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02-04-08

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## **Attachment 1**

## **CPUC Decision 93-03-066**

1993 Cal. PUC LEXIS 185, \*; 48 CPUC2d 511

In the Matter of the Application of the Southern California Water Company (U 133 W) for authority pursuant to Public Utilities Code Sections 454, 830, and 1001 et seq. to participate in the State Water Project and to recover all present and future costs under a contract with the Central Coast Water Authority to deliver water to its Santa Maria District

Decision No. 93-03-066, Application No. 92-06-044 (Filed June 25, 1992)

California Public Utilities Commission

1993 Cal. PUC LEXIS 185; 48 CPUC2d 511

March 24, 1993

CORE TERMS: state water, prudence, entitlement, ratepayer, memorandum, basin, rate base, deliver, customers, redesign, overdraft, retention, estimate, annual, plant, interest-bearing, shareholders, contracted, intend, engineer, construct, estimated, abandoned, proposed decision, water treatment, reasonableness, subscriber, effective, pipeline, booked

O'Melveny & Myers, by Patricia A. Schmiege, Attorney at Law, for Southern California Water Company, applicant; Graham & James, by Martin A. Mattes, Attorney at Law, for Central Coast Water Authority, interested party; Izetta Jackson, Attorney at Law, for Division of Ratepayer Advocates.

PANEL: [\*1]

Daniel Wm. Fessler, President; Patricia M. Eckert, Norman D. Shumway, P. Gregory Conlon, Commissioners

OPINION: OPINION

Statement of the Case

By this application, Southern California Water Company (SCWC), seeks authority to participate in the State Water Project (project), to establish a balancing account into which it may book all costs and expenses of such participation, and to recover such costs and expenses in rates from its Santa Maria District ratepayers without such costs and expenses being subject to reasonableness or prudence review by the Commission. In addition, SCWC requests that in the event its application is not approved, all past costs of participation in the project be treated as abandoned project costs and passed on to its ratepayers. For the reasons which follow, we must deny the application.

Notice of filing of the application was published in the Commission's Daily Calendar [\*2] on July 3, 1992. Several hundred letter protests urging denial of the application were received from SCWC's customers, as were several hundred petitions similarly urging denial of the application. In addition, several letters and petitions in support of the application have been received.

Because of the extremely short period of time available to SCWC to decide whether to participate in the project, and in view of the extremely high cost of obtaining an extension of time to consider

that question, SCWC requested the Commission, as an interim matter, to authorize the establishment of an interest bearing memorandum account into which it could book all costs and expenses of participation in the project during the time necessary for the Commission to consider this application. In addition, SCWC requested that because all costs and expenses incurred during this limited period would be for entitlement extension agreement payment and capital expenditures for construction of project facilities over which it had no control, all entries into such memorandum account should not be subject to reasonableness or prudence review by the Commission. By Decision (D.) 92-10-018, issued October 6, [\*3] 1992, and effective that date, the Commission authorized SCWC to establish an interest-bearing memorandum account into which it could book all costs and expenses of its participation in the project during the period necessary for Commission review of its application, subject however, to review by the Commission for reasonableness or prudence of such costs and expenses.

While we are compelled today for the reasons set forth to disapprove the application, we nevertheless acknowledge that the acquisition of imported water, at some level, from the State Water Project is a potential solution to an extremely difficult, multifaceted, longstanding problem. It is with this in mind that we invite SCWC to file a Petition for Modification bearing in mind that the problems discussed herein must be addressed in accordance with the Commission's Rules of Practice and Procedure.

#### Summary

SCWC is seeking Commission approval for SCWC to participate in the Santa Maria State Water Project (Project) under a contract with the Central Coast Water Authority (CCWA) to deliver water to SCWC's Santa Maria District, and to recover all present and future costs of that participation from SCWC's ratepayers. [\*4] Participation in the project will require SCWC to enter into contractual obligations to contribute to the capital and overhead and maintenance (O&M) costs of the project. SCWC's application seeks the Commission's consent to incur open-ended obligations and the Commission's approval, in response to this application, to SCWC's including present and future costs of satisfying those obligations in rates without further prudence review. In this application, SCWC also desires to increase water rates in its Santa Maria District by \$ 2.3 million effective January 1, 1993. This translates into an additional 59.1% increase over the requested 31.13% rate increase proposed in SCWC's 1993 General Rate Case (GRC) (Application (A.) 92-05-033), currently pending before the Commission.

