

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



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In the Matter of the Application of San Gabriel Valley Water Company (U337W) for Authority to Increase Rates Charged for Water Services in its Los Angeles County Division by \$10,232,700 or 17.8% in July 2011; \$1,767,700 or 2.6% in July 2012; and \$2,245,800 or 3.2% in July 2013 and in its Fontana Water Company division by \$1,252,200 or 2.1% in July 2011.

Application 10-07-019  
(Filed July 16, 2010)

**COMMENTS  
OF THE DIVISION OF RATEPAYER ADVOCATES  
ON THE PROPOSED DECISION APPROVING THE SETTLEMENT  
AND AUTHORIZING REVENUE REQUIREMENTS**

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**I. INTRODUCTION**

Pursuant to Rule 14.3 of the Commission’s Rules of Practice and Procedure, the Division of Ratepayer Advocates (“DRA”) offers these opening comments on the legal and factual errors contained in the Proposed Decision Approving Settlement And Authorizing Revenue Requirements dated August 26, 2011 (“PD”).

The PD approves a partial Settlement Agreement between San Gabriel Valley Water Company (“San Gabriel”) and DRA. With regard to the disputed items between San Gabriel and DRA, the PD properly declines to adopt the balancing account requested by San Gabriel for its employee health and dental expenses, and properly finds that, pursuant to Commission Decision 10-10-018, San Gabriel may not incorporate into its rates any of the costs that San Gabriel has booked to its Water Quality Litigation Memorandum Account (“WQLMA”).

The only errors in the PD are related to the discussion at Section 8.3 (pages 32-35), wherein the PD permits San Gabriel to include \$166,000 per year in its administrative and general (“A&G”) expenses for projected legal expenses related to water contamination at San Gabriel’s Baldwin Park Operable Unit. Here the PD commits legal error by finding that contamination-related legal costs may be included in customer rates (through A&G), notwithstanding the clear mandate of D.10-10-018 that ratepayers are not to be charged for contamination-related expenses when contamination proceeds exist. In this instance, San Gabriel’s WQLMA has a credit balance of over \$11 million. The definition of “Net Proceeds” in Ordering Paragraph of Decision 10-10-018 requires that all contamination-related costs should therefore be recorded to and paid for through that WQLMA.

**II. THE PD COMMITS LEGAL ERROR BY ALLOWING CONTAMINATION-RELATED EXPENSES TO BE CHARGED TO RATEPAYERS WHERE THERE IS A CREDIT BALANCE IN SAN GABRIEL’S WQLMA**

**A. The Proposed Decision**

In the discussion at Section 8.3 (pages 32-35), the PD grants San Gabriel’s request to include in the test year revenue requirement a projection of \$166,000 per year for legal expenses related to enforcement of a contamination-related settlement agreement. In approving this expense, the PD acknowledges that the projected legal costs are contamination-related costs. However, the PD finds that because the contamination-related costs are “predictable expenses [they] are appropriately included in forecast A&G expenses.” PD at 35. The PD reasons that allowing these costs to be included in San Gabriel’s revenue requirement is appropriate because “[n]either the original Commission resolution authorizing the WQLMA nor any more recent Commission decision require that predictable ongoing expenses should be included in the WQLMA, and consistent with general ratemaking principles, we find that such costs should be paid as they are incurred, by the ratepayers benefitting from the expenditures.” PD at 34-35.

The entire discussion in Section 8.3 of the PD runs contrary to one of the primary holdings of D.10-10-018. If approved, the rule in the PD would create a significant exception to that decision, permitting water utilities to preserve WQLMA proceeds for later “sharing” with utility shareholders by simply normalizing virtually any projected contamination-related costs for inclusion in rates, rather than collecting them from a WQLMA.

## **B. Background**

For approximately 15 years, extensive litigation has been underway regarding water contamination issues in Southern California. Among other things, ratepayers have sued their water utilities and water utilities have, in turn, sued the polluters in an attempt to obtain funds to replace the polluted water sources, or, where possible, to remove the contaminants from the polluted aquifers. In some cases, the litigation against the polluters has been successful, with polluters paying for the costs of remediation, including both fixed and recurring costs, as well as legal costs. These proceeds and costs must be booked to memorandum accounts – known as WQLMAs. With regard to its Baldwin Park Operable Unit, San Gabriel successfully settled with the polluters, and currently has over \$11 million in its WQLMA. However, San Gabriel continues to incur on-going contamination-related costs that should be booked to and recovered from this WQLMA, such as the \$166,000 per year in legal costs to enforce the Baldwin Park settlement.

The issue here is that San Gabriel seeks to stop booking costs to its WQLMA, and instead pass those costs onto its ratepayers, including the \$166,000 in legal costs. By charging these contamination-related costs to ratepayers, San Gabriel seeks to preserve the balance in its WQLMA in the hopes that the Commission will, in some later proceeding, allow San Gabriel shareholders to “share” a larger balance of the proceeds in the WQLMA.

