dr. Rhodes Trussell, Chair of the National Research Council (NRC) Committee on Water Reuse, on the recently released report, *Water Reuse: Potential for Expanding the Nation’s Water Supply Through Reuse of Municipal Wastewater*; (2) a presentation on funding opportunities for investor-owned water company projects; and (3) an open discussion in reaction and response to both the Report and the funding presentations among certain of the public agencies with jurisdiction, the Water ReUse Association (a nonprofit advocacy organization), and the audience, which included representatives from a number of CWA members, including California American Water, California Water Service, San Gabriel Valley Water and San Jose Water.

The NRC report explains in detail all of the parameters surrounding potable reuse of municipal wastewater. It coins a new term, “de facto reuse,” to describe unplanned reuse of treated wastewater for potable reuse, noting that such use is actually quite common (e.g., when a drinking water system uses a surface water supply that receives upstream wastewater discharges). Trussell explained that that de facto reuse occurs “where reuse is practiced, but not officially recognized or permitted as a reuse project.” The report notes the need for a systematic nationwide analysis to determine the extent of de facto reuse.

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The report spends a lot of time on risk analysis and water quality assurance, explaining the role of natural systems for water treatment and the role of environmental buffers (e.g. blending, retention) and concluded that these natural buffers do not provide anything more than engineered processes in potable water reuse. With respect to health risks associated with different potable reuse scenarios, the report set up a “risk exemplar” and compared those different potable reuse scenarios against the estimated risks of a conventional drinking water source. It concluded that the potable reuse scenarios did not present any higher risk than is present in existing drinking water systems.

The report concludes with a discussion of the social, legal and regulatory factors associated with water reuse projects, but possibly erred with its emphasis on a top-down U.S. EPA approach to regulating potable water reuse (a state-driven approach may be more practical since recycled water will develop on different timetables at the state level). Still, the report suggests that federal EPA regulations will provide more uniformity and will engender public confidence in accepting potable water reuse. The report lists the following research priorities:

*Health, Social, and Environmental Issues*

1. Quantify the extent of de facto potable reuse in the United States.
2. Address critical gaps in the understanding of health impacts of human exposure to constituents in reclaimed water.
3. Enhance methods for assessing the human health effects of chemical mixtures and unknowns.
4. Strengthen waterborne disease surveillance, investigation methods, governmental response infrastructure, and epidemiologic research tools and capacity.
5. Assess the potential impacts of environmental applications of reclaimed water in sensitive ecological communities.
6. Quantify the non-monetized costs and benefits of potable and nonpotable water reuse compared to other water supply sources to enhance water management decision making.
7. Examine the public acceptability of engineered multiple barriers compared to environmental buffers for potable reuse.

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#### *Treatment Efficiency and Quality Assurance*

8. Develop a better understanding of contaminant attenuation in environmental buffers.
9. Develop a better understanding of the formation of hazardous transformation products during water treatment for reuse and ways to minimize or remove them.
10. Develop a better understanding of pathogen removal efficiencies and the variability of performance in various unit processes and multi-barrier treatment and develop ways to optimize these processes.
11. Quantify the relationships between organisms detected (using the polymerase chain reaction (PCR)) and viable organisms in samples at intermediate and final stages of treatment.
12. Develop improved techniques and data to consider hazardous events or system failures in risk assessment of water reuse.
13. Identify better indicators and surrogates that can be used to monitor process performance and develop online real-time or near real-time analytical monitoring techniques for their measurement.
14. Analyze the need for new reuse approaches and technology in future water management.

CWA Regulatory Attorney Mari Lane has furnished CWA's Regulatory Committee with a memo detailing the full workshop, and it can be made available for members upon request. Among the next steps indicated by ALJ Gary Weatherford and outgoing CPUC policy analyst Cindy Truelove (who is leaving the Commission this month to join the Stanford University Woods Institute for the Environment to direct the new Water-Energy Policy Research Initiative in the Institute's Water in the West Program) outlined the next steps for the rulemaking proceeding, as follows:

- Development of a draft "application," along the lines of a Tier 3 Advice Letter, that is specific to recycled water projects, such that a new, expedited procedure is created to enable recycled water projects to be initiated and reviewed between general rate cases.
- PUC staff will circulate these draft documents in order to allow interested parties the opportunity to discuss these items at a future-scheduled workshop.

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- In addition to a discussion of the draft “application” and guidelines, ALJ Weatherford expressed an interest in further discussing rate-setting related to recycled water, as well as further developing guidelines for customer outreach and education programs related to the use of recycled water, which will also be part of the fifth and final workshop – the date of which is still to be determined.
- Commission staff plans to circulate workshop summaries from Workshop Nos. 3 and 4 soon (before Cindy leaves). Once all workshops have been completed, Commission staff will develop a full Workshop Report – summarizing discussions from all (likely) five workshops – upon which parties will be invited to comment.
- Once the comment period for the Workshop Report is closed, ALJ Weatherford will develop a Proposed Decision. In terms of overall timing, ALJ Weatherford indicated it was likely that the proceeding will extend into early 2013 and that there will be an Assigned Comr/ALJ ruling to extend the statutory deadline.