#### Comments on Proposed Decision

Subsequent to the circulation of the ALJ's Proposed Decision (PD) herein, separate comments were submitted by SCWC, CCWA, Division of Ratepayer Advocates (DRA), the Coalition of Labor, Agriculture & Business (COLAB), and by Herb Gerfen, a registered Civil Engineer and a member of several local committees which have dealt with the water problem in the Santa Maria area for several [\*5] years.

DRA supports the ALJ's PD with a modification. CCWA, COLAB and Gerfen oppose the ALJ's PD, noting in general that state water is the best and least costly method of resolving the area's chronic water problems. The arguments set forth do not raise any issues within the scope of the application which have not previously been considered.

SCWC alleges that the Commission's insistence on prudence review of any costs of SCWC's participation as a ground for denial ignores the fact that SCWC's costs were reviewed in this proceeding, and thus that objection has no basis. Most simply put, such an argument borders on being specious as this was not a prudence review in the sense used in connection with memorandum or balancing accounts, and the criteria for examining such accounts were not applied to this application.

SCWC alleges error in the PD's disallowance of interim participation costs as abandoned project

costs, and claims such costs should be subject to review under the specific terms of D.92-10-018, the decision which allowed the establishment of the memorandum account into which such costs were booked. This argument appears to have merit, and appropriate changes have been [\*6] made herein.

SCWC also alleges error in the PD's treatment of \$ 9 million on deposit with CCWA if SCWC does not participate in the project. SCWC is correct. If SCWC participates in the project, there will be no redesign costs charged by CCWA, and the \$ 9 million currently on deposit with CCWA will be credited to SCWC. Appropriate changes have been made to reflect this correction.

SCWC alleges several factual errors in the PD, however, if such errors were made, which we do not determine, they would not result in a change in the outcome.

In its comments, DRA notes some confusion in the PD's intended treatment of \$ 735,000 that DRA found reasonable to be added in SCWC's pending GRC to reflect costs associated with retention of entitlement to 3000 acre-feet per year (AFY) of water and participation in the project. The amendments made herein with respect to abandoned project costs address and resolve that confusion.

#### Background

The State Water Project is a system of reservoirs, aqueducts, pumping plants, and canals designed to supply water to agricultural and urban users throughout California. Thirty water agencies have contracted to receive 4.2 million AFY from the State [\*7] Water Project. For the Coastal Branch of the State Water Project, the Department of Water Resources (DWR), CCWA, and SCWC propose to construct different parts of the Mission Hills and Santa Ynez Extensions. DWR will construct an extension of the Coastal Branch of the California Aqueduct called the Phase II of the Coast Branch. The pipeline will begin near Devils Den in western Kern County, traverse San Luis Obispo County, and terminate in northern Santa Barbara County, approximately 12 miles south of the Santa Maria River. The Phase II pipeline will be approximately 102 miles in length, and will include four pumping plants, one power recovery plant, and five tank facility sites. This will permit delivery of project entitlement water to the San Luis Obispo County Flood Control and Water Conservation District and the Santa Barbara County Flood Control and Water Conservation District. DWR anticipates that construction of the project will be completed in 1996.

CCWA's construction responsibility has changed due to DWR Project Order No. 35 which amended the project's construction responsibilities in this application. CCWA's amended proposed construction responsibility includes 42 [\*8] miles of pipeline, associated facilities, and a water treatment plant.

SCWC proposes to take water at Reach 36A (see Exhibit 35, Att. 1) in the area generally between the Santa Maria River and Casmalia power plant after the water is treated by a CCWA constructed water treatment plant. SCWC will not use any of the 42 miles of CCWA constructed pipeline or facilities other than the water treatment plant. However, SCWC will need to construct some additional facilities of its own to accept project water if it participates in the project.

Through its agreement with CCWA, SCWC plans to increase its water supplies by 7,900 AFY, asserting that this supplemental water source is needed to offset the groundwater overdraft of over 20,000 AFY in the Santa Maria Basin, improve water quality and serve future water demands (see Exhibit 18, p.2). SCWC states that its primary reasons for participating in the project are to improve the quality of water it delivers to its subscribers and to meet future growth water demands.