San Gabriel’s efforts to preserve the credit balance in its WQLMA are not unprecedented. In this rate case, San Gabriel complained that it has “been awaiting recovery of the plaintiff-related costs in its WQLMA for over 12 years.” San Gabriel

Opening Brief at 10. This problem is of San Gabriel’s own making. Instead of seeking to offset its legal expenses from the proceeds in its WQLMA, which DRA would support, San Gabriel has routinely sought to recovery its contamination-related legal costs from its customers – thus preserving its balance in the WQLMA. In 2005, the Commission found that proposal “unfair” to San Gabriel’s customers specifically because of the existence of settlement proceeds in the account.<sup>1</sup> The PD also – and properly - finds this tactic unacceptable for all of San Gabriel’s contamination-related legal costs *except* the \$166,000 per year at issue here. PD at 27-32.

**C. Decision 10-10-018**

Adopted slightly less than a year ago, D.10-10-018 established standardized rules for the treatment of contamination-related proceeds, and the ultimate “sharing” of “net proceeds” between utility ratepayers and shareholders. D.10-10-018 at 4 and 55 (“Going forward, the accounting treatment and rules adopted in this decision shall govern.”). See also PD at 29. Prior to D.10-10-018, the Commission had issued decisions for roughly a decade regarding contamination-related proceeds, each with its own “unique outcome based on the specific circumstance of each case.” D.10-10-018 at 4. Decision 10-10-018 was designed to develop a consistent regulatory treatment for these contamination proceeds going forward. Ultimately, the primary holding of D.10-10-018 was to ensure that all contamination-related costs be paid out of contamination-related proceeds, before any contamination-related costs were paid by ratepayers. Most significantly, D.10-10-018 defines “net proceeds” available for sharing to be gross proceeds, minus all reasonable costs and expenses “that are the direct result and would not have been incurred in the absence of such contamination, including all relevant costs already recovered from ratepayers...” D.10-10-018 at 46. In other words, *all* contamination-related costs must be subtracted before net proceeds could be shared between shareholders and ratepayers,

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<sup>1</sup> “If we were to approve San Gabriel's request, those litigation costs would now be collected instead from its ratepayers while it books the settlement award as a shareholder gain. That would be unfair. If ratepayers are to be asked to bear litigation expenses, then any recoveries should first be used to offset those expenses.” D.05-07-044 at 23.

including costs already paid by ratepayers. The “net proceeds” definition of D.10-10-018 expressly requires that any contamination-related costs already funded by ratepayers be refunded before net proceeds are calculated for sharing. .

While D.10-10-018 does not expressly require the utilities to book their contamination-related *costs* to a WQLMA, the decision certainly requires that all such costs should be paid from contamination-related *proceeds*, which are booked to WQLMAs. Thus, as here, where there is a credit balance in the WQLMA, there is no reason – given D.10-10-018 - why any contamination-related cost – such as the \$166,000 in annual legal fees - should be included in rates, as the PD allows. Rather, the costs must be booked to the WQLMA so that they can be paid from the existing contamination-related proceeds.

The PD makes much of the fact that D.10-10-018 does not address “predictable expenditures” to justify this pass through to ratepayers. The logic of the PD is that somehow, D.10-10-018’s application to *all* contamination-related costs does not reach to those costs which are “predictable.” The PD fails to explain how charging “predictable” contamination-related costs to ratepayers satisfies the definition of “net proceeds” and whether it anticipates that such charges will be refunded to ratepayers before net proceeds are calculated for sharing.

The PD’s finding that “predictable” contamination-related expenses can be passed through to ratepayers because this treatment is purportedly “consistent with general ratemaking principles” conflicts with D.10-10-018 and the Commission’s attempt to spare ratepayers from contamination-related costs where other funds exist to pay those costs. Among other things, the PD’s “predictability” exclusion would create a significant exception to D.10-10-018 such that a water utility could avoid booking contamination-related costs to its WQLMA (thus preserving the proceeds for later “sharing”) by normalizing its projected costs for inclusion in rates—effectively vitiating one of the basic holdings of that decision. The “general ratemaking principle” articulated in the PD cannot be legally employed to override the clear intent of D.10-10-018 – which embodies very

specific ratemaking principles regarding the treatment of contamination-related costs and proceeds.

### **III. THE COMMISSION HAS A LEGAL OBLIGATION TO COMPLY WITH DECISION 10-10-018**

As discussed above, Decision 10-10-018 adopts rules requiring, among other things, that all contamination-related costs be deducted from available contamination-related proceeds. The Commission may not ignore the rules adopted in D.10-10-018 and apply different determinations here – such as the creation of a “predictability” exclusion from those rules. First, the Commission is obligated to follow its rules, and failure to do so constitutes legal error.<sup>2</sup> Second, to the extent that the Commission elects to deviate from the Rules in D.10-10-018, Public Utilities Code § 1708 requires that it must provide notice and an opportunity to be heard to the general public, including specifically parties to the rulemaking which produced the Rules.

