



BOOK 1

TESTIMONY

IN REBUTTAL TO DRA REPORT ON
GENERAL ISSUES

GENERAL RATE CASE
TEST YEAR 2014
APPLICATION 12-07-007

APRIL 30, 2013

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1 **CHAPTER 1: INTRODUCTION & SUMMARY**

2

3 **1.1 INTRODUCTION**

4 California Water Service Company (“Cal Water”) presents this rebuttal to the Division of
5 Ratepayer Advocates (“DRA”) report for Cal water’s 2012 General Rate Case. Cal Water
6 appreciates the dedication and work that DRA put forth in preparing its results of operations
7 reports. Cal Water realizes the difficulty in analyzing water systems without having a long-term
8 working knowledge of the systems. Cal Water accepts some of the recommendations in the
9 DRA Reports, but challenges many areas where customer service, infrastructure, and long-term
10 viability are compromised in order to meet short-term, rate related objectives.

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1 **CHAPTER 2: EXECUTIVE SUMMARY**

2 This rebuttal is comprised of five sections or books, which together represent the overall
3 Cal Water rebuttal to the DRA report. The following provides a brief overview of each book and
4 rebuttal section.

5
6 **Book 1 – General Rebuttal**

7 This first section (or book 1) is considered an overview to explain Cal Water’s position
8 regarding many general issues. The Company discusses its compliance with various
9 components of the Affiliate Transactions Rule in this book. Cal water also defends its position in
10 regard to its pension, benefits, health care plan and increasing health care costs. Cal Water
11 presents additional comments regarding its executive compensation program. This book also
12 houses the rebuttal to all of the special requests made in this case, such as its request for the
13 proposed Sales Reconciliation Mechanism as a method to help alleviate large swings in the
14 customer bills resulting from WRAM/MCBA surcharges. Other special requests address
15 providing assistance for customers, such as the Rate Support Fund changes, and the
16 implementation of the Balanced Payment Plan. In chapter 8 of this book, Cal Water discusses
17 areas where it agrees and disagrees with DRA in regard to the existing memorandum and
18 balancing accounts. This book houses the rebuttal to intervenor reports in this case regarding
19 general issues. Finally, Cal Water presents it rebuttal in regard to the conservation programs.

20
21 **Book 2 – General Office Rebuttal**

22 In this section, Cal Water focuses rebuttal on it the General Office. In this section, Cal
23 Water focuses on differences in projections of expenses between Cal Water and DRA. Much of
24 this book stresses the need and reasons why Cal Water’s request for additional compliment at
25 General Office to serve the customer should be adopted by the Commission.

26
27 **Book 3 – Global and district specific expenses**

28 In regard to operating expenses and those expense projections in each district, Cal
29 Water has reviewed DRA recommendations and finds much consistency in how DRA projects
30 and estimates different accounts. Cal Water presents its sales and service rebuttal in this book.
31 In certain instances, such as maintenance expenses, Cal Water does not agree with DRA
32 recommendations and presents both global and district specific expense rebuttal. There are
33 other expenses that differ between the parties base on differences in position on sales or

1 service figures, but where the underlying methodology is consistent between the parties. This
2 book addresses each district.

3

4 **Book 4- Global and district specific plant**

5 The fourth book of the rebuttal addresses differences between Cal Water and DRA in
6 regard to plant. This includes a beginning section that addresses global plant issues that are
7 found across districts, such as the rebuttal to DRA's capitalized interest position, tank painting
8 characterization, the need for a pipeline replacement program, SCADA, vehicles, and
9 responses to the plant audit.

10 This is followed by specific plant rebuttal regarding each district. In general, Cal Water
11 takes great efforts to propose and complete infrastructure projects to improve water quality,
12 increase system reliability, and improve customer service. The specific plant rebuttal for the
13 East Los Angeles, Hermosa-Redondo, Dominguez, and Palos Verdes Districts will be submitted
14 on May 14, 2013, reflected the delay from DRA in providing these reports.

15 Sources

16 In this GRC, Cal Water makes significant efforts to improve its water sources. This
17 includes enhancing the local groundwater supply in many districts, especially those in the Los
18 Angeles area. Cal Water believes this focus on groundwater usage is much cheaper to the
19 customer than imported surface water in the long-run and this cost savings is passed onto the
20 ratepayer. The further benefit of additional groundwater sources is that it provides a reliable
21 local supply in the event of a major disaster interrupting import supplies, such as a major
22 earthquake. DRA opposes many of these groundwater projects and conducts very short-term
23 economic analysis.

24 Additionally, Cal Water has proposed additional groundwater wells in many districts
25 because of water quality issues with existing older wells. This category includes new wells
26 proposed primarily to replace older wells with nitrate or other water quality issues.

27 Generally, DRA indicates that since overall system demand has decrease slightly in
28 recent years, some of these additional sources are not required. This is simply not the case, as
29 peak daily demand has not significantly decreased with decreased sales. Additionally, the
30 average age of Cal Water wells is quite high and these are becoming less reliable and more
31 susceptible to failure. Cal Water and Cal Water's customers need to continue to invest in wells
32 to replace aging infrastructure.

33

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1 Pipelines

2 In regard to pipelines, Cal Water has historically achieved a 0.3% pipeline replacement
3 rate per year and in this case has proposed to slightly increase this rate, with a continued
4 “ramp-up” of this program as post World War II boom mains continue to age in many districts.

5 DRA recommends a much lower replacement level because of general economic
6 conditions. However, a 300 year or more replacement schedule is simply not realistic.
7 Infrastructure needs to be constantly renewed or society runs the risk of more failures in the
8 form of large leaks and breaks. Leaks and breaks can cause significant damage to surrounding
9 homes, sewer lines, roadways, and the environment. Examples of this damage include street
10 flooding, home flooding, roadway sink holes, land erosion, and damage to fish bearing streams.
11 Customers are also subject to loss of water service and potential bacterial contamination that
12 may happen when a pipe is depressurized.

13 More information on the main replacement program can be found in the global pipeline
14 rebuttal section. Unique specific pipeline rebuttal for each pipeline can be found in district
15 specific plant rebuttal area.

16 Pumping

17 Cal Water presents many pump replacement project in this GRC to improve efficiency,
18 save energy, improve water system reliability, and help to reduce greenhouse gas emissions.
19 DRA agrees with many of these where logical and Cal Water does not rebut those without a
20 short term payback. Cal Water also proposed many conversions of oil lubricated pumps to
21 water lubricated pumps. Oil lubricated pumps have contributed to bacteriological problems in a
22 number of installations leading to customer service issues, clean up, and testing. Cal Water
23 believes it is important to eliminate this additional concern. DRA opposes these where the oil
24 lube pump have not exhibited bacteriological problems. Cal Water contends that it is simply
25 best for customers to eliminate this risk.

26 Storage

27 Cal Water proposes constructing new tanks in this case where they are needed based
28 on Water Supply and Facility Master Plans. These tanks provide storage for 3 purposes,
29 including operational demand, fire flow demand, and emergency storage. Cal Water contends
30 that the size and amount of these tanks should be fairly easy to determine. Operational storage
31 and fire flow storage volumes are well documented. DRA and Cal Water continue to have
32 differenced in this GRC over what the correct amount of emergency storage should be. Cal
33 Water has conducted an extensive amount of research into this issue and finds that emergency
34 storage in the water industry varies from a low of 4 hours to a maximum of 72 hours. Obviously
35 the higher the number of hours of emergency storage designed for a system, the larger the

1 corresponding tank size and the impact to the customer. Cal Water targets 24 hours for typical
2 situations and more for isolated systems with single source of supply or critical customers
3 including hospitals. In distributed source districts with interconnections to other systems, Cal
4 Water targets less than 24 hours of emergency storage.

5 The storage projects in this GRC have been scaled down to those that Cal Water
6 believes are critical to operations. DRA opposes many of these projects based on one-size-fits-
7 all logic, and not what is best for the ratepayers. Cal Water offset specific rebuttal on each tank
8 project and this can be found in the district specific plant rebuttal sections.

9 Treatment

10 Cal Water proposes some treatment technology for various sources in this case. In
11 general this is to comply with Department of Public Health (“DPH”) recommendations. This is
12 appropriate for projects to comply with the revised Waterworks Standards, treatment for iron
13 and manganese rather than blending and disinfection by-product control

14 Cal Water urges the Commission to rely on recommendations of DPH in matters of
15 public health and that the Commission should authorize these important public health related
16 projects. These individual projects are discussed in the plant section in districts where Cal
17 Water requested these facilities.

18 Electrical Components

19 Cal Water proposes replacing many electrical components and controls for the water
20 systems. These are collectively referred to as Supervisory Control and Data Acquisition
21 (“SCADA”) projects. Cal Water’s SCADA systems allow 24-hour automated operations to
22 control pumps, valves, tank levels, and flows. Many of these systems are requirements for DPH
23 monitoring and reporting. Most of these projects in this case are identified to replace existing
24 components to maintain the integrity of the water system.

25 In addition to the routine replacement of these electrical components, Cal Water also
26 proposes enhancements to the SCADA system to better enable flow and energy monitoring
27 where it is not currently in place. Cal Water contends that this more sophisticated equipment
28 will allow better use of natural resources by optimizing the operations and using the most
29 efficient pumps available for a given condition.

30 DRA categorized all SCADA projects under a broad brush and simply recommends
31 eliminating all of them because Cal Water has not done a good job on justifying the energy
32 monitoring components of the SCADA system. However DRA has no solid testimony on
33 SCADA equipment replacement. Just like other components of a water system, these
34 components do wear out and need to be renewed. These projects are discussed in the global

1 rebuttal and on an individual basis in each district. Cal Water recommends that these projects
2 be included in ratebase for the test year.

3 Pressure Improvements

4 In several districts, Cal Water proposes infrastructure to improve water pressure to
5 existing customers. Cal Water prepared detailed reports and plans to document the low
6 pressure and the poor service to customers in those specific areas. The Cal Water specific
7 plans in this case will improve pressure to customers.

8 DRA holds to the minimums established in General Order 103-A, which allow a minimum
9 pressure of 30 PSI at the customer's meter during peak hour and a minimum pressure of 40 PSI
10 at the customer meter at other times. DRA also discusses the lack of customer complaints in
11 these areas.

12 Cal Water contends that low pressures tend to occur in older parts of a system, in lower
13 socio-economic areas, where customers are simply less likely to complain about pressure. Cal
14 Water also contends that today's backflow requirements can create a situation where customers
15 have very poor pressure at their fixtures. Cal Water offers both global rebuttal to this issue and
16 district specific project rebuttal in the following sections.

17

18 **Book 5- Attachments**

19 This final book simply includes all the attachments associated with plant rebuttal from
20 book 4. This is intended to serve as reference for book 4 for manageability. The attachments in
21 this section are sorted by district and follow the order that they are address in book 4 rebuttal.

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1 **CHAPTER 3: NON-TARIFFED PRODUCTS & SERVICES AND**
2 **AFFILIATE TRANSACTIONS (DARIN DUNCAN)**

3
4 **3.1 AFFILIATE TRANSACTIONS**

5 DRA raises some concerns about certain transactions between Cal Water, the regulated
6 utility, and two of its affiliates: (1) CWS Utility Services (“CWSUS”), an unregulated affiliate
7 operating in California; and (2) California Water Service Group (“CWS Group” or “Group”). Cal
8 Water addresses those concerns below.

9 **3.1.1 Dominguez Field Yard Transaction with CWSUS**

10 This transaction is discussed in Cal Water’s Rebuttal Book 4 (which addresses plant
11 issues) in the chapter that addresses the Dominguez District.¹ DRA also requests that Cal
12 Water “disclose when a property it is purchasing or has already purchased[,] and that it is
13 requesting to include in rates[,] has been previously owned by CWS.”² Given that Cal Water
14 has been in existence since 1926, that some companies purchased by Cal Water were in
15 existence prior to then, and that official government records are not electronically available that
16 far back, Cal Water hesitates to agree to this request as a blanket requirement. Cal Water is
17 nevertheless agreeable to considering variations on this request if more specific parameters can
18 be developed so that Cal Water can be confident of its ability to comply.

19 **3.1.2 Loan Transactions with Affiliates**

20 ***Treatment of Short-Term Loan to CWSUS***

21 In data request responses, Cal Water has acknowledged to DRA that a loan of
22 \$4,151,811 made by Cal Water to CWSUS in 2011 was erroneously rendered “interest-free”
23 until the error was realized at the end of 2011. Cal Water agrees with DRA’s position that
24 CWSUS should be retroactively charged for the use of those funds at the rate of 5.5%, the rate
25 that Cal Water is currently charging CWS Group for funds.³

26

¹ The Dominguez Chapter of Cal Water’s Rebuttal Book 4 will be submitted on May14, 2013, paralleling the 2-week extension granted to DRA to submit its Results of Operations Report on the Dominguez District.

² DRA Company-Wide Report at page 3-10, lines 14-18.

³ *Id.* at pages 3-12 (line 12) to 3-13 (line 2).

1 **Future Loan Practices and Modification of Annual Affiliate Report**

2 DRA also recommends that Cal Water modify its practices so that all cash loans with an
3 affiliate “are subject to formalized terms and interest rates priced as directed by Rule VI of D.10-
4 10-019,” and that all such loans, including principal and interest, should be clearly disclosed in
5 the company’s annual affiliate transactions report.⁴ Cal Water agrees with these
6 recommendations, and has modified the affiliate transactions report that will be submitted to the
7 Commission for 2012 transactions.

8
9 **3.2 NON-TARIFFED PRODUCTS & SERVICES (“NTPS”)**

10 Cal Water’s Report on Unregulated Activities describes the methodology that Cal Water
11 uses to allocate the costs and revenues of unregulated activities between ratepayers and
12 shareholders in order to forecast rates.⁵ This approach was developed primarily as a result of
13 the Commission’s adoption of industry-wide rules for “non-tariffed products and services”
14 (“NTPS”) provided using regulated resources in A.09-04-012.⁶ For compliance with the new
15 rules, Cal Water restructured many of the unregulated contracts that CWS Utility Services
16 (“CWSUS”), Cal Water’s unregulated affiliate, held with third parties, primarily municipalities.
17 Cal Water now provides the non-tariffed services directly to the third parties using Cal Water’s
18 “excess” or unused utility resources. The Commission allows regulated utilities to perform such
19 activities as long as the needs of customers remain paramount, and ratepayers do not subsidize
20 the unregulated activities.

21 While Cal Water does not oppose most of the specific adjustments recommended by
22 DRA, Cal Water does not agree with DRA’s proposal to escalate unregulated revenues by a
23 composite factor, as discussed below. Some specific unregulated expenses are also addressed
24 in the Cal Water rebuttal on expense issues in Books 2 and 3.

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⁴ *Id.* at page 3-13 (lines 1-5).

⁵ Most unregulated activities are associated with specific contracts that Cal Water has with third parties, usually municipalities. There is also some ad hoc miscellaneous work that Cal Water employees do (internally identified as “job orders”) that do not fall within a tariff, resulting in minor unregulated costs and revenues. Cal Water’s methodology for unregulated activities accounts for all of these costs and revenues.

⁶ D.10-10-019, as modified in D.11-10-034 and D.12-01-042.

1 **3.2.1 Revenue Forecasting Methodology**

2 In discussions with DRA, Cal Water agreed that using recorded 2011 data to forecast
3 unregulated revenues would not be appropriate. This is because the new Commission rules
4 became effective half-way through calendar year 2011, the year upon which Cal Water's
5 forecasted rates for 2014, 2015, and 2016 are based. The result is that the revenues recorded
6 on Cal Water's books for 2011 (which actually appear as a credit to expenses in the category of
7 "administrative charges transferred") are an amalgam: the unregulated revenues recorded for
8 January through June reflect an old NPTS allocation methodology; the remainder of the year
9 reflect the new NPTS allocation methodology described in Cal Water's Report on Unregulated
10 Activities. Cal Water therefore provided DRA with more current data, and agrees with DRA that
11 the unregulated revenues shared with ratepayers in the forecast should be modified so that
12 there are 12 months of revenues shared under the current (new) NPTS allocation methodology.⁷

13 ***HomeServe USA Forecast***

14 Cal Water agrees with DRA's adjustment to shared revenues to reflect the settlement
15 agreement adopted by the Commission in D.13-02-026.⁸ In the settlement, Cal Water agreed
16 that ratepayers should receive a share of the annual payment that Cal Water receives from
17 HomeServe starting in 2012. DRA's increase in revenue sharing for the forecast is therefore
18 appropriate.

19 ***Antenna Lease Forecast***

20 Cal Water agrees with the addition of two new leases that are not reflected in recorded
21 2011 revenues.⁹ For the reasons discussed below, however, Cal Water opposes using an
22 escalation factor for unregulated revenues and expenses.

23 ***Expense Forecast***

24 With the exception of the issue discussed above regarding DRA's proposal to escalate
25 unregulated revenues without escalating unregulated expenses, there are no issues relating to
26 unregulated expenses that are in dispute between Cal Water and DRA.

27
28

⁷ See DRA Company-Wide Report at p. 206, lines 17-19.

⁸ D.13-02-026 is discussed in greater detail in Cal Water's rebuttal on the HomeServe Memorandum Account, Preliminary Statement Q.

⁹ The costs associated with antenna leases are typically *de minimus*.

1 **3.2.2 Expense Forecasting Methodology**

2 As discussed with regard to the Revenue Forecast Methodology, above, the unregulated
3 expenses recorded in 2011 are also an amalgam: the first half of the year reflect the previous
4 cost allocation methodology, and the last half of the year reflects the new cost allocation
5 methodology developed for the new NTPS rules.

6 For the expense forecast, Cal Water proposed to use an average ending in recorded
7 2011 expenses, with some adjustments that were an attempt to modify the first half of the year
8 of expenses as if the new NTPS rules had been in place. Over the course of discovery, Cal
9 Water agreed that, because the attempted expense adjustments were incomplete, it would be
10 appropriate to use an average ending in recorded 2011 expense data without any attempted
11 adjustments.

12 **3.2.3 Escalation Method**

13 Cal Water does not agree with DRA's proposal to escalate unregulated revenues by a
14 composite factor¹⁰ because, if the unregulated revenues shared with ratepayers are increased
15 over the rate case period for inflation, the expenses allocated to ratepayers should also increase
16 over that period. There is no basis for only escalating revenues without escalating expenses.
17 Further, given that all of the unregulated cost and revenue allocations are not significant
18 compared to the revenue requirement of the company, Cal Water does not recommend
19 attempting to escalate unregulated expenses, which would require a review of each unregulated
20 contract. The most practical approach that still addresses the Commission's concerns is to treat
21 unregulated expenses and revenues as static over the rate case period. This is the approach
22 that the Commission has historically approved for Cal Water in past GRCs and, conceptually,
23 this is the approach Cal Water used in its Application.

24

¹⁰ DRA Company-Wide Report at page 2-9, lines 10-12.

1 **CHAPTER 4: EXPENSE AND WAGE ESCALATION (DARIN DUNCAN)**

2

3 Cal Water recommends an inclusion of a 2% and 3% payroll increase in 2013 and 2014,
4 respectively. Although the test year is 2014 and does not specifically address 2013, the
5 escalation increase in 2013 provides a basis for the estimates for 2014. To accurately reflect
6 the payroll estimates for 2014, 2013 escalation should be considered.