SCWC's Santa Maria District is comprised of five separate service areas located in Santa Barbara and San Luis Obispo Counties. As of December 31, 1991, the Santa Maria District [\*9]

was providing metered service to 11,818 customers, about 98% of whom are classified as residential and business customers. SCWC expects to service a total of 17,500 customers on its system by year 2010 when the system is fully built out. SCWC's Santa Maria District is supplied by a total of 27 wells which pump from the Santa Maria Groundwater Basin. It is generally accepted that this unadjudicated groundwater basin is being overdrafted to the extent of 20,000 to 30,000 AFY by those who draw from this basin. It is also generally accepted that about 80% of the water pumped from the basin by all pumpers is used for agricultural purposes. As noted elsewhere in this decision, SCWC's pumping through its 27 wells accounts for only 6% of the total yearly basin overdraft.

In March 1986, SCWC entered into a Water Supply Retention Agreement with Santa Barbara County Flood Control and Water Conservation District to retain annual entitlement and capacity rights to 3,000 AFY of state water for the benefit of its customers in the Santa Maria District. Since that time, SCWC has expended in excess of \$ 3 million to retain that state water entitlement and right to participate in the Santa Maria [\*10] State Water Project. Retention fees have been paid to the DWR through the Santa Barbara County Flood Control and Water Conservation District and CCWA.

Rather than taking water from CCWA's facilities and delivering it directly to its customers or to some dedicated storage facility, officials of SCWC indicate that the company intends to inject the water it receives from CCWA into the Santa Maria Basin in order to replenish the same and to increase the quality of the water in the basin from which it draws.

It is interesting to note that because of uncertainty with respect to continuing availability of state water due to the unpredictable nature of weather conditions in watersheds which provide the state water, there is no guarantee that CCWA will be able to provide the entire quantity of water desired by SCWC. Even if CCWA was unable to obtain sufficient state water to fulfill its obligations to its subscribers, participants in the project would still be required to pay their full share of the cost of constructing, operating and maintaining CCWA's facilities without obtaining a rebate or reduction in their contribution commensurate with the supply shortfall. In other words, SCWC's [\*11] ratepayers would be obligated to pay CCWA the full \$ 72.67 million (or more) under its agreement with CCWA even if CCWA were unable to deliver a single drop of state water to SCWC.

By A.89-02-029, SCWC requested that \$ 312,000 be included in rate base to retain its 3,000 AFY state water entitlement and right to participate in the Santa Maria State Water Project. Staff at that time did not oppose that request and the Commission, by D.89-11-017, included in rate base (without comment) estimated costs of \$ 312,000 that SCWC was expected to incur in the period 1989 through 1991. The \$ 312,000 was included in rate base as follows: \$ 65,000 in 1989, \$ 111,000 in 1990, and \$ 136,000 in 1991.

On June 25, 1992, SCWC entered into a Water Supply Agreement with CCWA in which SCWC's annual entitlement and capacity right to state water was increased from 3,000 AFY to 7,900 AFY.

In its investigation in SCWC's currently pending GRC (A.92-05-033), DRA concluded that pending the Commission's determination in the instant proceeding, it appeared reasonable for SCWC to retain its state water entitlement to 3,000 AFY and preserve its rights to inclusion in the Santa Maria State Water Project, [\*12] and therefore found reasonable that \$ 1,047,000 be allowed in rate base to account for SCWC's costs (from 1986 through December, 1992) associated with the retention of entitlement to 3,000 AFY and participation in the Santa Maria State Water Project. Accordingly, DRA recommended that an additional \$ 735,000 for the 1992 capital budget be added to the \$ 312,000 retention costs already existing in rate base. Since we deny the application, this \$ 735,000 should be subject to prudence review to determine whether or not it should be recovered in rate base.

On October 2, 1992, in order to retain its annual entitlement and capacity right to 7,900 acre-feet

of state water through December, 1992, SCWC paid \$ 1,668,000 to CCWA. The payment was required for:

- \$ 500,000 - fixed project cost and fixed O&M costs through September 30, 1992.
- \$ 1,168,000 - deposit for costs to redesign the project in the event SCWC elects to "pull out" and not participate in the State Water Project.