Section 1708 provides:

The [C]ommission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it. Any order rescinding, altering, or amending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision.

In D.03-04-061 the Commission agreed that effectively modifying an earlier decision through a later decision without notice and an opportunity to be heard constituted legal error. In that case, The Utility Reform Network (TURN) pointed out that a Commission decision establishing rules regarding natural gas subscriptions effectively negated an earlier decision without providing the requisite notice and opportunity to be heard.<sup>3</sup> Decision 03-04-061 agreed and the Commission granted TURN’s application for rehearing.

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<sup>2</sup> See, e.g., *Southern California Edison Co. v. Public Utilities Com.*, 140 Cal App 4th 1085 (2006) (decision annulled for Commission’s prejudicial failure to proceed in the manner required by law).

<sup>3</sup> D.03-04-061, Ordering Paragraph 1 at p.10.

Thus, if the Commission elects to deviate from the Contamination Proceeds Rules established in D.10-10-018, it must provide notice and an opportunity to be heard to the parties to R.09-03-014, the rulemaking that resulted in the Contamination Proceeds Rules. However, it is more appropriate for the Commission to follow its recently adopted rules.

#### IV. CONCLUSION

For all of the foregoing reasons, the Proposed Decision should be revised as provided in the attached Appendix A entitled “Summary of Recommended Changes to Proposed Decision.” Consistent with the proposed changes, San Gabriel should be required to book all of its contamination-related costs, including the forecasted \$166,000 per year at issue here, to the Water Quality Litigation Memorandum Account. To the extent San Gabriel seeks to recover these and other contamination-related legal costs, it should be ordered to seek recovery of those costs from the credit balance in the Water Quality Litigation Memorandum Account pursuant to Ordering Paragraph 10 of Decision 10-10-018.

Respectfully submitted,

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## APPENDIX A

### Summary of Recommended Changes to Proposed Decision

- 1. Delete the last three paragraphs of Section 8.3, starting on page 34 with “The parties characterize their dispute as ...” and insert the following discussion:**

We find that, consistent with the discussion in Section 8.2, D.10-10-018 controls here. San Gabriel’s legal costs to enforce the BPOU Project Agreement – a contamination settlement agreement between San Gabriel and the polluters – are unquestionably contamination-related costs. But for the contamination, the costs would not exist. As such, ratepayers should be shielded from these costs to the fullest extent possible. San Gabriel’s attempts to characterize the costs as predictable, ongoing expenses does not change the fact that D.10-10-018 intends for *all* contamination-related costs to be paid for from gross proceeds. To the extent there are proceeds in San Gabriel’s WQLMA, it would be unfair to allow these costs to be included in San Gabriel’s revenue requirement so that San Gabriel can preserve the proceeds in the WQLMA for future “sharing” with its shareholders. San Gabriel’s request to include these costs in the test year revenue requirement is denied. San Gabriel shall book these costs, and all other contamination-related costs, to its WQLMA as they are incurred.

- 2. Revise Finding of Fact 12 to read:**

Outside legal expense costs incurred to protect San Gabriel’s rights under the BPOU Project Agreement, a contract between San Gabriel and other parties to settle contamination claims, are contamination-related expenses appropriately booked to San Gabriel’s WQLMA.

- 3. Revise Conclusion of Law 5 to read:**

It is consistent with the intent of D.10-10-018 that all contamination-related expenses, even those that are predictable and ongoing, should be booked to a water utility’s WQLMA.

- 5. Revise Ordering Paragraph 2 to read:**

The revenue requirement for the San Gabriel Valley Water Company Los Angeles Division in Test Year 2011-2012 is \$63,985,400, which reflects an adjustment of \$166,000 from the revenue requirement set forth in Appendix A hereto to recognize the disallowance of \$166,000 in administrative and general cost for legal services

associated with San Gabriel's enforcement of its settlement agreement related to the Baldwin Park Operable Unit.

**6. Revise Ordering Paragraph 9 to read:**

The estimated costs of outside legal services related to defending the settlement agreement addressing water contamination in San Gabriel Valley Water Company's Baldwin Park Operable Unit shall be booked to the company's water quality litigation memorandum account.

**7. A new Ordering Paragraph should be added, which reads:**

To the extent San Gabriel seeks to recover contamination-related legal costs it has incurred, it should seek recovery of those costs from the credit balance in the Water Quality Litigation Memorandum Account pursuant to Ordering Paragraph 10 of Decision 10-10-018.