7 Cal Water participates in the union bargaining agreement with International Federation
8 of Technical and Professional Engineers and the Utility Workers Union of America. These two
9 unions adopted a 2% annual pay increase for 2013 and 3% annual pay increase for 2014. Cal
10 Water is legally obligated to uphold the salary increase agreement with its two bargaining
11 entities. Approximately 66% of Cal Water's staff is part of the union bargaining agreement.
12 Since most of the Company's staff is involved with a bargaining entity, Cal Water uses the union
13 negotiated increase as measure for pay increases for non-union, or management employees.
14 For this reason, Cal Water recommends the Commission adopt a 3% increase in payroll for the
15 test year.

16

1 **CHAPTER 5: TAXES AND NON-PLANT RATEBASE (DARIN DUNCAN)**

2
3 **5.1 TAXES OTHER THAN INCOME**

4 Taxes other than income include: payroll taxes, business license fees, local franchise
5 fees and ad-valorem taxes. DRA and Cal Water agree on the methodologies used to forecast
6 the aforementioned taxes other than income.

7 **5.1.1 Income Tax**

8 DRA recommends the following parameters and assumptions in the calculation of
9 income tax expense:

- 10 a) For federal income taxes purposes, the corporate tax rate of 35% should be
11 used to compute FIT. CWS agrees and used the same FIT rate.
- 12 b) For state income tax purposes, the corporate tax rate of 8.84% should be
13 used to compute CCFT. CWS agrees and used the same rate.
- 14 c) All federal and state timing differences should be flowed through to the
15 ratepayers to the extent allowed by the Commission policy, and federal and
16 state tax laws.
- 17 d) DRA recommends that the tax effects stemming from the Tax Accounting
18 changes related to the deduction for Repair Cost be flowed-through to
19 ratepayers by normalizing the Section 481 catch-up deduction as well as the
20 test-year estimated deduction for both FIT and CCFT purposes. The current
21 estimate for the catch-up deduction in deferred taxes of \$30,349,524 (all
22 districts) attributable to Repair Costs should be adopted. The effect is a
23 reduction in rate base and lower revenue requirements. DRA and CWS
24 agreed and adopted this methodology.
- 25 e) DRA recommends that the accumulated ratepayer benefits stemming from
26 the Jobs Creation Act in the amount of \$287,800 computed by CWS be
27 returned to ratepayers. CWS proposes to refund this amount to ratepayers
28 with a billing surcredit. DRA agrees with CWS on this treatment.
- 29 f) DRA and CWS agree on the methodology for computing Qualified Production
30 Activities Deduction. Any differences between DRA and CWS are due to
31 differences in forecasted revenues, plant levels, and water production mix.
- 32 g) DRA recommends that the effects of the American Taxpayer Relief Act of
33 2012 related to the extension of Bonus Depreciation be incorporated into the
34 computation of regulated taxable income and deferred taxes for the years
35 2012-2015. It is DRA's understanding that CWS does not oppose this
36 methodology. DRA further recommends that any revenue requirement
37 impact of the Bonus Depreciation 2013 be captured in the Tax Memorandum
38 Account established by Resolution L-411A.
- 39 h) DRA recommends that any changes in federal and state laws made before
40 the close of this record in this proceeding be incorporated in to tax estimates
41 for the test year, after review of the new law(s) by DRA.

1 Cal Water agrees with most of the DRA's proposed recommendations except for
2 normalizing the impact of the new repair regulations in calculating state income taxes. Cal
3 Water uses the flow-through method for state corporate income tax calculations in compliance
4 with the provisions of D. 89-11-058. Cal Water only normalized the impact of the repair
5 deduction for federal income tax purposes. The benefits from the impact of the repair deduction
6 for state income taxes are reflected in the calculation of test year state income tax expense
7 through a higher tax depreciation expense, which translates to a lower state income tax
8 expense. Cal Water had worked closely with DRA on the methodology and calculation of the
9 repair deduction for both the "catch-up" and the future deductions. DRA agrees that there are
10 no methodological differences between DRA and Cal Water.¹¹ Cal Water wants to clarify that
11 the methodology and calculations presented use normalization for federal income tax purposes
12 only and use flow-through method for state income tax purposes. Cal Water does not expect
13 this to be a contentious issue.

14 **5.1.2 Working Cash**

15 For regulatory purposes, working cash is the amount of inventories and funds necessary
16 for a utility's ongoing operations. There are two components of working cash – materials and
17 supplies and working cash calculated using a detailed lead-lag study.

18 ***Materials and Supplies***

19 The Materials and Supplies account includes the cost of small tools and unapplied
20 supplies and materials (including fuel). DRA agrees with Cal Water on the use of historical
21 expenditures to forecast materials and supplies. DRA disagrees, however, with how Cal Water
22 used the data sets (i.e. two years average vs. four-year average) to forecast materials and
23 supplies and used different data sets to come up with their recommendations. Cal Water
24 agrees with DRA's recommendations.

25 ***Lag Study***

26 DRA generally agrees with CAL Water's calculation of working cash except for the
27 number of lag days included for Purchased Water and Purchased Chemicals. Cal Water agrees
28 with DRA's recommended lag days for Purchased Water and Purchased Chemicals.

29 Cal Water has also read and provides rebuttal testimony to TURN's several contentions
30 regarding the lead-lag study. This rebuttal is located in a separate report.

¹¹ *Id.* at page 6-11

1 **CHAPTER 6: PENSION AND BENEFITS (TOM SMEGAL)**

2
3 **6.1 EMPLOYER 401(K) MATCHING COST**

4 In its Application, Cal Water provides a 401(k) plan for its employees in which it matches
5 75% of employee contribution up to 8% of payroll, capped at the statutory contribution limit.
6 Thus, the maximum contribution under the program for Cal Water is 6% of the company payroll,
7 if all employees participate and contribute at least 8% of their salary, and no employee reaches
8 the statutory limit. Not all employees fully participate in the program and some employees hit
9 the statutory limit, making the effective contribution for those employees less than 8% of salary
10 and the effective level the company match is less than 6%. Cal water projected the costs based
11 on the actual participation levels in the last-recorded year (2011), which results in a contribution
12 rate of 4.3%. Cal Water applied the 4.3% contribution rate to its projected employee payroll
13 costs. **DRA agrees with Cal Water’s methodology.** The only difference between Cal Water’s
14 requested 401(k) matching costs and DRA’s recommendation is due to DRA’s modifications to
15 the projected payroll costs to which the 4.3% rate is applied. Cal Water recommends the
16 Commission adopt Cal Water’s method for estimating 401(k) matching expense.
17

18 **6.2 PENSION COST**

19 The individual salary increase assumption of 5.0% was developed in accordance with
20 Section 3.7 of Actuarial Standards of Practice No. 27 of the Actuarial Standards Board. That
21 section states that the salary increase assumption should be developed using the building block
22 method. Best-estimates for each component of the salary increase assumption are combined
23 into a single rate. The components include factors such as inflation, productivity growth and
24 merit scale. In developing the salary increase assumption, we assumed 3.0% for future inflation
25 and 2.0% for future productivity and merit increases. The 2.0% increase for productivity and
26 merit increases were based upon the historical salary increases for Cal Water. The combination
27 of these components produces expected future salary increase for individuals of 5.0% per year.
28

29 **6.3 PENSION CURTAILMENT**

30 DRA recommended that Cal Water close the defined benefit pension plan to new
31 employees and offer an enhanced 401(k) or enhanced savings plan. DRA then offered further

1 recommendations that Cal Water “first close the plan to new non-union employees, and begin to
2 address closing the plan or other options with the union employees in future negotiations.”¹²

3 DRA stated that many utilities including other water utilities in California have taken
4 these steps. DRA claimed that taking such steps would reduce future cost volatility associated
5 with the current plan. DRA’s proposal lacks evidence support, is misguided, and is unworkable.
6 Curtailment of the pension plan would not decrease volatility for a significant period of time
7 because volatility of the plan is caused by financial market conditions (discount rate and return
8 on invested assets), not whether the plan is curtailed to new employees. Furthermore, DRA
9 completely misunderstands Cal Water’s employment market competitors, which mainly consist
10 of public governmental agencies who exclusively offer defined benefit pension plans (usually
11 managed by the California Public Employment Retirement System -CalPERS). Finally, DRA’s
12 proposal to exclude new non-union employees is inconsistent with Cal Water’s sound
13 philosophy that non-union and union employees should be allowed the same benefits under Cal
14 Water’s “one team” approach. Rather than adopt DRA’s proposal to pit non-union employees
15 against union employees, Cal Water’s long-standing approach for any change in benefits is to
16 first negotiate that change with its unions, then apply the change to its nonunion workforce.

17 **Importance of union negotiations and one-team approach**

18 Cal Water’s arm’s-length union negotiations by definition result in market level wages
19 and benefits. It is unreasonable and excessive for DRA, which is not a party to these
20 negotiations, to inflict a specific outcome to this process. Furthermore, by intimating that
21 negotiations with the unions might result in “other options”, DRA leaves new non-union
22 employees in a limbo where they may be the only people left uncovered by a defined benefit
23 plan. Not only does this fray the essential fabric of Cal Water’s one team philosophy, given the
24 small population of potential new employees involved, adopting this recommended course of
25 action will result in confusion and resentment for a handful of affected people.

26 **Health of Cal Water’s Plan**

27 Cal Water has a well-managed and funded pension plan. Most public agency pension
28 plans, including the various plans managed by CalPERS, are funded only on a “pay as you go”
29 basis, which means that each year the agency is only required to put into the plan an amount
30 needed to pay that particular year’s pension payment liabilities. This approach has led to the

¹² DRA GO Report at page 6-12.

1 monumental “unfunded future pension liabilities” that have been highlighted in the news and so
2 worry many public agency employees. Cal Water’s pension plan, on the other hand, is
3 designed and managed to meet actuarial requirements of an IRS qualified pension plan. This
4 means that, unlike public agencies, Cal Water calculates the future pension liability for each
5 employee at the time of his or her retirement, and then calculates back the present value of that
6 liability using an approved discount rate. This design is in accordance with GAAP, IRS, ERISA,
7 and SEC rules and is as different an approach to the public agency approach as apples are
8 from bananas. Cal Water’s plan was 86.3% funded on an ERISA standard as of December 31,
9 2012.

10 **DRA’s rationale regarding reduced volatility**

11 DRA’s proposal would not significantly lower the volatility of Cal Water’s pension
12 obligations. Because of the method by which Cal Water’s pension plan is calculated – i.e. upon
13 the present value of the future liability of each employee’s pension, the discount rate which is
14 applied to calculate the present value, is the largest driver to the volatility that DRA complains
15 about. The amount of employees in the plan has no effect on the volatility of the plan. The other
16 driver to the volatility of the pension plan has to do with the earnings that the plan assets
17 achieve in any particular year. In years that financial markets provide higher returns to invested
18 pension assets, annual contributions by the company are less, and conversely in years that
19 financial markets provide a lower return on invested plan assets, company contributions are
20 more. Again, the amount of employees in the plan has no effect of the volatility of the plan. So,
21 from this perspective, DRA is attempting to solve a problem using the wrong formula.

22 DRA’s proposal may eventually change the overall magnitude of the volatility by
23 shrinking the plan, but Cal Water has (and desires to continue having) long-tenured employees,
24 so even a closed pension plan would continue to require funding and face funding volatility well
25 into the future.

26 **DRA’s comparison to other public utilities**

27 It is not relevant that some other public utilities have closed defined benefit plans
28 because these are not the typical competitors for Cal Water’s talent. Cal Water’s competitors
29 for water operations talent are predominantly public agencies whose employees receive defined
30 benefit pensions. These agencies and cities are generally members of CalPERS. Cal Water’s
31 management believes that defined benefit pensions are more attractive to the type of employee
32 who will be the most knowledgeable, productive and best investment for the company and
33 customers in the long term.

1 Cal Water has traditionally cultivated a career-focused approach to employment.
2 Highlights of this philosophy include developmental opportunities, tuition reimbursement
3 programs, and the management trainee program. Because Cal Water's employees are
4 responsible for protecting public health and safety, it is important that they be well-trained and
5 expert in operations. Since the water business and our systems operate on the same basic
6 principles year-after-year, our customers benefit from the growth in experience and expertise of
7 our employees. Defined contribution programs on the other hand, can be more attractive to
8 those who plan to change employment numerous times over the course of a career are not
9 necessarily in the best long term interests of Cal Water's customers.

10 **6.4 HEALTH COST**

11 Cal Water is requesting an amount on a per employee basis for 2012, 2013, and 2014
12 as detailed in its original filing work papers. In addition Cal Water is proposing an expanded
13 Health Care Balancing Account because 1) it does not have enough experience with the
14 provisions of the ACA to reliably predict the costs of insuring dependents and the cost of stop-
15 loss insurance, 2) Cal Water has taken on additional risk in medical cost compared to other
16 water utilities, saving money but increasing volatility of the plan, and 3) the escalation process
17 does not recognize the continuously escalating cost of providing medical coverage to
18 employees. Cal Water also separately requests authority to file a Tier 2 advice letter to
19 amortize the balance in the existing memorandum account at the conclusion of 2013.

20 **Summary of DRA's position**

21 DRA adopts Cal Water's cost for 2014 on a per employee basis, after adjusting for
22 employees not covered by the plan. DRAs estimate also reflects fewer new employees due to
23 unrelated recommendations in its report. DRA does not recommend adopting Cal Water's
24 medical cost estimates for escalation years. Instead, DRA recommends Cal Water use CPI-U
25 to escalate 2015 medical costs and recommends Cal Water increase employee contributions in
26 future union contract negotiations. DRA notes that the employee contribution covers
27 approximately 8.0-9.2% of medical costs during the period 2012-2014. DRA cites a Kaiser
28 Study that states the average employee contribution to family coverage is 27%. DRA also cites
29 an "informal survey" of Class A water utilities whose employees contribute 15% to 30% of
30 medical premiums.

31 Cal Water strongly disagrees because DRA makes a number of fundamental errors in its
32 position including (i) assuming that only 95% of Cal Water employees will be covered by its
33 health care plan in the test year, (ii) using CPI-U to escalate health care cost increases rather

1 than more appropriate indices, (iii) using incomplete and inappropriate peers to compare
2 medical benefits to, (iv) incorrectly calculating employee contributions towards the medical plan
3 when formulating its recommendation, and (v) assuming that Cal Water's plan is not
4 comparable to its market for labor. I will explain each of these errors further in my testimony.

5 **Percentage coverage issue**

6 It is not correct to assume only 95% of employees are covered by Cal Water's health
7 care plans. Workers' compensation injuries and illnesses as well as various leaves permitted by
8 law under the Family Medical Leave Act accounted for 46 leaves of absence as of April 1, 2013.
9 Due to strict complement or headcount requirements Cal Water must use temporary employees
10 to cover for individuals on leaves. Cal Water had approximately 5.8% of the workforce or 55
11 temporary employees as of April 1, 2013 in order to cover for these leaves as well as short term
12 business needs. In addition, new permanent employees are not covered until the 60th day of
13 employment, increasing this percentage by an additional 1% or more¹³. In 2014, the Affordable
14 Care Act (ACA) will require that Cal Water provide medical coverage to this group if it consists
15 of 5% or more of the total headcount. Since there are significant penalties for noncompliance
16 with this requirement, Cal Water must make a change in either its coverage practice or hiring
17 practice to substantially reduce the likelihood of reaching the 5% threshold. Potential options
18 Cal Water may evaluate include adding permanent employees as a reserve pool in lieu of
19 temporary employees, providing temporary employees with medical coverage, or reducing the
20 wait time for new employee coverage from 60 days. Any of these alternatives will be designed
21 to significantly increase the percentage of Cal Water employees covered by its medical plans
22 and will need to be implemented in the test year. The result will be a much higher percentage of
23 Cal Water employees covered by the health insurance plan. For this reason, DRA's 95%
24 recommendation is not correct beginning in 2014. The uncertainty in Cal Water's response to
25 this requirement is another consideration the Commission should evaluate to determine whether
26 to allow a health cost balancing account.

27 **Internal evaluation of medical benefits against market**

28 Cal Water uses an outside consultant (Mercer) to evaluate the comparability and cost of
29 its health care plans relative to Cal Water's competitors for talent. In addition, Cal Water uses
30 outside consultants to review and compare the total compensation for each position in the

¹³ Assuming an average employee tenure of 15 years means that Cal Water would have a steady state of 6.7% staff turnover, and an annual average uncovered population of $6.7\% \times 60/365$ or around 1.1%

1 company including salary and benefits. This information is used by management to set salaries
2 and benefits for non-union employees and as information to use during negotiations with the
3 unions and to set wages and benefits for represented employees. Cal Water's compensation
4 consultant Mercer recently estimated that Cal Water's medical plan benefit value of \$15,916 per
5 active employee is only 84% of the eight-member peer group value of \$18,941 [as shown on the
6 attached letter].

7 Cal Water reviews its health care plans and health care costs on a regular basis and
8 compares them to its peers. Cal Water uses this information when it negotiates benefits and
9 wages with its two unions and applies any changes in benefits or benefit costs to all employees
10 concurrently.

11 Given the cost effectiveness of Cal Water's health benefits among its peer group, DRA's
12 recommendation to increase contributions for Cal Water employees is not reasonable.
13 Increasing employees' monthly contribution is not necessary to bring Cal Water's medical
14 benefits into alignment with the comparable market, according to the analysis performed by
15 Mercer. Cal Water's medical plan costs are already below the midpoint of its peers.

16 **DRA's lack of appropriate market analysis**

17 DRA inappropriately uses information it obtained from Kaiser to compare Cal Water's
18 benefits to general industry plans throughout the country. Cal Water operates in the water utility
19 sector and should be evaluated against similar sized and located utilities whether public or
20 private. In general industry, due to competitive pressures including pressure from foreign firms,
21 part-time work-forces, and new business models, a number of companies including retail and
22 manufacturing have reduced benefits to employees to exclude those costs from their business
23 models. Those are typically not the market that Cal Water competes with for its talent. Based
24 upon the level of benefits in the utility business and among public water agencies, it is more
25 appropriate to evaluate Cal Water's benefits among those peers.

26 DRA's informal survey of medical contributions omits critical information. There are four
27 significant problems with DRA's comparison. First, DRA excluded San Jose Water Company,
28 Cal Water's closest competitor for talent. San Jose Water's website states it has "no payroll
29 contribution for employee, two-party or family under [the Kaiser HMO] plan."¹⁴ San Jose Water
30 is a peer utility of Cal Water used in evaluating employee compensation and benefits. Cal
31 Water's Kaiser option is similar to that offered by San Jose Water.

¹⁴ http://www.sjwater.com/about_us/san_jose_water/careers/benefits/.

1 Second, DRA’s comparison of Cal Water to Suburban Water and Valencia Water is not
2 an appropriate comparison as those are much smaller utility companies which may require
3 employee contributions to offset high costs due to the lack of scale economics.

4 Third, DRA did not compare benefits levels with Cal Water’s peer group of similarly sized
5 government-operated utilities. As an example, East Bay Municipal Utility District provides “no
6 premium” coverage of the Kaiser HMO, no employee premium for PPO plans, and a 15%
7 premium for dependents on PPO plans. Vision and dental plans have no monthly premiums for
8 employees or dependents.¹⁵ Another example, Santa Clara Valley Water District requires a 15%
9 premium for medical coverage but no premiums for vision or dental coverage. A third example,
10 Alameda County Water District provides no-premium health, dental, and vision coverage for
11 union employees.¹⁶

12 Finally, DRA does not account for the fact that Cal Water’s health care plan requires
13 percentage contributions toward medical cost. In 2011-2012, Cal Water’s employees electing
14 the self-insured plan contributed an average of \$1,500 annually in medical co-pays. When these
15 co-pays are added to their monthly premiums, employees actually pay closer to 20% of medical
16 costs. As these costs increase, so do the costs of employee co-pays.