SCWC requested that authorization for recovery of the \$ 1,168,000 redesign cost be included in the Santa Maria District GRC which was being litigated at that time. At an October 20, 1992 meeting [\*13] between DRA and SCWC management, it was agreed by both parties that the issue of recovery of redesign costs be deferred to this proceeding.

SCWC filed its application herein on June 25, 1992, seeking the Commission's approval for SCWC's participation in the Project that could cost \$ 72,671,000 to \$ 130,000,000. At the time of filing its application, SCWC requested permission to establish an interest-bearing memorandum account and to book into that account for future recovery in rates without Commission prudence review, all costs of participation in the Project during the period required for final action by the Commission on this application. As noted earlier, by D.92-10-018 issued October 6, 1992, the Commission authorized SCWC to establish an interest-bearing memorandum account into which it may book its costs associated with the Santa Maria Water Project during the pendency of the instant application for authorization to participate in that Project, but specifically provided that such costs shall be subject to Commission prudence review as to appropriateness for recovery in a future ratemaking order.

Pursuant to notice, an evidentiary hearing on the application was held before [\*14] Administrative Law Judge (ALJ) Robert L. Ramsey on January 11-15, 1993. Concurrent opening briefs were submitted by the parties on or prior to January 29, 1993, and concurrent reply briefs were to be submitted by February 5, 1993, which was later extended to February 7, 1993. Following the submission of opening and reply briefs, Public Participation Hearings (PPH) were held before ALJ Ramsey in Santa Maria on February 17, 1993. Approximately 500 persons attended those PPHs, of whom approximately 10% made public statements supporting or opposing SCWC's application. In addition, representatives of SCWC and DRA were present, explained their respective positions regarding the application, and participated in a question and answer session at each of the PPHs. Upon the conclusion of the PPHs, the record was closed and the case submitted.

It is worthwhile to here note that many of those who wrote to the Commission, as well as a number of those who spoke at the PPH, alluded to a special election held in 1989 to determine if "state water" should be made available in the area. It is generally accepted that approximately 30% of those eligible to vote in that election did so, and of that [\*15] 30%, approximately 80% cast their ballot in favor of having state water. The supporters of the application here under consideration point to that election and claim that the issue of whether SCWC should participate in the State Water Project was decided "once and for all" by that vote. Opponents of the project claim that the vote was flawed in that no realistic financial information regarding the enormous cost of participation was presented to the voters, and as a result, the voters were not truly informed, and therefore, the election result is not or should not be binding.

Questions regarding the legal sufficiency of the information provided at the time of the vote and/or the binding effect of such a vote is not within the jurisdiction of this Commission, and if such questions are to be resolved, they must be considered in another forum. Even if we had such jurisdiction, because of our disposition of this application, it would not be necessary for us to reach that particular issue.

Discussion

Water is a precious commodity in California, particularly in the semi-arid central and southern regions of the state, where normal average annual rainfall is insufficient to maintain [\*16] adequate long-term supplies of high quality water to support the needs of the residential, industrial, and agricultural communities. This, coupled with a drought of some six years' duration, has resulted in a degradation of the quality and a decline in the quantity of available water reserves in the area. As noted, the Santa Maria Basin has been in a state of overdraft for several years and without replenishment, this situation is expected to last for only 20 or so years into the future. During this period, the quality of the water drawn from the basin is expected to steadily decline. It is partly to address these problems and to provide a reliable source of high quality water sufficient to meet the anticipated needs of its present customers and to provide for future growth that SCWC desires to participate in the State Water Project.

In order to clear up any misconceptions which might otherwise arise, it should be made perfectly clear at this point that this Commission is not in the water business any more than it is in the electric, gas, or telephone business; that is, it is not in the business of supplying any of those commodities to any community. The supply function is the [\*17] responsibility of the individual utility company servicing the geographical area involved. The Commission is not interested in "micro-managing" any utility company, and has no desire to dictate the manner or method by which a utility company satisfies its duty to provide services. The role of the Commission is simply to insure that every public utility company which is subject to the Commission's jurisdiction performs its authorized services in a manner which best serves the public interest.

Here, it is not the duty of the Commission to provide water to the Santa Maria District, nor is it the duty of the Commission to dictate what method must be utilized by SCWC to meet its present and future responsibility of providing a safe and adequate supply of water at reasonable rates. The Commission's function in this matter is to determine whether the method chosen by SCWC meets those criteria. We find that it does not, and must deny the application.