**SB 1000 Fails in Assembly Committee; AB 1541 Moves in Senate**—Senate Bill 1000, Senator Leland Yee’s (D-San Francisco) bill that would amend Sec. 583 of the Public Utilities Code to make changes relative to the California PUC’s exemptions procedures from the California Public Records Act, failed to move forward June 25<sup>th</sup> in the Assembly Utilities & Commerce Committee when only four members of the 16-member committee voted in favor of the June 14<sup>th</sup> amended version. The remaining 12 members of the U&C Committee, including Chair Steven Bradford (D-Inglewood) abstained from the vote, thereby killing the bill.

In the meantime, Assembly Bill 1541 (Dickinson), on which CWA sent a Support letter June 21<sup>st</sup> to Senate Energy, Utilities & Communications Committee Chair Alex Padilla, passed the Senate EU&C 10-2 on June 25<sup>th</sup>. AB 1541 now moves to the Senate Judiciary Committee, but the California PUC Office of Governmental Affairs is working feverishly to convince Assembly Member (Assm) Roger Dickinson (D-Sacramento) to accept amendments that would change existing language in the bill. Among the PUC’s proposed amendments are:

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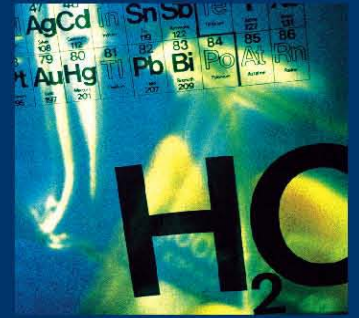


- Reinsertion of language in Sec. 583 of the Public Utilities Code [(a)(6)(D)] that would add “upon a determination by the commission that the public interest in disclosure of the information clearly outweighs the public interest in nondisclosure.”
- Switch the order of subsections (b) and (c) in Sec. 583, and change the first sentence of the new (b) to read as follows, while retaining the second sentence: (b) *The commission shall initiate a proceeding to establish functional definitions for the classes of information listed in subdivision (a), and to designate the specific types of information that are subject to the disclosure authorization requirements and legal sanctions in this section.*

Additional late-breaking news is that Assm. Dickinson is being pressured to remove the subsections exempting security-related information, proprietary business information, market-sensitive information and labor communications for the Sen. Judiciary Cte. hearing on July 3<sup>rd</sup>. He said he would acquiesce if they can be reinserted when the bill goes to the Senate Appropriations Cte. This is a tall order, however, and CWA will likely have to change its support to opposition if those categories are lost. We'll keep you apprised of the bill's status.

**Attendees Laud CWA Business Opportunity Fair**—CWA's Utility Supplier Diversity Committee hosted its annual Northern California “Business Opportunity Fair” in San Ramon on June 27<sup>th</sup>, and Committee Chair Emma Maxey of Golden State Water reports that it was a great success. Emma, who opened the conference and introduced the participating CWA member companies, said the event was well received, the attendance was good (better than expected) and that Consultant Lily Otieno, President and CEO of Infinity Business Solutions, who facilitated the event for CWA, was “phenomenal.” Lily's presentation, titled “Developing Winning Strategies for Diverse Business Enterprises,” was delivered flawlessly, and had two great attributes – it was wholly relevant to investor-owned water companies and it held everyone's attention to the very end. She concentrated on three elements for DBEs: (1) strategies for winning contracts; (2) optimizing the vendor's capability statement; and (3) strategies for meeting clients and buyers.

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The second phase of the Fair consisted of the now-institutionalized “matchmaker” sessions, at which vendors meet with water company representatives to network and develop business relationships. San Jose Water’s Charmaine Jackson wrapped up the event with a Q&A session and closing remarks. Following the Fair, I met with CPUC staff member Douglas Phason, who attended the event and confirmed that CWA hosted a terrific exchange for diverse vendors. Douglas said he hoped the energy companies would follow CWA’s lead on this type of event.

Among the testimonials received from participants were these:

- “The course was on target with all topics presented –this would be a very valuable training tool for any company.”
- “Well presented and effective presentation. Timely and extremely valuable information to sustain and grow any business.”
- “Lily was outstanding in training how to win contracts with big businesses. Her passion for communication, deep knowledge of subject and practical focus came through and was extremely useful.”
- “Lily is full of energy and pertinent information for diverse business owners. This practical approach, coupled with real work experience, is priceless. Thank you for using a different approach to outreach and technical assistance.”

Congratulations to the USDP Committee on what was clearly a successful event. CWA is looking forward to its Southern California Business Opportunity Fair, scheduled for September 12, 2012, in Rancho Cucamonga.

**Northern California Congressional Democrats Object to BDCP Revisions**—In a June 22<sup>nd</sup> letter sent to Secretary of Interior Ken Salazar and Acting Secretary of Commerce Rebecca Blank, 12 members of Congress from Northern California addressed their recent briefing on a proposal to retool the Bay Delta Conservation Plan (BDCP) so as not to run afoul of existing statutory requirements. The signatories, however, expressed misgivings with the proposed BDCP revisions, and they asked Salazar and Blank not to finalize or formally announce the new framework until a more detailed version is available for review.