17 **Interactions of cost sharing and the Affordable Care Act**

18 There are potential consequences if the Commission adopts DRA’s recommendation for
19 employees to absorb all cost increases above CPI-U. First, there is a significant problem under
20 the Affordable Care Act (ACA) that Cal Water’s plan could lose its “grandfathered” status if it
21 decreases the percentage the employer pays and increases the employee contribution by more
22 than 5%¹⁷. If the plan’s grandfathered status is revoked, Cal Water and its customers could bear
23 significantly greater costs to comply with all laws regarding new plans. Those include the cost of
24 free preventative care among other new benefits required under ACA.

25 Second, DRA currently forecasts CPI-U at 1.7% for 2015 and 1.8% for 2016 and
26 proposes to include only that amount of increase in rates beginning in 2015. Conversely, Cal
27 Water’s actuarial estimated that employee medical costs will increase approximately 9-10% per
28 year through 2014 and will continue to rise at a rate of 9% per year after 2014. This means
29 there is a large gap between what DRA would include in rates and Cal Water’s plan costs. DRA
30 would propose that employees bear this burden and I estimate that employee premiums would

¹⁵ <http://www.ebmud.com/about/jobs/health-benefits>.

¹⁶ <http://www.acwd.org/DocumentCenter/View/43>.

¹⁷ http://www.healthreform.gov/newsroom/keeping_the_health_plan_you_have.html.

1 have to rise from 8% in 2014 to 12.8% in 2015 and 21.2% in 2016. Under its proposal DRA
2 would have employees pick up approximately \$5.5 million in additional medical cost over the
3 next three years. As mentioned earlier, this would likely trigger a loss of the Company plan's
4 grandfather status which would cost customers more, or these prudent and necessary costs of
5 doing business would have to be absorbed by Cal Water's stockholders, depriving them of a
6 reasonable opportunity to earn a fair return on their investments.

7 **Medical Cost Balancing Account**

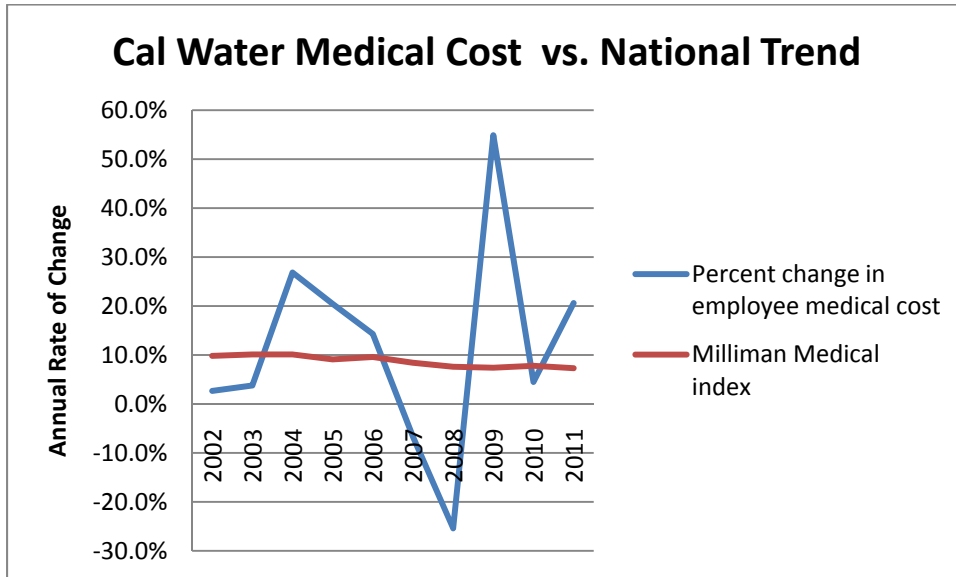
8 DRA recommends the Commission not adopt the medical cost balancing account. DRA
9 claims that Cal Water's medical costs are not volatile, that there has been no significant under-
10 recovery of employee medical costs, that Cal Water's employee contribution to these costs is
11 too low, and that Cal Water's stop loss policies protect against unexpected losses. DRA further
12 claims that there is no reason to adopt a balancing account because DRA adopted Cal Water's
13 test year medical cost estimate. DRA also asserts that there have been no costs associated
14 with the ACA for which Cal Water has a memorandum account. Finally, DRA asserts that a
15 balancing account will take away Cal Water's risk-based incentive to control costs.

16 **Cal Water's Original Policy Rationale**

17 Thomas Smegal's direct testimony pointed out the advantages of Cal Water's self
18 administered plan. Based upon our actuary's calculation, it is approximately 10% less
19 expensive than a comparable fully-insured health care plan. While a self administered plan has
20 the advantage of lower overhead costs, the downside is that Cal Water accepts that costs may
21 vary more dramatically year to year based on specific claims activity than a larger fully-insured
22 plan. For this reason, Cal Water is taking more risk than companies and agencies in its peer
23 group who use outside managed fully-insured plans. Obviously Cal Water is not compensated
24 for this additional risk and could take steps to mitigate the risk by, for example, signing a three-
25 year contract with a medical plan insurer with a guaranteed price to match CPI. The
26 Commission's current escalation year procedures for water utilities allow only the use of CPI-
27 based escalation rates for most categories of expense. However, if Cal Water were to take
28 these actions to control escalation year cost increases, base year charges would have to
29 increase. This is because the outside firm would be taking on the risk that costs will increase
30 faster than CPI. Since this approach would not be as cost effective for customers as compared
31 to Cal Water's balancing account proposal, the company's approach provides real cost benefits
32 to its customers, without unreasonably exposing Cal Water to the risk of significant claims
33 variability year to year.

1 **Clear Volatility**

2 Data provided to DRA showed significant year-to-year variation in employee medical
 3 cost compared to national averages, as shown graphically below:
 4



5
 6 Once again, the variation is due to claims activity. This variation or volatility would be
 7 dramatically moderated if Cal Water contracted solely with a third-party insurer for medical
 8 benefits, but our customers would pay more overall.

9 **Difficulties with DRA's cost analysis**

10 There are problems with DRA's data analysis regarding cost recovery. DRA did not
 11 include that part of Cal Water's authorized PBOP costs which is an amortization authorized by
 12 D.08-03-021. The annual amortization of \$658,000 is recorded in a different account than the
 13 current period costs for PBOP.

14 If these costs were added to DRA's table, its conclusion of substantial overcollection
 15 would not be correct. Shown below is DRA's table with the addition of Cal Water's recorded
 16 PBOP regulatory asset amortization as authorized by D.08-03-021.

17

	2008	2009	2010	2011
Actual	\$9,423,166	\$13,780,233	\$14,327,935	\$17,716,333
PBOP Amortization	\$658,000	\$658,000	\$658,000	\$658,000
Total Actual including PBOB amortization	\$10,081,166	\$14,438,233	\$14,985,935	\$18,374,333
Adopted	\$10,927,200	\$14,134,900	\$15,392,300	\$17,510,200
Difference	(\$846,034)	\$303,333	(\$406,365)	\$864,133

18

1 The corrected table shows that costs for the four year period in question Cal Water's
2 costs were approximately equal to adopted costs.

3 While this snapshot does imply a somewhat of a breakeven situation, the problems Cal
4 Water is trying to address with a balancing account are still very evident.

5 This data set includes two test years¹⁸ out of four years. Cal Water and DRA agree in
6 this case that Cal Water has a reasonable opportunity to forecast its test year expense, but Cal
7 Water's multiple concerns relate primarily to escalation year expenses, both due to effects of the
8 ACA and due to medical cost inflation not being appropriately accounted-for in the standard
9 escalation process of the rate case plan. That two of four years represented above are test
10 years is unusual. It relates to the Commission's transition to a new rate case plan. Going
11 forward, the pattern is one test year followed by two escalation years, which will likely skew the
12 overall balance between authorized and recorded costs unfavorably for the company.

13 DRA's witness incorrectly claims that Cal Water has not recorded additional costs
14 associated with the ACA. As described in Chapter 8 of this book, Cal Water has incurred
15 approximately \$425,000 in additional costs associated with the ACA provision to cover
16 dependents to age 26. In 2013, Cal Water has also incurred more than \$200,000 of costs
17 associated with a single covered individual above its previous \$1 million benefit cap. Benefit
18 caps were required to be eliminated by the ACA. Cal Water will also incur a "transitional
19 reinsurance program fee" of \$63 per covered individual in 2014, or approximately \$165,186 in
20 the test year. This fee was just announced by the U.S. Department of Health and Human
21 Services on March 1, 2013¹⁹ and was not included in Cal Water's medical cost estimates with its
22 rate filing. As I described above, Cal Water will likely incur additional cost to cover substantially
23 all employees in 2014 due to provisions of the act.

24 **DRA's calculation of monthly copays**

25 DRA's witness incorrectly claims that Cal Water's employees are paying a "net" monthly
26 premium of \$16. All changes in pay and benefits for the majority of Cal Water's employees are
27 the result of union negotiations. Seven years ago, as a result of collective bargaining, there was
28 an increase in medical premiums with an offsetting increase to wage levels. The goal of union
29 negotiations is to reach a fair total compensation package, and this was achieved in those
30 collective bargaining sessions, but this was many years ago and is now history. In addition, for

¹⁸ The first test year in the data set is the July 1, 2008 through June 30, 2009 test year in A.07-07-001 and the second is calendar year 2011, test year in A.09-07-001.

¹⁹ <http://www.businessinsurance.com/article/20130301/NEWS03/130309976>.

1 263 permanent employees who have joined Cal Water since 2007, they elected to come to work
2 at the company knowing the wage level and the medical premium level on their paycheck – not
3 some prior distribution of wages and benefit costs.

4 **Stop-Loss Policies and Volatility**

5 Cal Water’s stop loss policies do not protect against all volatility. Medical claims cost
6 volatility arises from both the magnitude of claims and the number of individuals making claims.
7 Very few covered individuals reach the stop-loss threshold in any given period as shown in the
8 following table:

9

Stop Loss Plan Years	<u># of people who hit stop-loss</u>
10/01/11 thru 9/30/12:	04
10/01/10 thru 09/30/11:	02
10/01/09 thru 09/30/10:	04

10

11 Balancing account and incentive to control costs

12 DRA unreasonably claims allowing a balancing account will place Cal Water in a position
13 where it has no incentive to manage medical costs. Cal Water has and will continue to support
14 programs to control medical costs. Cal Water and its unions run a joint health committee which
15 promotes preventative care, health education, and wellness programs including employee “boot
16 camp” exercise classes. Cal Water uses a third party provider to evaluate and audit medical
17 claims to identify mistakes, fraud, and abuse.

18 Other balancing accounts, such as the Modified Cost Balancing Account (MCBA) have
19 performance reporting requirements. In the case of the MCBA, Cal Water must demonstrate in
20 its GRC that it exercised due diligence and must report annually on any significant change in the
21 water mix:

22

1 7. MAINTAINING LEAST COST WATER MIX:
2

3 If there are significant changes in purchased water in a district that has
4 multiple sources (which in turn affects the amount of purchased power and
5 pump tax), Cal Water will make a showing in the district's next GRC filing
6 demonstrating that it has exercised due diligence in ensuring the least-cost
7 mix for its water sources, and that the significant change in water purchases
8 was reasonable. For the purpose of the Trial Program, significant changes in
9 water purchases are defined as when the annual volume of purchased water
10 in a district is greater than 10% of the purchased water adopted in the most
11 recent GRC for that district.
12

13 Cal Water management believes this provision is working effectively. This should be
14 obvious from other aspects of the rate case filing. Cal Water continues to aggressively pursue
15 lower-cost groundwater projects in districts with surface water/groundwater mixes in order to
16 lower customer rates. Cal Water is open to a medical cost balancing account which contains
17 similar performance evaluations and reporting requirements in order that it continue to actively
18 manage medical costs. Unfortunately, as discussed above, the volatility in costs is related to the
19 number and cost of employee claims which are difficult to control in the short term, and
20 inevitable increases in health care costs are expected as a result of the ACA. Cal Water
21 respectfully requests that the Commission approve a Health Care Balancing Account as
22 requested in its application.

23 Attachment 1 of 2 - Ch. 6 Section 4 (Health Cost)

24 Attachment 2 of 2 - Ch. 6 Section 4 (Health Cost)

25 **6.5 EXECUTIVE COMPENSATION**

26 DRA proposes that the Commission allow no rate recovery for three components of
27 executive compensation:

- 28 1. The Supplemental Executive Retirement Program (“SERP”);
29 2. Officer stock grants; and
30 3. Personal use of company vehicles.
31

32 The combination of salary, retirement, long-term incentive, and personal use of vehicles
33 is set by California Water Service Group’s (“CWS Group’s” or “Group’s”) Board of Directors
34 based upon a competitive market analysis. Executive compensation and the competitive
35 market analysis is updated and reviewed by the Board’s independent Compensation Committee
36 consistent with the rules of the Securities & Exchange Commission (“SEC”) and the New York
37 Stock Exchange (“NYSE”) on an annual basis.

38 Cal Water is a regulated utility. Cal Water’s parent company holds four regulated
39 utilities, plus two small unregulated affiliates with *de minimis* revenues. It is necessary for Cal

1 Water to offer competitive compensation and benefits in order to attract and retain qualified
2 individuals to serve in key managerial positions. As shown in the confidential Executive
3 Compensation Assessment (“Confidential Report”) provided to DRA in response to Data
4 Request MSD-006, the overall level of compensation is reasonable in comparison to Cal
5 Water’s peer group.²⁰ However, DRA’s recommendation to eliminate rate recovery for three
6 components of reasonable officer compensation that have previously been allowed in rates
7 would result in one of two outcomes: 1) Cal Water’s parent company will reduce officer
8 compensation substantially below market levels; or 2) Cal Water’s stockholders will be forced to
9 accept a rate of return that is effectively below that determined to be reasonable by the
10 Commission in Cal Water’s last cost of capital proceeding. A fundamental principle of rate-of-
11 return ratemaking is that reasonable operating costs should be covered in rates to give the utility
12 a reasonable opportunity to earn the Commission-authorized rate of return. Either of these two
13 outcomes could have serious consequences, either in the quality of the company’s
14 management team or in deterring investment in Cal Water, thereby reducing its ability to invest
15 in necessary capital improvement programs.

16 **Role of Executive Team**

17 Cal Water’s management team is not performing solely for stockholder interest. Cal
18 Water’s officers and management team lead the utility in meeting customer needs, operating
19 facilities to provide reliable, safe and quality water service, supporting and developing
20 employees, and managing the utility in a fiscally prudent and reasonable manner. As evidenced
21 in this GRC Application, Cal Water has taken a proactive role in:

- 22 • Enterprise risk management – comprehensive review and prioritization of
23 enterprise risks that affect the utility’s ability to provide reliable, safe, and quality
24 water to customers.
- 25 • Vulnerability assessments – regular reviews and updates to vulnerability
26 assessments to minimize risk of water supply disruptions to customers.
- 27 • Long-term water supply plans – diversification and augmentation of water supply
28 through long-term planning for each of its independent systems to insure reliable
29 and cost-effective service to customers.
- 30 • Facility improvements – reviews and updates of asset management and facility
31 improvement programs to enable them to provide uninterrupted service to
32 customers.

²⁰ MSD-006, Attachment (Confidential Executive Compensation Assessment (“Confidential Report”)).

- 1 • Maintenance – preventative management programs for underground and
2 aboveground facilities to improve reliability and reduce costs to customers long-
3 term.
- 4 • Improved customer service – new customer information portals and other
5 enhancements to customer service to improve our customer’s experience when
6 working with Cal Water.
- 7 • Maximizing infrastructure investment and minimizing financing costs for
8 ratepayers – insuring that customers benefit from prudently installed facilities at
9 the lowest reasonable costs.
- 10 • Contributions to communities – working to be part of the local communities that
11 we serve to benefit our customers.
- 12 • Employee development – insuring that knowledge management programs,
13 certification programs, supervisor development programs, teamwork training, and
14 succession management programs enable Cal Water to meet customer and
15 community needs going forward.

16 **DRA’s lack of substantive support for their position**

17 Apart from DRA’s unsubstantiated claim that removing the costs associated with the
18 long-term incentive plan will result in a “more reasonable level of overall executive
19 compensation,”²¹ DRA has made no effort to analyze executive compensation as a whole
20 compared to the market peer group. For example, DRA states that **[BEGIN CONFIDENTIAL]**

21 [REDACTED]

22 [REDACTED]

23 [REDACTED] **[END CONFIDENTIAL]**²² This is an overly
24 simplistic analysis. The Commission should instead consider the overall reasonableness of the
25 total officer compensation program in comparison to the applicable market and peer groups.
26 The Commission should continue to allow a reasonable overall level of officer compensation to
27 be included in Cal Water’s revenue requirement.

28 Moreover, DRA’s claim that **[BEGIN CONFIDENTIAL]** [REDACTED]
29 [REDACTED] **[END CONFIDENTIAL]** is based on faulty reasoning. DRA simply quotes, out of
30 context, one component from California Water Service Group’s executive compensation
31 consultant’s November 8, 2011 report to the Board of Directors. The compensation consultant
32 evaluated the Group’s executive salaries and benefits to market. The report also stated that Cal
33 Water’s total direct compensation is **[BEGIN CONFIDENTIAL]** [REDACTED]

34 [REDACTED]

²¹ DRA GO Report at page 7-5.

²² *Id.* at page 6-10.

1 [REDACTED]

2 [REDACTED] [END CONFIDENTIAL]²³

3 **Measure of cost of SERP relative to peers**

4 With regard to the Supplemental Executive Retirement Program (“SERP”), it is difficult to
5 calculate SERP benefits apart from Cal Water’s employee pension plan because different
6 officers will receive relatively different amounts from both plans based on tenure and pay levels.
7 Further, it should be noted that the plans “net” each other out, and the maximum benefit payable
8 under the any combination is capped at sixty percent, consistent with other major utilities in the
9 State of California. Further, it should be noted that the SERP program is a “mirror plan” to the
10 ERISA pension plan, and is designed to deal with the current income limitation imposed by the
11 IRS. However, removing the long-term incentive plan and personal use of vehicles would result
12 in Cal Water officer compensation that is [BEGIN CONFIDENTIAL] [REDACTED]

13 [REDACTED]
14 [REDACTED]. [END CONFIDENTIAL]

15 Furthermore, because of the wide distribution of Cal Water’s service areas and the
16 distances between them, significant business miles are driven by officers and management.
17 These trips are necessary for the business and use of personal vehicles by officers is not a
18 reasonable alternative given the mileage required. In addition because many officers live in
19 areas other than San Jose, requiring officers to drive to the office to pick up a company vehicle
20 prior to visiting service areas is also not practical or reasonable.

21 **Cal Water’s Alternative View on Cost of SERP**

22 As described on page 7 and 26 of the report, the consultant valued Cal Water’s total
23 retirement benefit, divided by normal years of service. Cal Water’s SERP vests [BEGIN
24 CONFIDENTIAL] [REDACTED]

25 [REDACTED]
26 [REDACTED] [END CONFIDENTIAL] The vesting period
27 explains the difference in the consultant’s conclusion regarding SERP benefits.

28 Cal Water looked at the total officer group’s estimated retirement benefit from the report,
29 page 17, which was [BEGIN CONFIDENTIAL] [REDACTED]

30 [REDACTED]

²³ MSD-006, Confidential Report at 4.