Our rejection of the application does not mean, and should not be interpreted as a rejection of state water as a solution to the overdraft problem of the Santa Maria Basin, or as a viable method of meeting SCWC's service obligation to its [\*18] customers, both present and future. We make no such judgment. It is a rejection of the terms under which such water would be supplied.

#### Memorandum Account

The concept of "Retroactive Ratemaking" precludes recovery of unauthorized past costs and expenses by adjustment of future rates. In order for past costs to lawfully be recovered in future rates, those past costs and expenses must have previously have been authorized by the entity having jurisdiction over the ratemaking process, here the Commission. The usual method followed is for the company (utility) to request the establishment of a so-called "memorandum account" into which it might book unanticipated or extraordinary costs or expenditures for possible future recovery from the utility's ratepayers through adjustment in its rates. At the time of that utility's next GRC, the costs and expenses booked to the memorandum account would be examined by the regulatory body's staff to determine the reasonableness and prudence, both in nature and amount, of those costs and expenses. This is commonly referred to as a "prudence review." To the extent that costs and expenses booked to the account were found to be reasonable and [\*19] prudent, they would be authorized to be included in those expenses upon which the new rates of service established at the GRC are predicated.

The obvious purpose of the prudence review is to prevent expenses that would otherwise properly be the responsibility of the company's officers, shareholders, or other parties, being passed on to the ratepayers. Here, as part of the application, SCWC requested the Commission to authorize SCWC to establish an interest-bearing memorandum account into which it could book all costs and expenses incurred in connection with its participation in the State Water Project during the time it takes the Commission to process this application, and to thereafter

recover those costs and expenses in future rates without prudence review by the Commission. As previously indicated, the Commission, in an Interim Order (D.92-10-018), authorized SCWC to establish such an account, but specified that all entries to that account would be subject to prudence review by the Commission.

As part of its application, SCWC also requests that the entire open-ended cost (estimated at \$ 72.67 million to \$ 130 million, and possibly more) of its participation in the [\*20] project be placed in an interest-bearing memorandum account to be passed on to the ratepayers through increased rates, without prudence review by the Commission. This request must be denied.

Unfortunately, neither the State Water Project nor the CCWA, through whose facilities SCWC intends to draw its water, is under the control of SCWC. SCWC is merely a present holder of entitlement rights currently authorizing it to draw 3,000 AFY from the State Water Project through the facilities of CCWA. SCWC desires to increase that entitlement by an additional 4,900 AFY for a total entitlement of 7,900 AFY. As noted, participation in the project at either level requires that SCWC participate in funding a share of the costs of constructing the various facilities necessary to deliver the water to the SCWC system.

As a subscriber to CCWA's services, SCWC would have no control over the cost of construction of the facilities required to be built or acquired by the State Water Project and/or CCWA to deliver water to SCWC in the Santa Maria area. In this regard, we note that just to extend the expiration date of its entitlement agreement with CCWA through March, 1993, SCWC has had to commit [\*21] to a cost of approximately \$ 9 million. In the event that SCWC's participation as requested by this application were to be approved, SCWC's share of the cost of construction of the facilities having the capacity to accommodate SCWC's entitlement to a total of 7900 AFY would be, as indicated earlier, between \$ 72.67 million and \$ 130 million.

Because of the extremely high cost of the proposed participation by SCWC, the lack of knowledge of the ultimate cost to SCWC, SCWC's lack of physical or fiscal control over the actual construction and costs of such capital improvements, and the lack of any guarantee that the water will actually be available in the quantity and of the quality contracted for, DRA strongly opposes the application and urges its denial. We find DRA's position that there are too many "ifs" in this undertaking persuasive.

It should be made crystal clear to all concerned that this Commission will not waive its prudence review of costs and expenses incurred by management in a situation such as this. Here, SCWC asks us to allow it to incur financial obligations which are essentially huge, open-ended and totally outside its control or even its review, and to allow it [\*22] to recover those costs, whatever they might ultimately be, from the ratepayers, without any prudence review by this Commission. To the best of our knowledge, such a request, if one has ever been made, has never seriously been considered by the Commission in the past, and we have no intention whatsoever to start now. It would be irresponsible for us to do so.