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Saying that the new proposal “raises far more questions than it answers,” the 12 representatives (George Miller, Jerry McNerney, Lynn Woolsey, Pete Stark, Zoe Lofgren, Barbara Lee, Jackie Speier, Doris Matsui, John Garamendi, Anna Eshoo, Mike Thompson and Michael Honda), said a poorly designed plan would cause significant disruptions to northern California and could increase exports from the Bay-Delta estuary, while failing to restore the Bay-Delta ecosystem, salmon and other fisheries – as required by law.

Specifically, the signatories objected to the proposed conveyance options, saying that while the BDCP needs a significant overhaul, “we do not believe it is wise to commit to massive new water pumping stations and conveyance tunnels, while sustainable solutions to the problems of water quality, fish and ecosystem restoration, local impacts, and water flows are made to wait. Nor do we believe that the proposal on which we have been briefed is permissible under state or federal law.”

They, of course, expressed their willingness to review a new detailed proposal and to work with the Secretaries to improve the process further. I will be interested in seeing the response to this letter. Stay tuned ...

**DWR Sends Urban Water Management Plans to Legislature**—The first of a two-part status report on California water agency and utility 2010 Urban Water Management Plans (UWMPs) has been sent to the state legislature by the Department of Water Resources (DWR). DWR’s report documents the water use baselines and targets that were reported in the UWMPs, which will be used to measure progress toward the statutory 20% reduction in urban water use by 2020.

The first report summarizes information from the plans submitted as of April 2012, and a second report to the legislature will be submitted when a majority of the UWMPs have been reviewed. The second report also will highlight exemplary elements of the individual plans. The DWR report can be accessed at:

<http://www.water.ca.gov/urbanwatermanagement/docs/Report%20to%20Leg%20on%2010%20UWMPs-6-25-2012.pdf>.

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As of April 12, 2012, DWR had received 381 UWMPs for which 342 retail water suppliers reported their baseline water use and associated targets. The statewide population-weighted average baseline water use was 198 gallons per capita per day (GPCD), and the statewide population-weighted 2020 target was 166 GPCD – at this point, a 16.2 percent reduction in urban water use.

As you know, UWMPs are prepared by California's urban water suppliers to support their long-term resource planning and ensure adequate water supplies are available to meet existing and future water demands. Every urban water supplier that either provides more than 3,000 acre-feet of water annually, or serves more than 3,000 or more connections, is required to assess the reliability of its water sources over a 20-year planning horizon considering normal, dry, and multiple dry years. This assessment is to be included in its UWMP, which is to be prepared every five years and submitted to DWR, which then reviews the submitted plans to make sure they have completed the requirements identified in the Urban Water Management Planning (UWMP) Act (Division 6 Part 2.6 of the Water Code §10610 - 10656).

Additionally, the requirements in the 2009 20x 2020 legislation are now required for inclusion in the UWMPs. These changes in the Water Code have affected the reporting requirements under the Urban Water Management Planning Act and other government codes. To accommodate these changes, the applicable urban water suppliers were given an extension to submit their 2010 UWMPs on August 1, 2011 (usually, UWMPs are due on December 31 of years ending in 0 and 5), in order to have additional time for water suppliers to address the SBX7-7 requirements.

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#### **Upcoming Industry Meetings/Conferences/Events:**

- July 10-12, 2012 – CWA Annual Budget Planning Meeting – Tenaya Lodge; Fish Camp, CA (Yosemite).

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- July 11, 2012 – California Dept. of Water Resources – CII Task Force Meeting (10:00a – 3:30 p.m.; San Diego County Water Authority; 4677 Overland Avenue San Diego, CA 92123)
- July 12, 2012 – California PUC Open Meeting (9: 00a – 12 :00p; 505 Van Ness Ave., San Francisco 94102)
- July 22-25, 2012 – National Association of Regulatory Utility Commissioners – Annual Summer Committee Meetings (10:45a – 5:15p Committee on Water Meetings; Hilton Hotel - Broadway Room - 921 SW 6th Ave, Portland, OR 97204); J. Hawks is presenting CWA's Small Company Assistance Program to the Water Committee on July 24<sup>th</sup>).
- August 8, 2012 – California Urban Water Conservation Council Board of Directors Meeting (9:30a – 3:00p; Regional Water Authority, 5620 Birdcage Street, Ste 180, Citrus Heights, CA 95610)
- August 9, 2012 - CWA Directors Meeting (9:30a-2:30p; California American Water; 1033 B Ave., Suite 200, Coronado, CA 92118); J. Hawks will attend.
- August 15, 2012 – ACWA Annual Regulatory Summit (8:00a – 5:00p; Doubletree Hotel, 1 Doubletree Dr., Rohnert Park, CA 94928); J. Hawks will attend.
- August 23, 2012 – California PUC Open Meeting (9: 00a – 12 :00p; 505 Van Ness Ave., San Francisco 94102)

—CWA—