1 [REDACTED] [END CONFIDENTIAL] Moreover, after
2 making this adjustment, assuming no change in long term compensation and vehicle allowance
3 the Cal Water executive compensation was [BEGIN CONFIDENTIAL [REDACTED]
4 [REDACTED] [END CONFIDENTIAL]

5 Cal Water requested that Milliman perform an analysis of the 2014 annual estimated
6 SERP obligation for a 15-year and 20-year vesting period. This report is attached to this
7 testimony. The Milliman Group concluded that a plan with that feature would have a savings of
8 approximately \$250,000 or 8.7% over Cal Water's current plan obligations under either Cal
9 Water's application assumptions, or under DRA's preferred "scenario 3" assumptions.

10 DRA's recommendation to remove the SERP from rates is unreasonable and does not
11 represent the market realities for executive compensation. The substantial difference between
12 the current SERP and one that is "at market," such that total compensation is "at market," is the
13 vesting period. The cost difference from having a plan with Cal Water's 15-year vesting, instead
14 of the market median vesting, is \$250,000 or 8.7% of plan costs.

15 Stock Awards

16 DRA removes officer long-term stock awards from its recommended revenue
17 requirement. DRA reasons that, because part of the rationale for officer stock awards was "to
18 align with stockholders," this cost should be borne by stockholders. DRA also alleges that
19 removing these costs will result in "a more reasonable level of overall executive compensation
20 costs for the officer group as a whole being included in test year expenses to be passed on to
21 ratepayers."²⁴

22 DRA also asserts that CWS Group's annual proxy report to stockholders acknowledges
23 that incentive compensation is not recoverable in rates. DRA confuses the form of
24 compensation with the overall level of compensation. DRA misconstrues the proxy information,
25 and DRA has no basis to claim their proposal results in "more reasonable" officer compensation,
26 as DRA has not assessed overall officer compensation. As disclosed in the proxy report, CWS
27 Group's long-term executive incentive plan has been in place since 1995. The Compensation
28 Committee of the Board of Directors evaluates stock awards as part of total compensation each
29 year. In the past ten years, the company has awarded stock appreciation rights ("SARs") and
30 restricted shares. The Board has continuously awarded stock based compensation since 2005.
31 Beginning in 2006, CWS Group issued a combination of restricted stock and SARs, and in

²⁴ DRA GO Report at page 7-5.

1 2010, the Group discontinued issuing stock appreciation rights. According to the Group's proxy
2 statements, the amount of compensation awarded to the entire officer group in this manner was
3 \$1,285,000 in 2012, \$1,039,000 in 2011, \$968,000 in 2010, \$933,000 in 2009, \$581,000 in
4 2008, \$437,000 in 2007, and \$512,000 in 2006. The amount of stock compensation awarded to
5 the officers of Cal Water has been significantly less on an individual basis than that of other
6 major utilities in the state of California.

7 Prior to this rate case, DRA had not expressed an opinion on components of executive
8 compensation, and the Commission had not disallowed the form of compensation from rates,
9 despite public financial disclosures. Workpapers from past GRCs do not reflect any adjustment
10 that would remove these costs from revenue requirements. Officers' restricted stock
11 compensation has increased as the company moved away from using SARs, and as the
12 restricted stock has vested. Cal Water records the expense over the vesting period of the stock,
13 as prescribed by accounting rules.

14 **Relevance of the form of compensation**

15 DRA criticizes the form of this compensation; however, the form is not relevant to a
16 discussion of whether these are reasonable ratepayer costs. The Compensation Committee of
17 Group's Board of Directors hires an independent compensation consultant to annually assess the
18 company's total compensation program for all officers. All elements of compensation are taken
19 into consideration and valued compared to the relevant market peer group. Because the
20 Compensation Committee considers the company's total compensation program to be
21 competitive with the market, and DRA's minimal analysis fails to articulate why shareholders
22 should be penalized for offering competitive compensation, Cal Water's compensation program
23 should be included in the adopted revenue requirement.

24 It is important to remember that the long-term interests of stockholders and ratepayers
25 are not mutually exclusive. Cal Water has been a regulated utility for 87 years. Cal Water's
26 management believes that its ability to earn an authorized return over the long haul is directly
27 related to the level of customer service, reliability, water quality, and community service it
28 provides. Cal Water continues to promote customer service, pro-active risk management,
29 maintenance, conservation, and other programs that have no direct stockholder benefit except
30 for the long-term stability of the regulated utility. The Commission is well aware that well-run
31 utilities consistently provide better service to customers, and stockholders are well aware that
32 providing better customer service leads to more consistent and reasonable returns. So the
33 relationship of stockholders and ratepayers is interdependent. Their interests are not opposed,
34 but are in fact complementary.

1 Furthermore, Cal Water’s Board of Directors recognizes the long-term incentive as being
2 different from annual bonuses. The paragraph to which DRA refers is an explanation of why Cal
3 Water does not give annual performance bonuses. The paragraph equates annual performance
4 bonuses with non-recovery in rates. DRA is confused by the term incentive. Where the proxy
5 talks about incentives not being recoverable in rates, the Board means short-term bonuses tied
6 to financial performance. Cal Water’s long-term incentive is intended not to reward specific
7 performance, but rather to incent officers to remain with the company for the long term. This is
8 consistent with Cal Water’s approach to investing in and retaining employees over the course of
9 their careers. Cal Water feels that this approach benefits ratepayers and stockholders alike as
10 officers develop and retain knowledge of the business.

11 **Statements regarding non-recoverability**

12 The proxy statement of Cal Water’s parent company unfortunately does not accurately
13 reflect historical Commission practice. There is ample evidence that short-term incentive
14 compensation has been at least partially included in the rates of other companies. Water
15 utilities such as Golden State Water Company include short-term incentives and recover the
16 costs in rates. As referenced in the opening comments to the proposed decision in A.10-12-005
17 submitted by Sempra, the Commission has recognized short-term incentive compensation in
18 both Southern California Edison’s most recent GRC, and in ALJ Wong’s proposed GRC
19 decision for Southern California Gas and San Diego Gas & Electric.

20 Despite asserting that Cal Water’s compensation is well above industry standards, DRA
21 has not actually evaluated the reasonableness of officer compensation, or the long-term
22 incentive program’s contribution, to the compensation packages of other Commission-regulated
23 utilities.

24 **Recent updates to officer stock compensation**

25 As of 2013, Cal Water has changed its long-term compensation package where 50% of
26 the long-term incentive is no longer time-based. This portion of long-term incentive is based
27 upon performance in four key areas, three of which strongly support ratepayer interests. The
28 areas are: return on investment, capital investment, customer service, and water quality. All
29 categories are weighted equally. The benchmark for return on investment is the authorized
30 return on equity. The benchmark for capital investment is the authorized Commission-approved
31 capital budget along with budget plans in other regulated subsidiaries. The benchmark for
32 customer service is meeting the Commission’s General Order 103-A targets in every district,

1 every quarter. The benchmark for water quality is having no public health-related violations.
2 The stock is granted for performance to these measures over a three-year period.

3 Three of the four measures are directly relevant to ratepayer interest in that executive
4 long-term incentive compensation increases with better ratepayer outcomes in terms of
5 execution of system improvements, customer service, and water quality. The fourth component,
6 return on investment, indirectly supports ratepayer interests because a utility's ability to earn a
7 reasonable return will mean that it can attract capital with which to make system investments
8 and improvements which benefit customers.

9 **Conclusion**

10 Cal Water concludes that the officer stock compensation program is, as described above
11 more generally, part of market-based compensation. The form of compensation is desirable to
12 stockholders since an officer holding stock will have an interest in the long-term health of the
13 company. However, the form is not relevant to the fact that executive compensation is
14 comparable to the market.

15 Furthermore, the Company has recently taken steps to more closely align this form of
16 compensation to customer interests. If the Commission does not allow this compensation in
17 rates, the company will have the choice of eliminating it and offering less than competitive
18 compensation, or retaining it and effectively lowering stockholder returns below those the
19 Commission found reasonable in D.12-07-009. Cal Water requests that the Commission include
20 these reasonable incurred costs in its revenue requirement.

21 [Attachment 1 of 1 - Ch. 6 Section 5 \(SERP\)](#)
22

23 **6.6 ATTACHMENTS REFERENCED IN THIS CHAPTER**

24 [Attachment 1 of 2 - Ch. 6 Section 4 \(Health Cost\)](#)

25 [Attachment 2 of 2 - Ch. 6 Section 4 \(Health Cost\)](#)

26 [Attachment 1 of 1 - Ch. 6 Section 5 \(SERP\)](#)
27
28

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Helen Del Grosso
VP, Human Resources
California Water Service Company
1720 North First Street
San Jose, CA 95112

April 10, 2013

Confidential

Dear Helen,

Mercer conducted a total remuneration study for California Water Service Company (Cal Water) in 2011/2012 that included a valuation of Cal Water's benefit programs and an assessment of the value delivered relative to key talent competitors. This letter summarizes our findings regarding the competitiveness of Cal Water's medical benefits, as well as the methodology followed in conducting our analysis.

Benefits Valuation Methodology

Peer Group Selection

The market assessment compares the value delivered by Cal Water's benefits program to the benefits programs of the following eight peer organizations: Golden State Water, City of San Francisco, County of San Mateo, County of Santa Clara (data is the same as Santa Clara Valley Water District), LA Dept of Water and Power, Puget Sound Energy, San Jose Water, and Southern California Edison. These organizations represent key talent competitors of Cal Water, and include regulated water and energy utilities, as well as select governmental organizations in the major regions in which Cal Water operates. The peer companies used in the analysis represent a subset of a larger group of peers identified by Cal Water management for which Mercer had current data available in our benefits database or was able to solicit data from as part of our total remuneration study. All data used in the study were reported in 2010, 2011 or 2012.

Overall Valuation Methodology

Benefits were valued using the "walkaway" method. The values represented the cost to the employee of employer provided benefits if he or she left the employer and were to duplicate them in the marketplace. Values reflect the amount of salary that would be required to purchase the equivalent benefit, such that benefits that enjoy a tax-preferred status in relation to salary (e.g., medical plans) will include a tax "gross-up" to equate it to taxable salary required to purchase a similar benefit. These amounts are typically greater than the cost to the employer.

Overall Cal Water and peer company values reflected an incumbent-weighted workforce average and were calculated based on Cal Water's actual population demographics and cash compensation data across 66 jobs benchmarked as part of Mercer's 2011/2012 total remuneration study. The benefits calculations assume that all employees participate in the medical plan even when certain employees may have opted out. This gives a measure of the opportunity value to the employee.

Medical Benefits Valuation Methodology

In valuing medical benefits, we utilized actual claims experience from a sample distribution. POS and PPO plans were valued assuming the majority of claims occurred In Network and a lesser percentage Out of Network. HMO and EPO plans were valued to recognize some claims are Out of Network and, therefore, unpaid. These values were then normalized to market rates.

The value was adjusted for the employee contributions for individual or family coverage, and contributions were assumed to be made on a pretax basis.

Valuation was based on twenty eight global parameters and specific covered charges, each of which was either included or excluded from the value. Per incidence charges, such as a charge per admission to a hospital or a per visit co-pay for an office visit to a doctor, were applied either additionally to the coinsurance percent or instead of the coinsurance percent. Annual trends for utilization and price increases (decreases) were also applied.

Utilization rates and mean prices per utilization for each covered charge were determined from a sample claims distribution. The values for each covered charge were summed three ways: total included charges, charges subject to the deductible, and charges subject to coinsurance.

Total annual charges per enrollee and the associated number of enrollees were distributed into 48 ranges (i.e., from \$0-\$0 to \$8,000,000+) on both an in-network and an out-of-network basis. From these distributions, adjustments for deductible, coinsurance, and out-of-pocket maximum were determined.

Additional costs associated with carve-out provisions for outpatient mental health and chemical dependency were determined based on similar distributions of charges and adjustments for the deductible, coinsurance, and maximum. The resulting amounts were then weighted by the number of enrollees and totaled to determine the adjustment amount.

Adjustments for age/sex, administrative expenses, and individual premium were also applied.

Medical Benefits Plan Market Comparison

Based on the methodology described above, the value of Cal Water's medical benefits is the lowest among peers and is positioned at 84% of the peer group median, as shown in Table 1. This value does not include the value of retiree medical benefits or the value of dental, vision or other group benefits.

Table 1: Comparison of Cal Water Medical Plan Value to Peers

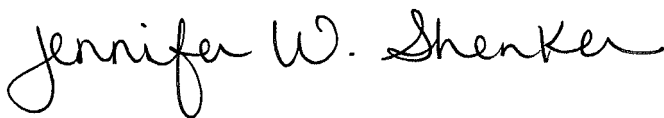
**Comparison of Medical Plan Values
California Water Services Company vs. Peers**

Organization*	Medical Benefits
Peer 1	\$16,555
Peer 2	\$20,087
Peer 3	\$17,360
Peer 4	\$18,351
Peer 5	\$20,397
Peer 6	\$20,852
Peer 7	\$19,531
Peer 8	\$16,548
Median	\$18,941
Cal Water	\$15,916
% of Median	84%

Market benefit practices are changing rapidly as organizations respond to the Affordable Care Act and seek to contain escalating healthcare costs. Accordingly, it is advisable to review market trends and evaluate competitiveness relative to market regularly.

Helen, I hope you find this information useful as you plan for your future benefits programs. Please feel free to contact me should you have further questions on the methodology or study results.

Sincerely,



Jennifer Wagner Shenker

* Individual organization names have been disguised to protect confidentiality.

I. Methodology

Basic methodology

Benefits are valued using the "walkaway" method. The values represent the cost to the employee of employer provided benefits if he or she left the employer and were to duplicate them in the marketplace. In many instances, these amounts will be greater than the cost to the employer. For example, an individual medical plan that is identical to the employer's medical plan will cost more because of the greater marketing, administrative, and underwriting costs associated with an individual plan.

Market or actuarial valuation

Valuation reflects market pricing wherever possible. If there is a market yardstick which employees are likely to use to determine the personal value attributed to an employee benefit, this is used. Where market pricing does not exist, an actuarial valuation using standard assumptions and pricing techniques will be used. For example, although individual medical or dental policies containing provisions matching an employer plan would typically not be available in the open market, the value of the employer plan is estimated by valuing the employer plan using the same rate methodology as is used for individual benefit.

Gross Salary Equivalent

Values normally reflect the amount of salary that would be required to purchase the equivalent benefit. Thus, the value of a benefit that enjoys a tax-preferred status in relation to salary (e.g., medical plans) will include a tax "gross-up" to equate it to taxable salary required to purchase a similar benefit.

Mean use

Two organizations with the same benefit plan will each have the same value attributed to their plan irrespective of the costs of the plan to the employers.

Participation

Values are calculated assuming that all employees participate in the primary plans offered even when they are voluntary and certain employees may have opted out. For example, it is assumed that all employees participate in medical, 401(k), and Stock Purchase plans (where offered). This gives a measure of the opportunity value to the employee.

Personal substitution

Values reflect as close substitution as possible to the benefit provided by the employer. For example, it has been assumed that employees will replace their life insurance benefit with the same amount of coverage. We understand that, in reality, this may not always be the case.

Health/Group Benefits

Medical Benefits

Medical benefits are valued utilizing actual claims experience from a sample distribution. POS and PPO plans are valued assuming the majority of claims occur In Network and a lesser percentage Out of Network. HMO and EPO plans are valued to recognize some claims are Out of Network and, therefore, unpaid. These values are then normalized to market rates.

Plan	% OF TOTAL CLAIMS	
	Inside Network	Outside Network
HMO	95%	N/A
EPO	95%	N/A
POS	95%	5%
PPO	90%	10%
Indemnity	N/A	100%

Where employee contributions are required, either for individual or family coverage, the value is adjusted for the employee contributions, which are assumed to be made on a pretax basis.

Valuation is based on global parameters and specific covered charges. The global parameters available for use are:

- Deductible - Individual and Family
- Coinsurance percentage
- Out-of-Pocket Maximums - Individual and Family
- Annual Maximum
- Lifetime Maximum
- Carve-Out Outpatient Mental Health
- Deductible

- Coinsurance
- Maximum Benefit
- Carve-Out Outpatient Chemical Dependency
- Deductible
- Coinsurance
- Maximum Benefit

The specific covered charges are:

- Inpatient Hospital Admissions
 - Medical
 - Surgical
 - Maternity
 - Mental Health
 - Chemical Dependency
- Outpatient Facilities
 - Medical
 - Surgical
 - Maternity
 - Mental Health
 - Chemical Dependency
- Inpatient Physician
 - Medical
 - Surgical
 - Maternity
 - Mental Health
 - Chemical Dependency
- Outpatient Physician
 - Medical
 - Surgical
 - Mental Health
 - Chemical Dependency
- Wellness Benefits

Newborn Nursery
 Well Baby
 Immunizations
 Physical Exams
 Outpatient Miscellaneous
 X-rays
 Medical Supplies
 Chiropractor
 Outpatient Department - No Other Specification
 Laboratory
 Other

Total annual charges per enrollee and the associated number of enrollees are distributed into 48 ranges on both an in-network and an out-of-network basis:

\$0 -	\$0
0 -	50
50 -	100
100 -	150
200 -	250
250 -	300
300 -	400
500 -	600
600 -	800
800 -	1,000
1,000 -	1,500
1,500 -	2,000
2,000 -	2,500
2,500 -	3,000
3,000 -	4,000
4,000 -	5,000
5,000 -	6,000
6,000 -	8,000
8,000 -	10,000
15,000 -	20,000
20,000 -	25,000
25,000 -	30,000
30,000 -	40,000
40,000 -	50,000
50,000 -	60,000
60,000 -	80,000
80,000 -	100,000
100,000 -	150,000

Each of these twenty-eight covered charges can be either included or excluded from the value. Per incidence charges, such as a charge per admission to a hospital or a per visit copay for an office visit to a doctor, can be applied either additionally to the coinsurance percent or instead of the coinsurance percent. For each covered charge, application of the coinsurance amount and/or deductible can be specified. Annual trends for utilization and price increases (decreases) are also applied.

Utilization rates and mean prices per utilization for each covered charge are determined from a sample claims distribution. A value for each covered charge is determined by first subtracting from the mean price per utilization any per utilization copays and then adjusting for trending in utilization and price changes from the date of determination of the data. The values for each covered charge are summed three ways: total included charges, charges subject to the deductible, and charges subject to coinsurance.

150,000	-	200,000
200,000	-	250,000
250,000	-	300,000
300,000	-	400,000
400,000	-	500,000
500,000	-	500,000
600,000	-	600,000
800,000	-	1,000,000
1,000,000	-	1,500,000
1,500,000	-	2,000,000
2,000,000	-	2,500,000
2,500,000	-	3,000,000
3,000,000	-	4,000,000
4,000,000	-	5,000,000
5,000,000	-	6,000,000
6,000,000	-	8,000,000
8,000,000+		

From these distributions, adjustments for deductible, coinsurance, and out-of-pocket maximum are determined. The method used to calculate the adjustments is to, first, for each range in the distribution, calculate a mean annual charge, apply the deductible, and calculate the amount that is then payable from the plan, subject to the coinsurance level and out-of-pocket maximum. These amounts are multiplied by the number of employees in each range and totaled. The mean percentage of total cost over the deductible and mean percent saved from coinsurance (subject to the out-of-pocket maximum) are then calculated. The adjustments for deductible and coinsurance are then applied to the previously determined charges subject to deductible and charges subject to coinsurance.

An adjustment for annual maximum is similarly calculated.