Under SCWC's scheme, its shareholders would bear virtually no risk in this venture, as liability for payment of all costs and expenses of project participation would be placed squarely, irrevocably and permanently (the applicant expects the memorandum account to be in effect for 40 years) on the ratepayers, both present and future. It is particularly worthy of note here that James Gallagher, the Secretary-Treasurer and Chief Financial Officer of SCWC testified (TR pp. 556-559, see also Exh. 24, pp. 6, 7) that the company considers the investment of stockholder equity funds in this project to be too risky for the shareholders at the current authorized rates of return, and that the use of stockholder funds at this point would be too speculative an investment because of the uncertainty of economic growth. He apparently has [\*23] no such concerns or reservations when dealing with ratepayers funds, even though he acknowledged that to the extent that growth as projected does not occur, the costs to the ratepayers will go up (TR p. 558). It appears he is saying that the financial risk involved in participation in the project is unacceptable to the shareholders, but acceptable if placed on and borne by the ratepayers.

It is further interesting to note that Mr. Gallagher also testified (TR pp. 575-579) that because of the debt/equity ratio requirement or limitation in the company's current debt agreements, if the costs of the project were required to be recorded as company indebtedness on the company's balance sheet, the company would be in violation of its bond agreement, and would, because of the cross default provisions in its existing debt agreements, be in default on virtually all of its outstanding debt obligations, and would then have to enter into either negotiations with the debtholders to restructure the debt, "or some other circumstance which some utilities have faced in the past, such as bankruptcy." A clearer statement of the financial magnitude of the proposal and the staggering burden management [\*24] desires to place on its ratepayers would be hard to find or imagine.

#### Open-endedness of Obligations

The costs to SCWC of its participation in the project are imprecise, but have been estimated at between \$ 72.67 million and \$ 130 million. The smaller figure is, according to Thomas J. Bunosky, SCWC's Manager of Operations, a "good engineer's estimate . . . as to [SCWC's] share of the project" (TR p. 79) and that "everyone agrees that that engineer's estimate of our participation is a good estimate." (TR p. 80.) The \$ 130 million figure, according to Mr. Bunosky, represents approximately 175% of the lower figure (\$ 72.67 million), and is derived from a 175% [of the engineer's estimate] cost cap on the cost of SCWC's participation in the project contained in the contract between SCWC and CCWA. Mr. Bunosky acknowledged, however, that the contract between CCWA and SCWC also contains a provision that if SCWC refuses to participate in [the payment of] any costs over the \$ 130 million, it would lose a proportionate share of the water entitlement contracted for (TR p. 81). Thus, while the \$ 72.67 million figure may be a "good engineer's estimate" of the project's cost to SCWC, it [\*25] is clear that the parties have made provision for SCWC's greater liability if the costs go as high as the 175% "cost cap," and have further provided a penalty in the event SCWC refuses to participate in the payment of costs exceeding even the "cost cap."

Under the above circumstances, we must take the position that regardless of "everybody's" opinion that the \$ 72.67 million figure is a good engineer's estimate of SCWC's project cost liability, the amount that SCWC will pass on to its ratepayers should we grant this application, might, in actuality, be far greater. Further, it is not uncommon in the construction industry, indeed it is to be expected, that actual construction costs exceed estimates. Thus, for our purposes, we must consider the cost of SCWC's participation in the project to be indefinite, but ranging from \$ 72.67 million upward.

#### Lack of Cost Control by SCWC

SCWC has, on a number of occasions, pointed out that with the possible exception of a water treatment plant which must be constructed for it, SCWC has no control over the facilities which CCWA will construct in order to deliver water from existing facilities to the point at which connection with the facilities [\*26] of SCWC will occur. The facilities which CCWA intends to construct will be restricted to that size necessary to deliver only the total AFY contracted for by subscribers to the project. CCWA does not intend to build any excess capacity into its facilities to accommodate future growth, thus SCWC's participation in the project is a "now or never," "once in a lifetime" proposition. Because the sizing of CCWA's facilities will be "tailor made" to the total AFY demand of those who subscribe to the project now, SCWC has agreed to pay additional charges representing CCWA's cost to redesign its facilities in the event SCWC withdraws from the project.