Additional costs associated with carve-out provisions for outpatient mental health and chemical dependency are determined based on similar distributions of charges. For each of the forty-eight ranges, a mean charge is computed. These means are then subjected to the deductible, coinsurance, and maximum. The resulting amounts are then weighted by the number of enrollees and totaled to determine the adjustment amount.

Adjustments for age/sex, administrative expenses, and individual premium are then applied.

For postretirement coverage, retirement age assumptions are the same as for the defined benefit retirement plans. Current premium rates are projected and an increasing annuity (reflecting the plan's coordination with Medicare) is valued

using the same techniques as are used for the defined benefit retirement plans. Medicare benefits are valued on the same manual rating basis and projected. It is assumed that there will be no cost shifting from Medicare to the employer plan.

No assumption is made to take into account future caps on the level of benefits that can be provided to retirees.

Therefore, the values that are shown for postretirement health may overstate the values of the benefits for employers with caps. However, given the current uncertainty in the health care system in the U.S. and the lack of regulatory guidance regarding benefit changes for retirees, we feel this is a reasonable assumption. These benefits are assumed to accrue with service. Thus an employee who is age 50 with 10 years of service who is retiring at age 65 will have earned 10/25 of the postretirement health benefit.

Assumptions for Postretirement Medical:

Discount rate: 7.0%

Preretirement increases in medical costs and Medicare:

9.0% for the first two years

7.5% for the next eight years

6.0% thereafter

Postretirement increases in medical costs and Medicare:

Annual increase - 6.0%

Aging - 1.5%



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April 18, 2013

Mr. Thomas F. Smegal III
Chief Financial Officer and Treasurer
California Water Service Group
1720 North First Street
San Jose, California 95112-4598

***Projected Net Periodic Pension Cost for 2013 through 2016
for Cal Water's SERP if Accrual Period Changed to 20 Years***

Dear Tom:

As requested, we have determined estimates of the projected net periodic pension cost for Cal Water's SERP for fiscal years 2013 through 2016 if the plan's benefit rate were to be reduced from 4% to 3% so that full SERP multiplier of 60% would be accrued after 20 years of service instead of 15 years.

For our estimates, the above change to the plan's accrual period was assumed to take effect on January 1, 2013. We prepared the projections based upon census data as of January 1, 2011, which was also the basis for our projections dated June 7, 2012 for Cal Water's general rate case filing.

Exhibit 1 contains two sets of estimates that we have prepared based on different sets of assumptions. The estimates in Table 1 are based on the assumptions used in our original general rate case projections dated June 7, 2012. The estimates in Table 2 are based on the assumptions that were used in Scenario #3 in our letter dated January 4, 2013 containing proposed responses to items 15d. and 15e. of DRA data request MSD-012.

Limitations

The projections are based upon census data as of January 1, 2011. The assumptions, except where indicated as being different, are the same as those that were used in our projections dated June 7, 2012, for Cal Water's general rate case filing. In performing this analysis, we relied on data and other information provided by Cal Water. We have not audited or verified this data and information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete. Furthermore, actuarial estimates are subject to uncertainty from various sources, including changes in interest rates, investment returns, demographic data and patterns of retirement. To the extent that actual experience differs from the assumptions, future results will change.

Thomas F. Smegal III
April 18, 2013
Page 2

The estimates herein have been prepared for Cal Water for use in their general rate case. Milliman's work may not be provided to any other third parties without Milliman's prior written consent. Milliman does not intend to benefit any third party recipient of its work product, even if Milliman consents to the release of its work product to such third party.

The undersigned is a member of the American Academy of Actuaries and meets the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

If you'd like to discuss, please give me a call at (415) 394-3716, or you can call Kevin at (415) 394-3717.

Sincerely,


Rich Wright

RAW:km

enc.

cc: Martin Kropelnicki
David Healey

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Exhibit 1

Table 1

Projected Net Periodic Pension Cost for SERP*
Under Current Plan and With Proposed Change to Accrual Period –
Based on Assumptions from Original GRC Projections Dated June 7, 2012

	Original GRC Projections Dated June 7, 2012	Accrual Period Increased to 20 Years
	(\$000s)	(\$000s)
Discount Rate:	4.3%	
Salary Increases	5.0%	
<u>Fiscal Year</u>		
2013	\$ 3,081	\$ 2,830
2014	2,937	2,681
2015	2,824	2,561
2016	2,746	2,479

* Excludes Washington Water, New Mexico, and Hawaii.

Table 2

Projected Net Periodic Pension Cost for SERP*
Under Current Plan and With Proposed Change to Accrual Period –
Based on Assumptions for Scenario #3 Projections Dated January 4, 2013

	Scenario #3 Projections Dated Jan. 4, 2013	Accrual Period Increased to 20 Years
	(\$000s)	(\$000s)
Discount Rate:	3.7%	
Salary Increases	4.0%	
<u>Fiscal Year</u>		
2013	\$ 3,016	\$ 2,762
2014	2,864	2,614
2015	2,727	2,470
2016	2,626	2,364

* Excludes Washington Water, New Mexico, and Hawaii.

1 **CHAPTER 7: SPECIAL REQUESTS (TOM SMEGAL)**

2

3 **7.1 SPECIAL REQUEST #1: ADDITIONAL RATE DESIGN PHASE**

4 As discussed during the Prehearing Conference, Cal Water has proposed that parties be
5 given the chance to prepare rates and tariffs based upon the Commission’s proposed revenue
6 requirement, rather than having Commission staff prepare rate and tariff sheets that are
7 included in the proposed decision. No party has objected to this proposal in either the
8 Prehearing Conference or in testimony.²⁵ The December 3, 2012 Scoping Memo indicates that:

9 [The] POD [Presiding Officer’s Decision] will resolve all issues but not include
10 rates and tariffs. The parties will jointly propose rates and tariffs consistent with
11 the POD in their comments on the POD [footnote omitted].

12 In addition, there are several issues that Cal Water, DRA, and the Intervenors have
13 raised several issues that would be appropriate to discuss in the context of rate design, after a
14 clearer picture of potential revenue requirement increases develops. These include changes to
15 the Rate Support Fund (“RSF”), the Low-Income Ratepayer Assistance (“LIRA”) program, and
16 rate phase-ins. Cal Water will be working with interested parties on the schedule for settlement
17 discussions, and suggests that these rate design-related issues would be best discussed
18 towards the end of the settlement period, after the revenue requirement issues have been
19 addressed. As indicated at the Prehearing Conference, Cal Water does not advocate
20 establishing a special rate design phase, however.

21 In sum, Cal Water agrees with DRA’s statement that no Commission action is needed at
22 this time regarding Special Request #1.²⁶

23

24 **7.2 SPECIAL REQUEST #2: COORDINATION WITH OPEN PROCEEDINGS**

25 DRA expresses concerns about the cumulative impact of reflecting the outcome of active
26 Commission proceedings in the final rates adopted in this proceeding for January 1, 2014.²⁷ In
27 the General Report submitted with Cal Water’s Application, Cal Water identified three pending
28 matters. DRA also addresses Special Request #8 regarding Subsequent Rate Offsets in this
29 section. Cal Water addresses these issues, as well as the impact of another pending

²⁵ See, e.g., 10/29/12 Reporter’s Transcript, pages 52-58.

²⁶ DRA Company-Wide Report at page 11-2.

²⁷ *Id.* at 12-2.

1 proceeding, A.12-06-016, which is Cal Water’s request for the recovery of costs relating to
2 renovation of a General Office building.

3 For the reasons discussed below, Cal Water does not anticipate that incorporation of the
4 outcomes of the above issues into GRC rates will result in an increase above the revenue
5 requirement publicly noticed in our GRC Application, and these therefore should not trigger the
6 concerns expressed by DRA.

7 **7.2.2 Billing Contracts with HomeServe USA (A.08-05-019)**

8 On March 4, 2013, the Commission issued a decision in A.08-05-019, the HomeServe
9 proceeding described in the General Report submitted as part of Cal Water’s Application.²⁸ In
10 D.13-02-026, the Commission authorized an all-party settlement that adopted, among other
11 things, amortization of the associated memorandum account (Preliminary Statement Q) through
12 two sets of customer surcredits.²⁹ Consistent with the decision, Cal Water submitted Advice
13 Letter 2105 on March 29, 2013 to implement 12-month surcredits (starting on May 1, 2013) that
14 will return \$2,161,610 to ratepayers.

15 As part of the settlement in D.13-02-026, DRA and Cal Water also agreed on the
16 methodology for tracking costs and revenues in the HomeServe memo account until new rates
17 adopted in this proceeding become effective. After a final GRC decision, Cal Water will file to
18 amortize the balance in the memo account that, by design per the settlement, will only result in
19 funds being returned to customers.³⁰ In addition, as discussed further in Cal Water’s rebuttal
20 testimony on Non-Tariffed Products & Services (“NTP&S”), Cal Water agrees with DRA’s
21 proposed revenue-sharing forecast for this unregulated contract, which would thus fulfill the
22 terms of Ordering Paragraph 12 of D.13-02-026.

23 For the reasons discussed above, there will be no additional impact of D.13-02-026 on
24 the final rates adopted in this proceeding. After new rates go into effect, Cal Water will return
25 the funds remaining in the HomeServe memorandum account to ratepayers.

26 **7.2.3 Cost of Capital Application (A.11-05-001 et seq.)**

27 On July 12, 2012, the Commission resolved Cal Water’s cost of capital application in
28 D.12-07-009. Based on the June 25, 2012, proposed decision in that case adopting the all-

²⁸ CWS General Report (Company-Wide Report No. 1) at 9.

²⁹ D.13-02-026 at Ordering Paragraphs 5, 6, and 10.

³⁰ The settlement at Section III.B(4) states that “[a]ny remaining balance in the memorandum account will be addressed in Cal Water’s next general rate case. In no event, [sic] will a surcharge be levied against ratepayers.” D.13-02-026, Attachment 1 at 4.

1 party settlement, Cal Water incorporated the agreed-upon decrease in return on equity into its
2 proposed rate increase calculations when it filed this GRC application on July 5, 2012.
3 Therefore, the subsequent resolution of the cost-of-capital proceeding will have no impact on
4 the publicly-noticed rates for this GRC.

5 **7.2.4 LIRA Petition to Modify D.06-11-053 (A.05-10-035)**

6 In D.12-09-020, the Commission approved the settlement agreement between DRA and
7 Cal Water resolving all issues in the proceeding. Consistent with the decision, Cal Water has
8 already implemented a temporary surcharge to recover historical balances in the memo
9 account, and has modified the ongoing surcharge to reflect the current level of LIRA subsidies
10 likely to be provided over the course of 2013.

11 **7.2.5 Renovation of IT/HR Building on General Office Campus (A.12-06-016)**

12 In A.12-06-016, Cal Water's requested cost recovery related to renovation of the
13 Information Technology and Human Resources ("IT/HR") building on the General Office campus
14 that was completed at the end of 2011. Because the beginning plant balance for this rate case
15 application is based upon plant in service as of December 31, 2011, the proposed rates in this
16 GRC already incorporate the costs of the building renovation. As Cal Water explained in A.12-
17 06-016, however, Cal Water is aware that the settlement from the 2009 GRC indicated that Cal
18 Water would file a separate application for the IT/HR building renovation. Upon the
19 Commission's determination of the reasonable level of recovery for that renovation, a surcharge
20 will be applied to customers' bills, and will end upon implementation of new rates from this GRC.
21 DRA has agreed with this approach in an all-party settlement filed on March 4, 2013. Because
22 the proposed settlement would decrease the costs for the project (PID 16992) from \$6,011,172
23 to \$5,734,400, DRA and Cal Water have agreed that the costs for this project must also be
24 decreased in this GRC.

25 **7.2.6 Subsequent Offsets (Special Request #8)**

26 Between Cal Water's GRC Application and the implementation of rates that are based
27 on new revenue requirements adopted in this proceeding, Cal Water will likely have filed
28 additional authorized increases through the advice letter process. For example, Cal Water is
29 allowed to file certain increases associated with water production as "offsettable expenses." In
30 addition, Cal Water was authorized in its last GRC to complete certain capital projects, and then
31 obtain cost recovery through an advice letter once the projects are used and useful (often
32 referred to as "rate base offset letters").

1 To the extent that the rates adopted in this proceeding do not also reflect any increases
2 that occur in this manner, the increases will effectively be eliminated. Cal Water's request in
3 this proceeding is the same as that requested in the 2009 GRC, in which Cal Water and DRA
4 recognized the potential problem and agreed as follows:

5 The Parties agree to reflect the present rates and last adopted offset water
6 production costs (purchased water, purchased power, and pump taxes) in the
7 final tables attached to the decision.

8 ... In order to ensure reasonable continuing recovery of costs, the Parties agree
9 that the adopted rates in this decision should not discontinue any surcharge or
10 delineated rate component for a rate base offset letter approved prior to the
11 implementation of rates in this proceeding.³¹

12 DRA does not reference any circumstances that would dictate a different outcome in this
13 proceeding. Approving Special Request #8 provides the procedural vehicle to carry out the
14 Commission's intentions when it authorizes a specific rate increase through the advice letter
15 process that occurs prior to the effective date of new GRC rates.
16

17 7.3 - SPECIAL REQUEST #3: RATE DESIGN PILOT

18 Cal Water's rebuttal on Special Request #3 is addressed by David Morse in Chapter 15
19 of Book 1, Cal Water's rebuttal on company-wide issues. Some additional rate design issues
20 are addressed in Chapters 12, 13, and 14 of Book 1.
21

22 7.4 - SPECIAL REQUEST #4: SALES RECONCILIATION MECHANISM

23 ***Rebuttal to DRA's Testimony***

24 DRA's testimony on Special Request #4, Cal Water's proposed "Sales Reconciliation
25 Mechanism," fails to address the key point of the mechanism.³² The Direct Smegal Testimony
26 extensively discusses how the need for the mechanism stems from the unfortunate historical
27 circumstances experienced by the water companies with full WRAM/MCBAs that, in many
28 districts, sales forecasts adopted in previous rate cases have diverged so significantly from
29 actual sales that large WRAM/MCBA balances develop.³³ To reiterate:

30 Currently, the WRAM/MCBA balancing accounts absorb all sales changes, with
31 various significant impacts as detailed on the record in A.10-09-017 (in which

³¹ D.10-12-017, Appendix C at 497-498.

³² DRA Company-Wide Report at Chapter 14.

³³ Direct Smegal Testimony (CWS Testimony No. 1) at 4-5.

1 D.12-04-048 was recently adopted). In addition to the impact on accrued WRAM
2 balances, the absence of a sales reconciliation mechanism presents customers
3 with major rate component increases ... to offset sales changes....

4 Part of the difficulty is that, regardless of the apparent technical
5 sophistication of a sales forecast, if conditions change the forecast will prove
6 incorrect. In Cal Water's 2009 GRC, for example, sales forecasts were made
7 based on 2008 and earlier recorded data. They could not factor in the effect of
8 conservation rate design, conservation programs, drought, or the economy.
9 Rates based on those sales forecasts will be in use through 2013. Even
10 forecasts made in the present case will use 3-year old data (ending 2011) by the
11 test year, leaving considerable potential for additional demand changes in 2014-
12 2016.³⁴

13 Cal Water appreciates DRA's recognition that "an adherence to rigid regulatory
14 orthodoxy should not be the sole reason for the Commission denying CWS' Special Request #4
15 at this time."³⁵ DRA takes this position after explaining how the Sales Reconciliation
16 Mechanism ("SRM") proposed by Cal Water is "in conflict" with the Commission's Rate Case
17 Plan ("RCP"). Cal Water understands the caution with which the Commission should proceed
18 when considering any variation from the explicit processes laid out in the RCP, but notes that, in
19 the 2009 GRC, the parties agreed to deviate from the expense escalation procedures by
20 adopting fixed amounts for employee health insurance, retiree health insurance, conservation
21 expenses.³⁶

22 Further, DRA overstates its case by characterizing the SRM as "in conflict" with the Rate
23 Case Plan, and alleging that adopting the proposed mechanism "would allow untested
24 assumptions and calculations to immediately impact customer rates through the ... automatic
25 and ministerial process [used in escalation years]."³⁷ The current escalation process already
26 allows a modification to reflect the five-year average change in customers by customer class.³⁸
27 The SRM would allow a further modification to account for any significant divergence between
28 adopted sales and actual sales experienced the previous year. Far from being an "automatic
29 and ministerial process" that the SRM would irreparably complicate, the current escalation filing
30 requires numerous detailed steps and calculations to which the SRM would be added.

31 DRA's suggestion that adopting the SRM would decrease "accountability for customer
32 rate changes" is an even greater overstatement, particularly when paired with a discussion

³⁴ *Id.* at 4-5.

³⁵ DRA Company-Wide Report at page 14-2, lines 20-21.

³⁶ D.10-12-017, Appendix C at pages C-36 and C-504-505.

³⁷ *Id.* at 14-2, lines 9-11.

³⁸ D.07-05-062, Appendix A at 20.

1 about the impact of California’s Proposition 218 on rate increases by municipal utilities. DRA
2 then goes on to claim that “the past three years have seen revenue requirements increase
3 nearly twice that envisioned by the Commission in CWS’ last general rate case.”³⁹ This
4 deceptively simple statement is in fact fundamentally misleading in two ways. First, the
5 Commission’s adoption of advice letter treatment for several capital projects means that the
6 Commission was authorizing revenue requirement increases, up to certain capped amounts,
7 prior to the next rate case. Second, DRA’s statement implicitly discounts any responsibility for
8 having agreed, and then joined Cal Water in proposing to the Commission, that Cal Water
9 should be allowed to increase revenue requirements through numerous advice letter projects.
10 Accordingly, all involved parties, including the Commission, bear responsibility for any rate
11 increases stemming from authorized advice letter projects completed since the 2009 GRC
12 decision.

13 DRA is further misguided in implying that the SRM offers some way for Cal Water to
14 “hide” something from customers. If DRA and the Commission continue to support the public
15 policies behind the full WRAM/MCBA, DRA and the Commission should also have an interest in
16 customer acceptance of these public policies. Regardless of any other changes to Cal Water’s
17 full WRAM/MCBA that parties may discuss, implementing an additional mechanism to directly
18 address the potential disconnect between forecasted and actual sales make sense from both
19 ratemaking and ratepayers’ perspectives. And as the water companies explained in A.10-09-
20 017, the Commission’s energy utilities have long had the energy equivalent of full
21 WRAM/MCBAs. From the ratepayers’ point of view, a key difference is that any balances in
22 those accounts are folded into base rates, rather than appearing as separate surcharges on
23 customer bills. From the utilities’ point of view, a key difference is that, when energy usage is
24 lower than forecasted, rates can then be adjusted to recover those balances the following year.

25 Given that DRA has failed to address the substantive issue of whether the SRM furthers
26 the Commission’s conservation goals, and focuses instead on perceived secondary drawbacks
27 of the SRM, the Commission should accord minimal weight to DRA’s conclusions regarding
28 Special Request #4.

29 ***Rebuttal to TURN’s Testimony***

30 TURN appears to oppose Cal Water’s proposed Sales Reconciliation Mechanism under
31 the mistaken belief that Cal Water is attempting to make a substantive modification to the
32 existing WRAM/MCBA mechanism by “add[ing] another element of the ratemaking process

³⁹ DRA Company-Wide Report at page 14-3.