SCWC claims that because it has no control over the cost of construction, it would be illogical and unfair for the Commission to conduct prudence reviews on SCWC's share of the cost of CCWA's project, and that, therefore, all such costs should be passed through to SCWC's ratepayers without prudence review. As indicated above, we simply will not permit such an arrangement.



## Abandoned Project Costs

SCWC has requested that in the event this application is not approved, all past costs of its participation in the state water project be [\*27] deemed "abandoned project" costs and passed on to its ratepayers. The Commission has, by D.89-11-017 and D.92-10-018 provided for recovery by SCWC of many of the project participation costs incurred to date. It is our opinion that recovery of any such costs not provided for by the above proceedings should, in conformity to D.92-10-018, be subject to prudence review for possible recovery in future rates.

## Conclusion

Rehabilitation of the Santa Maria Groundwater Basin is not the responsibility of, and is beyond the physical and financial resources of any single individual, company, or agency. Even if SCWC were to stop drawing from the basin entirely and injected into the basin the entire 7,900 AFY it desires to obtain from CCWA, the basin's fundamental problems of declining quantity and water quality would not be solved. Most simply put, the basin's salvation as a water source requires the immediate, undivided, sincere and selfless attention of all its users.

We recognize the need for water utility companies to take steps now to provide for high quality water resources sufficient to meet present and future needs, and applaud SCWC's desires and efforts in this regard. [\*28] We fully understand SCWC's sense of urgency in making and prosecuting this application, and appreciate the fact that deadlines for project participation imposed by CCWA are one of, if not the immediate motivating factor or driving force behind SCWC's haste. We believe that the severe time limitations placed on SCWC to unconditionally accept or forever lose the opportunity to participate in the project are counterproductive, if not unreasonable, and in this instance have deprived SCWC of bargaining power or leverage, and have led SCWC to discount the viability and feasibility of other presently available techniques to address the problem which it, and every other drawer from the Santa Maria Basin, faces. Ultimately, this has, we believe, led SCWC, in its haste to resolve the problem, to adopt a position and make contractual compromises which we feel are not in the best interest of its ratepayers.

## Findings of Fact

1. SCWC draws its water from 27 wells located in the Santa Maria Groundwater Basin, an unadjudicated basin.
2. The Santa Maria Basin has been overdrafted for a number of years, and is currently being overdrafted by all users to the extent of 20,000 to 30,000 [\*29] AFY, and unless immediate remedial steps are taken, is expected to become exhausted as a water source in the next 20 to 30 years.
3. SCWC's share of the overdraft amounts to approximately 6% of the total overdraft.
4. Approximately 80% of the water drawn from the Santa Maria Basin is drawn for agricultural use, while the remaining 20% is drawn for business, industrial, and residential use.
5. In March, 1986, SCWC entered into a Water Supply Retention Agreement with Santa Barbara County Flood Control and Water Conservation District to retain annual entitlement and capacity rights to 3000 AFY of state water for the benefit of its customers in its Santa Maria District.
6. Since entering into the Water Supply Retention Agreement, SCWC has expended or is committed to expend in excess of \$ 9 million to retain its entitlement and participate in the Santa Maria Water Project.
7. The retention fees have been paid to the State Department of Water Resources through the

Santa Barbara County Flood Control and Water Conservation District and CCWA.

8. By A.89-02-029, SCWC requested that \$ 312,000 be included in rate base to retain the 3,000 AFY state water entitlement and right to participate [\*30] in the Santa Maria State Water Project.

9. By D.89-11-017, the Commission (without comment) included in rate base estimated costs of \$ 312,000 that SCWC was expected to incur in the period 1989 through 1991. The \$ 312,000 was included in rate base as follows: \$ 65,000 in 1989, \$ 111,000 in 1990, and \$ 136,000 in 1991.

10. In its investigation in SCWC's GRC currently pending before the Commission (A.92-05-033), DRA concluded that pending the Commission's determination in this proceeding, it appeared reasonable for SCWC to retain its state water entitlement to the 3,000 AFY and preserve its rights to inclusion in the Santa Maria State Water Project, and therefore found reasonable that \$ 1,047,000 be allowed in rate base to account for SCWC's costs (1986 through December, 1992) associated with the retention of entitlement to the 3,000 AFY and participation in the Santa Maria State Water Project. Accordingly, DRA recommended that an additional \$ 735,000 for the 1992 capital budget be added to the \$ 312,000 retention costs already existing in rate base.