1 (sales levels) to the adjustment.”⁴⁰ TURN characterizes the SRM as “single-issue ratemaking,”
2 drawing an analogy between adjusting for sales under the SRM, and adjusting for “debt costs,”
3 or “the cost of computer memory,” in the escalation calculation.⁴¹

4 The SRM merely proposes to determine the extent of any divergences between
5 authorized and actual sales at the time of escalation, and to carry extreme divergences forward
6 by adjusting the next year’s rates, rather than allowing known divergences to compound, year
7 after year, potentially resulting in a large net WRAM/MCBA balance. TURN’s examples of costs
8 – debt costs and computer memory costs – are not at all comparable because, absent a special
9 mechanism, those costs are not already “trued up” in the current ratemaking process.⁴² The
10 annual calculation of the net WRAM/MCBA balance, however, already takes into account the
11 difference between forecasted and actual sales, as well as changes in water production costs,
12 the two elements that the SRM would consider in the escalation calculation.

13

14 **7.5 - SPECIAL REQUEST #5: RATE SUPPORT FUND**

15 DRA agrees that the LIRA program should continue. Cal Water agrees to report on the
16 requalification and verification processes for the LIRA program as requested by DRA. DRA also
17 agrees that the RSF program should be expanded as proposed by Cal Water. For both
18 programs, however, DRA and other interested parties question the structure and magnitude of
19 benefits that customers should receive under the programs in this difficult economic
20 environment. As indicated elsewhere, Cal Water is open to discussing ideas and modifications
21 to both programs in an effort to make water rates more affordable in those districts where there
22 is a small customer base, low income levels, and high per-unit water rates.

23

24 **7.5 - SPECIAL REQUEST #5: RATE PHASE-IN**

25 In its discussion with community leaders and customers, Cal Water found that many
26 individuals expressed a desire for a rate phase-in, or a recovery of the proposed revenue
27 requirement over two or three years. Cal Water realizes that a rate phase-in is not a panacea in
28 that it has the result of rates increasing rates by more than what it would be compared to

⁴⁰ Direct Rubin Testimony (TURN) at 34 (lines 12-13).

⁴¹ *Id.* at lines 14-17.

⁴² For the last cost-of-capital ratemaking period, a Temporary Interest Rate Balancing Account (“TIRBA”) to true up adopted and actual debt costs, however amortization was to the ratepayers’ benefit, and the mechanism was discontinued in Cal Water’s last cost of capital case.

1 recovery rates in one year. This is because the Commission’s practice allows revenue which is
2 phased-in to accrue interest at a rate equivalent to the Utility’s authorized rate of return. Cal
3 Water has assessed the reasonableness of this in its proposal for rate phase-ins. Cal Water
4 used a similar criteria to its assessment for RSF eligibility, which includes the size of the rate
5 increase, the unemployment rate in the district, what percentage of customers participate in the
6 LIRA program, and the amount of the typical water bill compared to the median household
7 income. Cal Water realizes that the final revenue requirement will likely be different than the
8 formal Application proposal. Cal Water is open to discussing the appropriateness of a rate
9 phase-in for different districts during settlement.

10 **7.7 - SPECIAL REQUEST #7: WAIVER OF NOTICE FOR ESCALATION RATES**

11 DRA opposes Cal Water’s request to waive the requirement to notify customers in the
12 event of escalation increases that exceed 10%. Given that Cal Water was required to provide
13 notice of rate increases in all three GRC years of this proceeding, and the Commission will be
14 approving rates for all three years, it is unduly confusing to again provide notice to customers
15 with every escalation increase. The opportunity for customers to weigh in on rate increases is in
16 this GRC; it is an empty gesture to give customers the illusion that their contributions will be
17 meaningful in the escalation process.

18 **7.8 - SPECIAL REQUEST #8: SUBSEQUENT OFFSET INCREASES**

19 See the rebuttal addressing Special Request #2, Coordination with Open Proceedings,
20 above.

21
22 **7.9 - SPECIAL REQUEST #9: BUENA VISTA**

23 DRA and Cal Water are in agreement that the Salinas District’s tariff should be applied
24 to Buena Vista customers.

25
26 **7.10 - SPECIAL REQUEST #10: JAMES WATER**

27 DRA and Cal Water are in agreement that the Kernville tariff in the Kern River Valley
28 District should be applied to James Water customers.

29

1 **7.11 - SPECIAL REQUEST #11: AMORTIZE AND CLOSE BALANCING AND MEMO**
2 **ACCOUNTS**

3 See Chapter 8 of this book.
4

5 **7.12 - SPECIAL REQUEST #12: AMORTIZE AND CONTINUE BALANCING AND MEMO**
6 **ACCOUNTS**

7 See Chapter 8 of this book.
8

9 **7.13 - SPECIAL REQUEST #13: HEALTH COST BALANCING ACCOUNT**

10 Cal Water’s rebuttal to DRA’s report on the health cost balancing account is included in
11 section 6.4, above.
12

13 **7.14 - SPECIAL REQUEST #14: WATER QUALITY FINDING**

14 DRA addressed water quality issues at the end of its District RO Reports. For each
15 district, DRA concluded that Cal Water appears to be in compliance with all applicable water
16 quality standards, and is addressing any issues raised by the California Department of Health
17 (“CDPH”). No party alleges that there are violations of General Order 103 that Cal Water has
18 failed to address. The Commission should therefore grant Special Request #13, and render a
19 finding in its decision that Cal Water meets all state and federal water quality requirements.
20

21 **7.15 - SPECIAL REQUEST #15: MODIFICATIONS TO CUSTOMER SERVICE RULES**

22 Cal Water proposed several modifications to its tariff rules relating to interactions with its
23 customers. DRA agrees with the modifications, with one exception. DRA opposes Cal Water’s
24 request to increase the customer fee for bad checks and electronic fund payments from \$10.00
25 to \$20.00 on the grounds that the increase is not supported by a showing of actual costs.⁴³ Cal
26 Water withdraws the proposed fee increase for bad checks and electronic fund transfers. With
27 the exception of this proposed fee increase, the Commission should approve Special Request
28 #15.
29

⁴³ DRA Company-Wide Report at pages 25-1 to 25-2.

1 7.16 - SPECIAL REQUEST #16: BALANCED PAYMENT PLAN

2 DRA supports Cal Water’s proposal to implement a “Balanced Payment Plan” option for
3 customers, with some caveats. Under Cal Water’s proposal, which is based upon an existing
4 program offered by Pacific Gas & Electric Company, a customer could submit more predictable,
5 level payments on their water bill based upon a 12-month average of their last bills (or, in the
6 absence of consumption history, a bill that is representative of the neighborhood).

7 DRA does not agree with Cal Water’s proposal to limit this option only to customers in
8 good standing, however. Instead, DRA argues that a Balanced Payment Plan should be
9 available to all customers, regardless of payment history. DRA recommends that Cal Water
10 develop guidelines for removing delinquent customers from the plan, and submit a Tier II advice
11 letter filing with a Balanced Payment Plan tariff that includes the guidelines.^[1] Cal Water agrees
12 to this proposal.

13 DRA also recommends that Cal Water track certain aspects of the program and report
14 on them in Cal Water’s next rate case and makes the statement, “Given this is a new program
15 with many uncertainties, DRA recommends that CWS be required to track the costs and monitor
16 the success of the program and report them to the Commission in its next GRC. The report
17 should include, but not limit to the program’s participation rate, costs, savings and its impact, if
18 any, on water conservation, working cash and uncollectible rates. CWS should also discuss if it
19 needs to make further adjustments to the program in order to make it more cost effective.”^[2]

20 Cal Water agrees that it would be useful to develop metrics by which to measure the
21 success of a Balanced Payment Plan, and to report on those metrics in its next rate case.
22 Those metrics should include participation rates, an analysis of whether there may be an impact
23 on water conservation, and consideration of whether the program could be improved. They
24 could also include an approximation of incremental costs incurred to start the program.
25 Resources should not be expended, however, in trying to identify such intangibles as embedded
26 cost savings.

27 Cal Water believes the best course is to obtain approval for the program with the
28 requirement to meet and confer with DRA once Cal Water has a plan for how the program will
29 be tracked. This will take a significant amount of time to establish as Cal Water will have to
30 engage a customer service team and IT team to ensure proper set-up.

^[1] *Id.* at page 26-3.

^[2] *Id.*

1 Cal Water requests the Commission approve this special request to establish a balanced
2 payment plan for customers.

3

4 **7.17 - SPECIAL REQUEST #17: CREDIT CARD REPORT (SPONSORED BY THOMAS F.**
5 **SMEGAL)**

6

7 **What did Cal Water request in its testimony on the no-fee credit card program?**

8 Cal Water requested confirmation that the no-fee credit card option was cost effective
9 and should be made a permanent payment channel. Cal Water did not request to amortize
10 costs in the Credit Card Pilot Program memorandum account (“CCPPMA”).

11

12 **What were DRA’s conclusions?**

13 DRA concluded that the program was not cost effective. This conclusion was partly
14 based on discounting the probability that credit cards were used to avoid shutoff for nonpayment
15 (“SONP”). DRA calls the assumption that a certain number of credit cards were used to avoid
16 shutoff “arbitrary.” DRA also ignored Cal Water’s suggestion to limit the credit card program to
17 residential customers which would also reduce costs. Because of this, DRA concludes that Cal
18 Water is not allowed to have non-participating customers absorb costs of this program under
19 section 755 of the Public Utilities Code.

20

21 **At the outset, can you reiterate Cal Water’s interest in providing a no-fee credit**
22 **card program?**

23 Yes, Cal Water is interested in providing this program to give customers the greatest
24 possible range of payment options so that it can meet customer expectations for payment
25 processing. Credit and debit card acceptance are a standard feature of many businesses
26 today, and a large segment of customers expects a no-fee credit card payment option. Credit
27 cards can be used for convenience, but critically they can also be used as a safety net when the
28 customer has no available funds to keep water in service. Cal Water does not profit from the
29 provision of a no-fee credit card option since no amounts are included in rate base.

30

31 **Do you have any concerns about DRA’s analysis?**

32 Yes, I have three concerns. First, DRA overemphasizes the total cost benefit of the
33 program. Second, DRA incorrectly uses PG&E data in an attempt to discredit Cal Water’s
34 assumption about disconnections. Third, DRA did not evaluate and completely ignores Cal

1 Water's suggestion that additional cost-effectiveness could be obtained by limiting the program
2 to residential participants.

3

4 **Why is DRA's claim of losses from the program misleading?**

5 DRA points out that Cal Water has accrued a net of \$1.4 million since the program's
6 inception. However, this figure represents only \$326,000 when annualized, which is less than a
7 tenth of a percent of Cal Water's revenue requirement or approximately \$0.06 per customer per
8 month without considering disputed benefits or Cal Water's proposed customer limitation. The
9 Commission should have a reasonable range when determining that a program is cost-neutral. I
10 believe this program falls within the reasonable range of cost-effectiveness without the disputed
11 benefits or customer limitation, and it is clearly cost effective when those items are considered.

12

13 **What are your concerns regarding DRA's analysis of the PG&E data?**

14 DRA calls Cal Water's assumed additional savings from payment in lieu of shutoff
15 "arbitrary" and cites data from PG&E's pilot to suggest this savings is not likely. However, DRA
16 is using PG&E data improperly to draw an incorrect conclusion about my assumption. First, in
17 2012, Cal Water had 40,852 credit card transactions recorded in its system in the last stage of
18 severance (after an SONP letter was issued). This is an increase from prior years and shows
19 no sign of decline. These transactions in 2012 represent approximately 0.7% of all payment
20 transactions. PG&E's data as cited by DRA is of the same type, meaning customers in the
21 severance process paying by credit card. Where PG&E and Cal Water diverge, however, is that
22 Cal Water's credit card transactions have been steady or growing while PG&E showed a clear
23 drop off in payments of this type.

24 DRA's PG&E data does nothing, however, to answer the admittedly open question of
25 how many of those customers paying by credit card would not have paid via another method,
26 leading to an expensive disconnection (and later reconnection) of service. There is a significant
27 pool of customers who may have made this decision and I described an example of 7% which
28 would make the program exactly cost neutral. PG&E apparently observed that the pool of
29 customers who potentially made this decision was quite small. Cal Water's data supports a
30 different conclusion.

31

32 **Why is it difficult to determine how many customers who paid by credit card may
33 have been disconnected?**

34 The problem with data collection in this case is that no independent, objective data
35 exists. Only the customer knows whether they could or would have paid by another method if

1 the credit/debit card option were not available. Aggregate information, such as a reduction in
2 the number of disconnections, is inseparable from other factors such as the economy, Cal
3 Water's efforts in collections and offering payment arrangements, and new initiatives to reduce
4 disconnections such as Cal Water's New Customer Experience project currently underway in
5 Bakersfield.

6

7 **Is DRA's effective assumption that all of customers paying by credit card would**
8 **have found another way to pay reasonable?**

9 This effective assumption is unreasonable based upon my discussions with Cal Water's
10 customer service management. It is also illogical, as customers who do not have ready cash
11 can have access to consumer credit⁴⁴.

12

13 **If the Commission wishes to test the sensitivity of this potential savings, what are**
14 **the effects of certain effective percentages?**

15 Below I show the program savings based upon 2012's known pool of 40,852 customers
16 paying by credit card while in the severance process:

17

Rate	Customers	Savings
1%	409	\$ 61,278
2%	817	\$ 122,556
3%	1,226	\$ 183,834
4%	1,634	\$ 245,112
5%	2,043	\$ 306,390
6%	2,451	\$ 367,668
7%	2,860	\$ 428,946
8%	3,268	\$ 490,224
9%	3,677	\$ 551,502
10%	4,085	\$ 612,780

18

19

20 Based upon the updated data, with all other things equal, a rate of 5% to 6% would bring
21 the program into almost exact balance. For clarification, these percentages are among the
22 customers using credit cards within the severance process, so this could be explained as
23 follows: "if 5 to 6% of the 0.7% of customers who use credit cards to avoid discontinuance had
24 no other option, the program is cost effective."

25

26 **Did Cal Water also recommend the program be limited to residential customers?**

⁴⁴ Or a friend or relative's consumer credit. It has been Cal Water's experience that customers have relied on third parties to pay bills by credit card, as I described in my direct testimony.

1 Yes, I pointed out that customers with commercial cards are charged a percentage
2 transaction fee while customers with basic cards are charged a flat “utility rate” per payment. By
3 restricting the payment channel to residential, I believe the program could save on fees
4 disproportionately to the loss in customer transactions. I estimated in my direct testimony that
5 this change could save \$100,000 per year based upon non-residential transactions recorded in
6 the last twelve months.

7

8 **Did DRA examine this provision?**

9 No, they did not.

10

11 **Do you have any other concerns with DRA’s testimony?**

12 Yes, I’d like to respond to DRA’s comments regarding non-utility benefits and other
13 utilities.

14

15 **Is Cal Water proposing to use customer-only benefits to support its contention**
16 **that the program is cost effective?**

17 No, but I did point out that the costs to a customer using traditional methods of mailing a
18 check are also quite high. Those costs are not included in the utility’s revenue requirement, but
19 converting customers from this traditional channel to electronic processing will save society fuel,
20 time, postage, and wear on vehicles.

21

22 **Does the fact that other investor-owned water utilities charge a third party fee for**
23 **credit card use undermine Cal Water’s request?**

24 No. These companies had no experience with an internal credit card acceptance
25 program with which to judge the effectiveness of such a program. Additionally, those programs
26 highlight a difference between an internal program and an outside program. Cal Water is able to
27 perform its program for an average cost (not including offsetting savings) of around \$1.50 per
28 customer, while a customer of Valencia or Park Water Company pays \$2.50. However, the
29 \$2.50 only covers outside costs – the companies’ other costs are absorbed in revenue
30 requirement. Not only is this an unnecessary burden on customers who use credit cards, but it
31 could, over time, dissuade this mode of payment and encourage other less efficient payment
32 channels such as walk-ins and mailing checks.

33

34 **Does Cal Water conclude, as DRA mockingly suggests, that its credit card**
35 **program is more cost-effective than that of PG&E?**

1 Not at all, Cal Water can only look at its own circumstances, but I would speculate the
2 major difference could be that Cal Water is less efficient in its billing, cash remittance, and
3 customer collections process than PG&E. This should not be a surprise. PG&E has many
4 multiples of Cal Water's customer base and can likely achieve significant economies of scale in
5 billing and cash remittance. Credit card fees are set by the credit card processors and are
6 relatively inflexible. While Cal Water is satisfied that it has negotiated a fair fee amount, it is not
7 likely that Cal Water negotiated a better deal than PG&E. However, I have no way of knowing
8 how different their processing fees are.

9
10 **Assuming for a moment that the Commission agrees with DRA that Cal Water's**
11 **program is not cost effective, what are the issues it should consider?**

12
13 If the Commission determines it cannot make a finding of cost neutrality in accordance
14 with section 755 of the Public Utilities Code at this time, I would suggest several additional
15 options:

16 1) Allow Cal Water additional time to change its data collection around how customers
17 avoid shutoff and collect additional supporting data;

18 2) Allow Cal Water to implement the proposed restriction to residential customers, collect
19 more cost-effectiveness data, and report on its new findings;

20 3) Allow Cal Water to attempt to renegotiate fees with credit card processing vendors
21 and file to continue or dissolve the program based upon the conclusion of that negotiation;

22 4) Allow Cal Water to explore an internal charging mechanism so that a for-fee credit
23 card program can be established at lowest cost to customers; or

24 5) Allow Cal Water sufficient time to transition its program to an outside "for-fee"
25 provider.

26
27 **Do you believe any of these proposals would be effective in ensuring Cal Water**
28 **has a credit card program in compliance with Section 755 of the Public Utilities Code?**

29 I believe any of the proposals preserves the Commission's responsibility to ensure the
30 program is cost effective.

31
32 **Did DRA agree that Cal Water would incur cost and take time to implement an**
33 **outside "for-fee" program?**

34 Yes. DRA recognizes there would be costs to implement a new system and that it would
35 take some time to develop.

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To summarize, how should the Commission consider the no-fee credit card program?

I conclude that with reasonable assumptions the program is already cost effective and could become more so by limiting it to residential customers. I believe the utility-operated no-fee program will attract more users than a program with a transaction cost. I believe customers increasingly expect parity between credit cards and other forms of payment. I suggest that the Commission consider the context of a cost in comparison to either the total revenue requirement or the typical customer bill and provide reasonable leeway before determining the program is more costly than the alternative. The overall magnitude of costs net of benefits in Cal Water's program even in DRA's worst case of assumptions is insignificantly small.

Finally, if DRA prevails and the Commission cannot conclude that the program meets the requirements of statute, Cal Water requests reasonable time to modify the program, collect more data, or inform customers of program termination.

7.18 - SPECIAL REQUEST #18: CHROMIUM 6 MEMO ACCOUNT (CHET AUCKLEY)

There are many unknowns surrounding the upcoming chromium 6 regulation. Until the draft MCL is released in July 2013, we do not know what level the proposed MCL will be. At this time we do not know how the state will handle the timing of the regulation. In the past CDPH has not given utilities time to come into compliance.

The grace period cited in the DRA report (page 28-4, lines 3-7) was allowed under a federal regulation. The Stage 2 Disinfection Byproduct Rule was not a California specific regulation. A better example to look at is the perchlorate regulation, which was a state regulation. The MCL was finalized in October 2007, and became effective at that time. Cal Water was able to be in compliance with that regulation because we had installed treatment for both wells with perchlorate, so treatment was permitted and active when the MCL became effective. There are far more wells with some level of chromium, and it would be fiscally irresponsible to treat them all.