11. On June 25, 1992, SCWC filed this application in which it requests permission to: (a) participate in the State Water Project, [\*31] (b) establish an interest-bearing memorandum account, (c) book to that account all costs of its participation in the State Water Project, (d) pass all such costs through to its ratepayers without prudence review by the Commission, and (e) increase water rates in its Santa Maria District by \$ 2.3 million effective January 1, 1993.

12. On June 25, 1992, SCWC entered into a Water Supply Agreement with CCWA in which SCWC's annual entitlement and capacity right to state water was increased from 3,000 AFY to 7,900 AFY.

13. SCWC intends to inject all state water received from CCWA into the Santa Maria Basin in order to replenish the same and to increase the quality of water drawn from the basin.

14. On October 2, 1992, in order to retain its annual entitlement and capacity right to 7,900 AFY of state water through December 31, 1992, SCWC paid \$ 1,668,000 to CCWA. The payment was required for (a) fixed project cost and fixed O&M costs through September 30, 1992 (\$ 500,000); and (b) deposit for costs to redesign the project in the event SCWC elects to "pull out" and not participate in the state water project (\$ 1,168,000).

15. It has been agreed by the parties to this proceeding that [\*32] the issue of recovery of redesign costs be considered in this proceeding.

16. SCWC's cost to participate in the state water project at the 7,900 AFY level is unknown, but is estimated at between \$ 72.67 million and \$ 130 million, and possibly more.

17. Because of uncertainty as to the availability of state water in the future, there is no guarantee that CCWA will be able to deliver any amount of water to SCWC under the agreement between them.

18. The agreement between CCWA and SCWA does not provide for a refund of any amounts paid by SCWC to CCWA in the event CCWA is unable to deliver all or any portion of the water contracted for.

19. SCWC's responsibility to pay its full share of the project will not abate in the event CCWA is unable to fulfill its contractual obligation to deliver water.

20. This is the only opportunity SCWC will have to obtain state water from CCWA as CCWA's facilities will be built to a service capacity sufficient to fulfill only its contractual obligations to those

companies which now commit to the project. That is, CCWA's facilities will have no "built in" excess capacity which could be contracted for at a later date.

21. SCWC's share of CCWA's [\*33] facilities construction costs would be payable by SCWC's ratepayers over the next 40 years.

22. Redesign costs incurred by CCWA by reason of SCWC's non-participation in the project should be borne by SCWC's shareholders, and not passed on to its ratepayers.

23. The costs of participation in the project should not be treated as abandoned project costs and passed on to the ratepayers.

#### Conclusions of Law

1. The Santa Maria Basin, from which SCWC draws, is an unadjudicated basin.

2. Only 6% of the overdraft of the Santa Maria Basin is attributable to SCWC.

3. Injection by SCWC of all 7,900 AFY into the Santa Maria Basin as it intends to do, would subsidize other users of that basin at the expense of SCWC's ratepayers.

4. Waiver by the Commission of its prudence review of memorandum accounts is contrary to Commission policy.

5. All costs of SCWC's participation in the project to date which have not been accounted for in D.89-11-017 or D.92-10-018, should be placed in the memorandum account authorized by D.92-10-018 and subject to prudence review for possible recovery in future rates.

6. Granting the application would not be in the public interest.

7. The application [\*34] should be denied.

8. The 20-day period for comment on this proposed decision should be shortened to 15 days and reply comments not accepted.

#### ORDER

IT IS ORDERED that:

1. The Commission will not waive its prudence review of amounts booked to any memorandum account now or previously authorized in connection with this application.

2. Redesign charges imposed on Southern California Water Company (SCWC) by Central Coast Water Authority as a result of SCWC's non-participation in the project are not to be passed on to SCWC's ratepayers, but are to be borne by the shareholders of SCWC.

3. All relief sought in the application and not specifically authorized herein is denied.

4. The 20-day period for opening comments on this proposed decision is shortened to 15 days and no reply comments will be accepted.

5. Any project costs incurred by SCWC prior to this decision, the recovery of which has not previously been provided for by an order or decision of this Commission shall be placed in the memorandum account authorized by Decision 92-10-018, subject to prudence review for possible future recovery in rates.

This order is effective today.

Dated March 24, 1993, at San Francisco, [\*35] California.