In order to stay in compliance we must continue planning for this regulation. The shortest time line for compliance would be about 2 years from summer of 2013, which is an incredibly tight time line for installation of treatment. If this is how the regulation is adopted, then Cal Water would likely be out of compliance for a time.

1 Cal Water has requested that CDPH allow for a grace period to allow time to install
2 treatment for chromium 6, however, the state has not committed to that. This memorandum
3 account is needed to continue the responsible planning for a regulation that will be issued.

4 As an alternative to this request, Cal Water could have included speculative treatment
5 projects in its rate case estimates; however, the approach to chromium 6 will be different
6 depending on the MCL, so such an approach could have been misleading.

7 It is prudent for Cal Water to plan for and comply with all state and federal water quality
8 regulations and it would be imprudent for Cal Water to go out of compliance awaiting funding
9 for what could be significant projects. This memorandum account has a clear ratepayer benefit
10 for that reason. Furthermore, there is no harm to having approved the account if the regulation
11 is delayed or has a long compliance period. The Commission will have to assess the
12 reasonableness of Cal Water's entries in the account at the time it requests amortization.
13

14 **7.19 - SPECIAL REQUEST #19: CROSS-CONNECTION RULES (DARIN DUNCAN)**

15 DRA does not oppose any of the proposed changes to Cal Water's tariff rule 16
16 regarding the company's cross-connection program. However, DRA recommends that Cal
17 Water take the following steps going forward:

- 18 1. "DRA recommends that once the full scale program is implemented, CWS should
19 begin tracking the error rate...on customers who are being notified to install a
20 backflow prevention device."
- 21 2. "CWS should be required to report its findings in its next GRC and inform the
22 Commission of the recorded error rate of the program."
- 23 3. "CWS should also be required to provide a proposal on how it may reduce the
24 program's error rate, if necessary, in its next GRC."
- 25 4. "Finally, DRA recommends that CWS needs to clearly identify in its notice to
26 customers who are notified to install the backflow device that they have the
27 option of having an onsite evaluation by CWS if they so choose before any
28 installation."

29 Cal Water does not oppose any of these recommendations, and will comply with them.
30

31 **7.20 - SPECIAL REQUEST #20: LOT AND TRANSMISSION FEES (DARIN DUNCAN)**

32 DRA and Cal Water agree that Cal Water's proposals should be adopted.
33

1 7.21 - SPECIAL REQUEST #21: TARIFF FOR FIRE SERVICE (DARIN DUNCAN)

2 In its Application, Cal Water proposed a simplified method to account for residential
3 services that have an associated residential fire sprinkler component. This is generally in
4 response to the changes that the California Building Standards Commission made by adopting
5 the 2009 International Building, Fire, and Residential Code. Cal Water proposed a simple policy
6 of “two-sizes lower for 1” meter and “one size lower for meters greater than 1”

7 DRA correctly notes that in standard practice U-7-W, there are appropriate rate design
8 procedures. Unfortunately, the residential fire service component of this standard practice is
9 limited to Appendix B, which is in fact simply a on sheet copy of a work paper from a Cal Water
10 advice letter establishing a residential fire service component in its Salinas District. While this is
11 indeed a valid approach, it should not be considered the only approach that can be used.

12 DRA notes that this approach is inconsistent with other water utilities and would require
13 additional Commission action. Cal Water disagrees with this assessment and notes that
14 California American has a provision of “one size lower for fire.”

15 DRA does state the method the Cal Water proposes is similar to SP-U-7-W. Cal Water’s
16 intent was to provide a simple rule.

17 Cal Water believes that by following SP-U7-W to the letter, there could be the need to
18 generate multiple calculations and multiple lines on each tariff to capture exact circumstances
19 for each possible situation. For example, one would first need to find the meter size without fire
20 protection required, then determine required fire service meter size, then perform the
21 calculations. Taken to an extreme, this could lead to 10 different meter and fire service
22 combination calculations in each district’s tariff. Cal Water system would be unable to handle
23 this.

24 Because of this complexity, Cal Water now recommends adopting a U-7-W rate only for
25 1” meters required for fire sprinkler. This would follow SP U-7-W and limit the calculation to
26 using the cost difference between a 5/8”x3/4” meter and a 1” meter. This would generally
27 provide 7-9% premium over a 5/8” x3/4” meter or generally a 50% reduction for a 1” meter with
28 fire sprinkler component. This is logical. Existing tariff calculations for larger meters do already
29 follow the SP U-7-W method, and Cal Water does not propose adding additional configurations.

30 DRA indicated that customer notice of any change should occur. Cal Water is
31 concerned about a large workload caused by this and requests a generous timeline for its
32 implementation. This would likely involve forming a customer service team that checks for
33 existing 1” services by district and performs a mailing for any service not identified as installed
34 after January 2011.

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1 **CHAPTER 8: BALANCING AND MEMORANDUM ACCOUNTS (TOM**
2 **SMEGAL)**

3
4 **8.1 – INTRODUCTION**

5 Cal Water addresses below the testimony DRA provides in its “Report on the Balances
6 in the Memorandum and Balancing Accounts of California Water Service Company” (“DRA
7 MA/BA Report”). DRA has evaluated 38 existing memorandum (“memo”) and balancing
8 accounts, and recommends that 21 accounts should be closed, and 17 continue.⁴⁵ As
9 discussed below, Cal Water urges the Commission to allow the company to amortize certain
10 accounts before they are closed, and to continue the following accounts that DRA recommends
11 closing: the Pressure Reducing Valve Memorandum Account and the International Financial
12 Reporting Standards Memorandum Account.

13 While DRA questions several costs in Cal Water’s memo and balancing accounts, and
14 criticizes Cal Water’s current process for recording costs in the accounts, DRA does not allege
15 that Cal Water is seeking to double-count or over-recover for costs through the memo/balancing
16 account process. As Cal Water has explained in data request responses, the company
17 conducts a careful review of costs and revenues, prior to requesting recovery, to ensure that
18 amounts that do not qualify, such as costs already in rates, are removed. Thus, DRA’s
19 observations that some accounts include costs incurred prior to the effective date of the
20 account, or non-incremental costs that are being (or will be) recovered through rates, are
21 accurate but should not be cause for alarm.

22 For those memo and balancing accounts for which amortization is authorized in a final
23 decision, Cal Water requests that it be authorized to file an advice letter within 6 months of the
24 implementation of new rates.

25 *Clarification on Current Health Care Memo Account vs. Proposed Health Cost Balancing*
26 *Account*

27 In Special Requests #13 and #18 submitted in Cal Water’s GRC Application, Cal Water
28 seeks authorization for two new accounts: (1) a Health Cost Balancing Account (“HCBA”
29 (Special Request #13); and (2) a Chromium 6 Memorandum Account (Special Request #18).
30 These accounts are addressed in this book in Chapter 7 regarding Special Requests.

⁴⁵ For one account, the Health Care Memo Account (Preliminary Statement AB), the parties do not agree whether amortization should occur prior to closing of the account.

1 In addition, however, there is an existing account called a Health Care Memorandum
2 Account (“HCMA”) (Preliminary Statement AB). Due to the difference in nature between the
3 existing HCMA and HCBA, the two healthcare-related accounts should be addressed
4 separately. Unintentionally creating confusion, however, Cal Water characterized its proposal
5 as essentially converting the Health Care Memo Account to a Health Cost Balancing Account.⁴⁶
6 This likely lead to DRA’s misunderstanding that Cal Water is requesting a new health-related
7 balancing account, and also asking for continuation of the existing HCMA. In fact, Cal Water
8 agrees that the HCMA should be closed. For the reasons discussed below, however, the
9 HCMA should be amortized before it is closed.

10 **8.1.1 Formal Tracking Process for Memo and Balancing Accounts**

11 Cal Water agrees with DRA that more formal procedures should be established in order
12 to ensure that the company’s memo and balancing accounts are more consistently
13 maintained.⁴⁷ Cal Water will retrospectively apply the processes established for new memo and
14 balancing accounts to existing memo and balancing accounts. In addition, Cal Water will
15 expand the tracking spreadsheets to include the categories identified by DRA on page 1-3. For
16 litigation invoices, Cal Water is considering a trial contract with a billing vendor widely used in
17 the legal profession. The vendor would require standardized reporting from outside law firms,
18 store invoices for future queries, and facilitating the coding of invoices that relate to
19 memorandum accounts.

20 Cal Water also emphasizes, however, that the company has been authorized, and in
21 many cases required, to open a wide variety of memo and balancing accounts. They vary in
22 terms of the intended beneficiary (ratepayers or shareholders), intended outcomes (tracking
23 amounts for recovery from ratepayers, for payment to ratepayers, or for reporting purposes),
24 and nature of amounts tracked (expenses, capital, theoretical cost allocation calculations). Cal
25 Water understands why DRA seeks to apply a uniform standard to all of the company’s memo
26 and balancing accounts. As a practical matter, however, each account must be considered on
27 its own merits to ascertain whether Cal Water’s current tracking, accounting, and ratemaking
28 practices meet the goals of the Commission when the account was authorized.

⁴⁶ In the Direct Smegal Testimony, Cal Water referred to the proposed new healthcare-related account as a Health Care Balancing Account. (Direct Smegal Testimony at 39, line 7.) In Special Request #13, Cal Water requested a new Health Cost Balancing Account. (*Id.* at 15-16.) This latter terminology is more appropriate because it would then mirror the existing Pension Cost Balancing Account, upon which the proposed new account is conceptually based.

⁴⁷ DRA MA/BA Report at pages 1-2 to 1-3.

1 As discussed with regard to specific accounts below, Cal Water agrees that it has not
2 been appropriately diligent in ensuring that all reporting requirements are met. However, the
3 primary regulatory function of memo and balancing accounts is to allow the Commission to
4 decide at a later time the appropriate ratemaking disposition of funds (costs and revenues)
5 without running afoul of the prohibition against retroactive ratemaking. Other features of memo
6 and balancing accounts may vary greatly, but the commonality is the preservation of the
7 Commission’s right to finalize the disposition of the amounts at a later time.

8 The important principles to which Cal Water currently adheres with regard to memo and
9 balancing accounts are that: (1) Cal Water does not ask for double recovery through the memo
10 and balancing account mechanisms; and (2) Cal Water does not mislead the financial
11 community by failing to identify regulatory assets and liabilities. To maintain the first principle,
12 Cal Water has explained to DRA that the nature and timing of all costs and revenues tracked in
13 a memo or balancing account are investigated before the company seeks disposition by the
14 Commission (through an amortization advice letter filing). To maintain the second principle, Cal
15 Water must evaluate the likelihood of recovery or disbursement of memo and balancing account
16 amounts based on an educated analysis regarding the facts of each account, as discussed in
17 greater detail below.

18 **8.1.2 “Balance Sheet” Treatment of Balances**

19 DRA also argues that Cal Water is inappropriately reflecting some balances on its
20 financial balance sheet. DRA suggests that all memo accounts must be recorded “off-book” and
21 should not have any impact on Cal Water’s financial reporting. Cal Water’s obligations as a
22 publicly traded company should not be confused with the Commission’s authority over
23 ratemaking. DRA does acknowledge that “Generally Accepted Accounting Principles have
24 requirements for recording and recognizing assets and liabilities, which may differ from
25 regulatory requirements.”⁴⁸

26 Cal Water’s external auditor informed Cal Water in 2010 that, under their interpretation
27 of Accounting Standards Codification 980-605-25-4, Cal Water must begin booking revenues as
28 a regulatory assets if disposition of the amount is objectively determinable and probable. This
29 provision is discussed at length in A.10-09-017. There is a corresponding requirement for “loss
30 contingencies” that applies the same test for regulatory liabilities in the Statement of Financial

⁴⁸ *Id.* at page 1-7.

1 Accounting Standards No. 5 (“FAS5”). The Financial Accounting Standards Board provides the
2 following summary of FAS5:

3 This Statement establishes standards of financial accounting and reporting for
4 loss contingencies. It requires accrual by a charge to income (and disclosure) for
5 an estimated loss from a loss contingency if two conditions are met: (a)
6 information available prior to issuance of the financial statements indicates that it
7 is probable that an asset had been impaired or a liability had been incurred at the
8 date of the financial statements, and (b) the amount of loss can be reasonably
9 estimated. Accruals for general or unspecified business risks (“reserves for
10 general contingencies”) are no longer permitted. Accounting for gain
11 contingencies under Accounting Research Bulletin No. 50, *Contingencies*,
12 remains unchanged; they are recognized when realized.⁴⁹

13 It is now considered a violation of accounting standards if Cal Water does not treat
14 amounts that meet these tests as a regulatory asset or liability, and book them on its balance
15 sheet. Therefore, Cal Water does not agree with DRA’s statements that the company needs
16 Commission approval to book an amount to its balance sheet. These determinations by Cal
17 Water’s accounting department as to whether a regulatory liability or asset exists are made
18 throughout the year, and must be correctly reported in Cal Water’s quarterly financial filings. If
19 Cal Water were required to also obtain Commission authorization for each determination, Cal
20 Water would constantly be placed in the untenable position of being in imminent violation of
21 either Commission requirements or financial accounting requirements.

22 One complicating factor may be that some utilities may have a separate set of books for
23 ratemaking and a separate set for financial accounting. Cal Water, however, maintains financial
24 accounting records consistent with its regulatory records . To the extent that costs are incurred
25 or revenues are received, financial accounting requires that they be put on the “operating
26 statement” and expensed (from an accounting perspective), or treated as a regulatory asset or
27 liability and put on the “balance sheet.” When Cal Water looks at the books for ratemaking
28 purposes, however, Cal Water begins with the operating statements, and adjusts them as
29 appropriate to develop a forecast. Through this ratemaking analysis, which only occurs when a
30 GRC is filed (or some other triggering event occurs), certain expenses and revenues may be
31 removed from the forecast. One category of amounts adjusted out should be those that the
32 Commission has determined must specifically be evaluated before recovery is allowed such as
33 those in memo accounts.

34 Because a separate set of ratemaking books is not maintained, there is no ratemaking
35 impact if memo account amounts are not identified as such on a monthly basis, as many

⁴⁹ <http://www.fasb.org/summary/stsum5.shtml>.

1 preliminary statements currently require. In some cases, there is a financial accounting need for
2 this monthly reconciliation when an amount is being booked on the balance sheet. Otherwise,
3 there is no ratemaking impact of amounts tracked in a memo account unless and until Cal
4 Water either files a general rate case, or requests recovery for the account.

5 Cal Water agrees generally that amounts that should be included in memo accounts
6 should be “off-book” from a ratemaking perspective, which is accomplished by not including the
7 amounts in rates. With regard to whether an amount is considered to be a regulatory liability or
8 regulatory asset is a determination governed by GAAP and financial reporting standards.
9 Therefore, the Commission should not find any violation of its policies with regard to Cal Water's
10 practice of booking some accounts to its balance sheet.

11 **8.1.3 Balances Incorporated into Beginning Plant Balance**

12 In this rate case, there are some projects that were closed to plant as of December 31,
13 2011, that are also referenced in a memo account. For example, the Caltrans memo account
14 allows capital and expenses to be booked into the memo account, and Phase 1 of the project
15 was closed to plant by 12/31/11. Cal Water kept the Phase 1 projects in beginning plant
16 balance for this GRC Application, requests approval that the work to-date be included in rates,
17 and requests that the memo account remain open for Phase 2 of the project and to capture
18 future litigation costs and recoveries. As another example, Cal Water also completed some
19 projects prior to 12/31/11 that qualify for use of MTBE litigation proceeds. As discussed with
20 DRA, they were put into beginning plant balance, but a portion of MTBE proceeds were also put
21 into contributions to offset those dollars, so the result is that there is no impact on rate base. If
22 the Commission approves these approaches, the Commission has conducted the review
23 intended when the memo accounts were authorized. It is a benefit to both ratepayers and the
24 company if these projects are handled as part of the GRC, rather than set aside for a separate
25 memo account review, because the account amounts that can be resolved in a timely manner
26 are resolved, rather than remaining in limbo. In some cases, this will also benefit ratepayers by
27 preventing large account balances.

28 Allowing projects like the Caltrans Phase 1 activities to be handled in the GRC can also
29 help to streamline our regulatory processes by eliminating (or decreasing) the need for advice
30 letter processing. In the case of Caltrans, if DRA insists on removing the projects from this GRC
31 and requiring that all parties engage in another, separate review of the project through the
32 advice letter process, Cal Water will have to file an advice letter for Phase 1 costs after new
33 rates go into effect. If the advice letter is approved, Marysville customers would then
34 experience another rate change. This would obviously be a waste of Cal Water resources; it

1 would also be a waste of DRA’s resources because staff has clearly already looked at the
2 reasonableness of the Caltrans Phase 1 projects. It will confuse customers who have already
3 received notice of the CalTrans related revenue requirements in this proceeding, only to receive
4 notice of a subsequent rate increase for the same costs. Finally, it would impose an
5 unnecessary burden on DWA staff, which would have to process the advice letter. For these
6 reasons, the Commission should approve Cal Water’s approach of resolving the disposition of
7 the Caltrans Phase 1 costs as proposed in Cal Water’s application.

8 **8.1.4 Account Balances That Should Qualify for Amortization**

9 DRA interprets Commission policy as requiring that amounts be “recorded” in a memo or
10 balancing account in order for them to be eligible for recovery. The primary case that DRA cites
11 is a decision regarding Great Oaks Water Company. The history and fact pattern of the memo
12 account-related issues addressed in that proceeding, however, were clearly contentious, and
13 many of the Commission’s findings and conclusions were made in that contentious context.

14 Cal Water cautions against attempting a “one-size-fits-all” approach to Cal Water’s
15 memo and balancing account balances when, as Cal Water has described, many different kinds
16 of accounts have been authorized for Cal Water. In an extreme example, Cal Water’s
17 HomeServe account originally required Cal Water to apply two different accounting
18 mechanisms, and report on the balance that would be in the account under each accounting
19 mechanism. It would be nonsensical to apply to that account the mandate that the Commission
20 gave to Great Oaks: Great Oaks must do monthly entries for its specific memo account, and any
21 amounts that are not so entered are disqualified for amortization. In addition, there are many
22 Cal Water accounts that benefit ratepayers such that applying this strict principle could therefore
23 harm ratepayers.

24 Since Cal Water’s review of accounts prior to requesting recovery will ensure the
25 outcome desired by DRA – including the removal of non-incremental and other non-qualifying
26 costs, as well as the inclusion of interest as appropriate – Cal Water recommends that the
27 Commission not adopt a strict reading of this principle in this rate case. The Commission
28 should agree, in cases like this where there is broad diversity of memo and balancing accounts,
29 no evidence of intentional bad behavior on the company’s part, and two-way impacts on
30 ratepayers and shareholders, public policy does not support such an interpretation.

31 **8.1.5 Transfer of Small Balances to a “General” Balancing Account**

32 As a general matter, when there is an over- or under-recovery through amortization, the
33 company may request further amortization, or may write off the balance in order to close the

1 account. In some cases, Cal Water has requested authority to move an account balance to a
2 “general” balancing account.

3 All account balances amortized via surcharges/surcredits are generally applied to
4 customer bills for a set time period, and then are removed from customer bills. The balance left
5 over is generally referred as the “under-“ or “over-“ amortized amount, and tends to be small in
6 magnitude. From a billing perspective, each surcharge or surcredit that results from
7 amortization of a memo or balancing account must be given a unique identifier so that the
8 customer payments associated with that surcharge/surcredit can be tracked to the appropriate
9 memo or balancing account. This tracking allows Cal Water to determine whether an account is
10 effectively “under-“ or “over-“ amortized at the end of the amortization period.

11 However, when amortized amounts are very small, the workload required for company
12 and Commission staff to process amortizations seems excessive, which is why Cal Water had
13 delayed the second amortization of some balances. In addition, some customers are confused
14 when surcharges or surcredits continue to change, even if the impact of the change is *de*
15 *minus*. If Cal Water is allowed to combine small balances into one “general balancing
16 account” that can then be amortized, regulatory resources could be maximized and customer
17 confusion minimized. All amounts would be aggregated at the ratemaking area level, but
18 amounts that apply to one ratemaking area could be amortized in one surcharge or surcredit.
19 Cal Water invites a discussion on the parameters that should be applied to this approach.

20 **8.1.6 Preliminary Statements for Memo and Balancing Accounts**

21 ***New Preliminary Statements for Existing Accounts***

22 DRA conducted a thorough review of Cal Water’s memorandum and balancing
23 accounts, some of which are associated with “preliminary statements” contained in Cal Water’s
24 tariff, and some of which are not. In general, Cal Water supports DRA’s recommendations to
25 have every memo and balancing account associated with a preliminary statement.

26 ***Minor Modifications to Existing Preliminary Statements***

27 In addition, as a result of the continuing review of Cal Water’s preliminary statements
28 over the discovery period, Cal Water identified minor modifications that should be made to some
29 preliminary statements. Cal Water does not anticipate that these clean-up modifications will be
30 considered controversial by any parties.

1 ***Modifications to Preliminary Statements to Ensure a Reasonable Likelihood of***
2 ***Compliance***

3 Cal Water has discussed in this introduction section the many challenges posed by the
4 various existing memo and balancing accounts. As part of Cal Water’s internal adjustments to
5 how it manages memo and balancing accounts, the parties should also consider modifying
6 some preliminary statements further to clarify which accounts can be tracked on a monthly
7 basis, and which accounts are not susceptible to that kind of tracking. An example of the latter
8 includes the 2010 Tax Memo Account, which requires an analysis that can only be conducted
9 after annual financial data is available.

10 **8.1.7 Conclusion**

11 Cal Water explained in data request responses that, in the majority of cases, the
12 amounts identified were not intended to reflect the amounts Cal Water would seek for
13 amortization. While DRA does not agree with the company’s lack of process and structure for
14 the internal management of its memo and balancing accounts, DRA does not allege that Cal
15 Water’s behavior was an attempt to derive some benefit for the company. In this respect, Cal
16 Water has given similar treatment to its memo and balancing accounts, whether their ultimate
17 amortization will benefit the company or ratepayers.

18 Cal Water urges the Commission to conclude that there is no evidence of questionable
19 activity with regard to the company’s memo and balancing accounts. Cal Water is actively
20 addressing how to prevent its historical lapses in reporting, and is committed to developing a
21 robust internal monitoring process that will ultimately benefit both the company and ratepayers.
22

23 **8.2 – SPECIAL REQUEST 11: MEMO AND BALANCING ACCOUNTS CWS PROPOSES TO**
24 **CLOSE**

25 **8.2 – Item 1: Recycled Water Memorandum Account (“RWMA”) (Preliminary**
26 **Statement E)**

27 There is no balance in this account, and Cal Water and DRA agree that it should be
28 closed. The Commission should therefore authorize Cal Water to remove the associated
29 preliminary statement from its tariff.

30 As a related matter, there is an outstanding balancing account for recycled water that
31 was embedded in a Dominguez tariff when Cal Water purchased the system. Cal Water has not
32 identified a balance for the Dominguez recycled water account. DRA states that Cal Water

1 should accordingly be precluded from seeking recovery.⁵⁰ Cal Water therefore requests that the
2 Commission authorize Cal Water to remove the reference to this account from its Dominguez
3 tariff.

4 **8.2 – Item 2: Military Family Relief Program Memorandum Account (“MFRPMA”)**
5 **(Preliminary Statement G)**

6 There is no balance in this account, and Cal Water and DRA agree that it should be
7 closed. The Commission should therefore authorize Cal Water to remove the associated
8 preliminary statement from its tariff.

9 **8.2 – Item 3: Water Conservation Memorandum Account (“WCMA”) (Preliminary**
10 **Statement I)**

11 There is no balance in this account, and Cal Water and DRA agree that it should be
12 closed. The Commission should therefore authorize Cal Water to remove the associated
13 preliminary statement from its tariff.

14 **8.2 – Item 4: Water Conservation Expense Memorandum Account (“WCEMA”)**
15 **(Preliminary Statement L)**

16 The balance in this account is currently being amortized. Cal Water and DRA agree
17 that, after amortization is complete, the account should be closed and the preliminary statement
18 should be cancelled. The Commission should therefore authorize Cal Water to amortize any
19 remaining under-collection of the surcharge. After amortization is complete, Cal Water should
20 be authorized to remove this preliminary statement from its tariffs.

21 **8.2 – Item 5: Water Conservation Expense One-Way Balancing Account**
22 **(“WCEBA”) (Preliminary Statement N)**

23 This account has been amortized, and a small balance remains due to under-
24 amortization. Cal Water and DRA agree that the account should be closed after the remaining
25 balance is further amortized. The Commission should therefore authorize Cal Water to amortize
26 the remaining balance, and to cancel the relevant preliminary statement from its tariff after
27 amortization is completed.

⁵⁰ DRA Memo & Balancing Account Report at page 2-4, lines 4-8.

1 **8.2 – Item 6: Groundwater Rule Compliance Cost Memorandum Account**
2 **(“GRCCMA”) (Preliminary Statement O)**

3 There is no balance in this account, and Cal Water and DRA agree that it should be
4 closed. The Commission should authorize Cal Water to remove this preliminary statement from
5 its tariff.

6 **8.2 – Item 7: A.08-05-019 Memorandum Account (“HomeServe/ESP MA”)**
7 **(Preliminary Statement Q)**

8 This memorandum account relates to a proceeding that was recently closed with the
9 Commission’s adoption of D.13-02-026, which approved a settlement between Cal Water and
10 DRA. Cal Water agrees with DRA’s statement that, “[i]f the proposed settlement is adopted,
11 only the costs left to be tracked will be those incurred between June 30, 2011 and January 1,
12 2014.”⁵¹ DRA indicates that it does not oppose the amortization and closing of this account
13 after the outstanding transactions are reviewed for reasonableness.

14 Section III.B(4) of the settlement in D.13-02-026 states that “[a]ny remaining balance in
15 the memorandum account will be addressed in Cal Water’s next general rate case. In no event,
16 [sic] will a surcharge be levied against ratepayers.” D.13-02-026, Attachment 1 at 4. In order to
17 close the loop on this issue, Cal Water proposes that the Commission explicitly indicate in a
18 final GRC decision that the balance in the HomeServe memo account referenced in the above
19 section of the adopted settlement will be addressed in the manner specified in Ordering
20 Paragraphs 10 and 11 of D.13-02-026.

21 As a related matter, D.13-02-026 allows the billing contract between Cal Water and
22 HomeServe to continue, with 10% of gross revenues shared with ratepayer consistent with the
23 Commission’s rules for “non-tariffed products and services” (“NTPS”). As part of the adopted
24 settlement, Cal Water and DRA agree that the forecast for NTPS revenues in this GRC
25 proceeding should reflect the 10% sharing of the “annual payment” that HomeServe provides to
26 Cal Water. DRA accordingly modified the allocation to unregulated contracts (Chapter 2 of
27 DRA’s Report on General Office) to reflect this annual payment. Cal Water agrees with DRA’s
28 modification.

⁵¹ *Id.* at page 2-18 (line 35) to 2-19 (line 1).

1 **8.2 – Item 8: Temporary Interest Balancing Account (“TIRBA”) (Preliminary**
2 **Statement R)**

3 This account is currently being amortized. Ratepayers are receiving surcredits
4 consistent with Cal Water’s most recent cost of capital decision. Cal Water and DRA agree that,
5 after the balance in this account is fully amortized, the account should be closed and the
6 preliminary statement should be cancelled. The Commission should therefore allow Cal Water
7 to cancel this preliminary statement after amortization is complete.

8 **8.2 – Item 9: Conservation Oil Expenses (I.07-01-022) Memorandum Account**
9 **(“COIIMA”) (Preliminary Statement Y)**

10 No costs have been booked to this account. Cal Water and DRA agree that this account
11 should be closed.

12 **8.2 – Item 10: 2010 Tax Law Memorandum Account (“2010 Tax Act MA”)**
13 **(Preliminary Statement AE)**

14 DRA, in its Report on the Balances in the Memorandum and Balancing Accounts of
15 California Water Service Company, ⁵²recommends that the Tax Law Memo Account remain
16 open to capture the effects of the American Taxpayer Relief Act of 2012. Cal Water agrees with
17 DRA's recommendation.

18 DRA further recommends that the Commission order Cal Water to provide on a CPUC-
19 jurisdictional, revenue requirement basis, the impacts of the Tax Relief, Unemployment
20 Insurance and Job Creation Act of 2010 (“The New Tax Law”) not otherwise reflected in rates
21 from April 14, 2011 until the effective date of the revenue requirement changes in Cal Water’s
22 next General Rate Case as stated in Resolution L-411A no later than mid-year 2013. Cal Water
23 acknowledges that there is a need to provide balances in this memorandum account to DRA.
24 However, it is not feasible to provide the information by mid-2013 for the following reasons:

- 25 • The data provided by Cal Water’s tax group is a preliminary pull of data from Power Tax
26 in excel format. Analysis had to be made manually to determine whether the plant
27 additions recorded qualify for bonus depreciation. Final audited numbers will not be
28 available until July or August 2013 before Cal Water files its income tax return in
29 September 2013 for tax year 2012.
- 30 • Even after final audited numbers become available, analyses are still required to
31 calculate the impacts to working cash and Qualified Production Activities Income
32 (“QPAI”). It is important to note that there is a large volume of data that needs to be

⁵² *Id.* at page 2-28.

1 analyzed; not to mention the fact that Cal Water still needs to separate the data by
2 ratemaking districts.

3 DRA also recommends that at the conclusion of the this GRC cycle (2016), the balance
4 in this account be reviewed once the Company has completed the required entries pursuant to
5 L-411A including bonus depreciation through 2013 and for the other years in the GRC cycle, if
6 the bonus depreciation is subsequently extended. Cal Water agrees to a detailed review of the
7 account through 2013 in its next General Rate Case (2015 GRC) for a determination to close
8 the account for the impact of 2011 through 2013 bonus depreciation. In the event that the
9 bonus depreciation is extended to 2014, Cal Water will discuss with DRA on the treatment of
10 such separately in the 2015 GRC since the data will likely not be available at the time of the
11 filing.

12 **8.2 – Item 11: Cost of Capital Interim Rate (“CCIRMA”) Memorandum Account**
13 **(Preliminary Statement AH)**

14 In the consolidated cost of capital proceeding involving Cal Water and three other water
15 companies, the Commission adopted a rate of return in July 2012 that was retroactively
16 effective back to January 1, 2012. This memo account tracked the difference in revenue
17 requirement resulting from the difference between the rate of return applied during that period
18 (8.58%), and the rate of return eventually adopted for the period (8.34%). This account is
19 currently being amortized, and ratepayers are receiving a surcredit.

20 DRA notes that, according to Preliminary Statement AH, interest should be included in
21 this account.⁵³ Cal Water agrees and will recalculate the balance to include interest. As a
22 result, Cal Water therefore seeks authority re-amortize any amounts remaining in the account
23 after the authorized surcredit has runs its course, and to subsequently close the memo account.
24 DRA does not appear to object to this approach.

25 **8.2 – Item 12: Kern River Improvement Memorandum Account (“KRIMA”) (No**
26 **preliminary statement)**

27 No transactions have been recorded in this account. Cal Water and DRA agree that the
28 account should be closed.

⁵³ *Id.* at page 2-30 to 2-31.

1 **8.2 – Item 13: Salinas Water Treatment Memorandum Account (“SWTMA”) (No**
2 **preliminary statement).**

3 There is no balance in this account. Cal Water and DRA agree that the account should
4 be closed.

5 **8.2 – Item 14: General Office Synergies Memorandum Account (“GOSMA”) (No**
6 **preliminary statement).**

7 There is no balance in this account. Cal Water and DRA agree that the account should
8 be closed.

9 **8.2 – Item 15: Incremental Cost Balancing Accounts (“ICBAs”) (No preliminary**
10 **statement)**

11 The remaining balances in these accounts are the result of over- or under-amortization.
12 Cal Water requested authority to move these balances to a general balancing account for
13 further amortization, and to subsequently close the ICBAs. DRA does not object. (DRA M/B
14 Accounts Report, page 2-40.)

15 **8.2 – Item 16: American Job Creation Act True-Up Mechanism (“AJCA Adj**
16 **Mechanism”) (No preliminary statement)**

17 DRA has reviewed the calculations for this mechanism, which were provided in the
18 Direct Smegal Testimony. DRA agrees that \$287,822 should be refunded to ratepayers, and
19 that the mechanism should then be discontinued. (DRA M/B Accounts Report, page 2-42.)
20

21 **8.3 – SPECIAL REQUEST 12: MEMO AND BALANCING ACCOUNTS CWS PROPOSES TO**
22 **CONTINUE**

23 **8.3 – Item 1: Low Income Ratepayer Assistance Memorandum Account**
24 **(“LIRAMA”) (Preliminary Statement H)**

25 In the Direct Smegal Testimony, Cal Water requested recovery for \$645,978 in
26 administrative costs related to the main LIRA program since the inception of the program in
27 2006.⁵⁴ Cal Water explained in data request responses that the correct amount is \$586,502,
28 and that these costs do not include those related to the data-sharing aspect of the program.⁵⁵
29 DRA recommends that approximately \$246,547 in labor costs (internal labor + benefits) should

⁵⁴ Direct Smegal Testimony (Testimony No. 1) at 38 and Attachment E.

⁵⁵ CWS Response to MSD-007, Question 14(f); DRA MA/BA Report at pages 3-5 to 3-6.

1 be removed from recovery because no documentation was provided to demonstrate that the
2 costs are incremental.⁵⁶

3 The costs associated with the main LIRA program (not those for data-sharing) are
4 booked as a regulatory asset on Cal Water's balance sheet. They have not been picked up in
5 the operating statement or rates, and therefore are incremental to Cal Water's proposed rates.
6 As discussed in Section 8.1, above, the LIRA administrative costs were not included in rates,
7 and therefore were "off-book" from a ratemaking perspective. Therefore the full amount of
8 \$586,502 should qualify for recovery.

9 In addition, the LIRA memo account continues to incur costs for both the main LIRA
10 program and for data-sharing, some of which are incremental. The Commission should allow
11 Cal Water to recover the costs incurred in this account up through the end of the GRC period
12 currently in effect.

13 Finally, due to different pagination in Cal Water's copy of D.06-11-053, Cal Water did not
14 identify the annual LIRA report in the decision. Cal Water has evidently been out of compliance
15 and will correct this oversight in the future.

16 **8.3 – Item 2: Conservation Expense Balancing Account ("CEBA") (Preliminary**
17 **Statement Z)**

18 DRA and Cal Water agree that this account should be amortized at the end of the rate
19 case cycle, and that the account should continue to the extent that conservation funds continue
20 to be tracked and be subject to a one-way balancing account.

21 **8.3 – Item 3: Health Care Memorandum Account ("HCMA") (Preliminary Statement**
22 **AB)**

23 While Cal Water and DRA both support closing this memo account, Cal Water first
24 requests amortization of the balance that will be in the account when new rates go into effect
25 (currently anticipated to be January 1, 2014). While DRA asserts that no amounts qualify for
26 recovery because Cal Water could not provide a balance during the discovery period, Cal Water
27 explains in Section 8.1 that rigidly applying this principle in all circumstances is not in the public
28 interest.

29 Cal Water has now determined that approximately \$438,600 were incurred over the
30 course of 2011 and 2012 to implement the required health care changes. In addition, illustrate
31 the magnitude of possible expenses that will be incurred in 2013, one employee has now hit Cal

⁵⁶ DRA MA/BA Report, page 3-6.

1 Water's historical lifetime maximum of \$1,000,000, and exceeded that amount by \$224,452.
2 This excess amount meets the criteria established for the memo account. Cal Water therefore
3 requests authority to amortize this account after new rates are implemented, and then close the
4 account.
5

6 **8.3 – Item 4: Pension Cost Balancing Account (“PCBA”) (Preliminary Statement**
7 **AA)**

8 DRA agrees with Cal Water's proposal to amortize this account (upon appropriate review
9 and Commission approval), and to continue it for the next rate case period, with the exception
10 that DRA rejects the future inclusion of expenses for the Supplemental Executive Retirement
11 Plan (“SERP”).⁵⁷ Because Cal Water disagrees with DRA regarding the reasonableness of
12 including the SERP in revenue requirements, Cal Water also disagrees with its exclusion from
13 the Pension Cost Balancing Account.

14 **8.3 – Item 5: Pressure Reducing Valve Memorandum Account (“PRVA”)**
15 **(Preliminary Statement AC)**

16 DRA's recommendation that this memo account be closed is based in part on the
17 mistaken conclusion that the project, which is related to the Operational Energy Efficiency
18 Program (“OEEP”), is closed because the OEEP itself is closed as described in the discussion
19 of the OEEP memo account. In fact, while Cal Water is not currently incurring costs for the
20 project, the company has stated, as quoted in DRA's report, that it is awaiting further activity by
21 the consultant, Black and Veatch (“B&V”), who is currently occupied with San Jose Water
22 Company's PRV project. DRA offers no other basis for concluding that this project has ended.
23 The Commission should therefore allow this account to continue as authorized in Resolution W-
24 4854.

25 **8.3 – Item 6: International Financial Reporting Standards Memorandum Account**
26 **(“IFRS MA”) (No Preliminary Statement)**

27 Cal Water and DRA disagree on the timetable on which the Securities and Exchange
28 Commission (“SEC”) will require compliance with IFRS. DRA argues that, because “it does not
29 appear likely that IFRS will be required to be adopted by U.S. corporations during this GRC
30 cycle, DRA recommends that this account be closed.”⁵⁸ Nevertheless, in the 2009 GRC, Cal

⁵⁷ *Id.* at 3-17.

⁵⁸ DRA MA/BA Report at page 3-23.

1 Water and DRA were able to agree that a triggered memo account to capture expenses to
2 comply with IRFS was appropriate.

3 While Cal Water has yet to incur costs for compliance with IFRS, DRA does not argue
4 that Cal Water will have to comply with IFRS, that the costs incurred will not be significant, or
5 that Cal Water can properly forecast the costs. Given that these key elements are not
6 challenged, and the only dispute is whether the trigger for the costs will occur in 2014, 2015, or
7 2016, the Commission should continue the account because no harm to ratepayers will occur if
8 the account is not triggered.

9 **8.3 – Item 7: Infrastructure Act Memorandum Account (“IMA”) PU Code Section**
10 **790 (No Preliminary Statement)**

11 DRA urges the Commission to order Cal Water to file a Tier 2 advice letter with “ a
12 complete audit trail showing how the dollars are used from Account 526100 to fund utility plant
13 projects and should identify the balance in the account...” “...within 60 days of a final decision in
14 this case.”⁵⁹

15 Cal Water provided DRA with a list of properties sold since 2003, including the original
16 cost, sale date, transaction cost, and gain/loss. For activities in 2003 and earlier, the
17 Commission reviewed Cal Water’s transactions without requiring that Cal Water provide the
18 “audit trail” requested by DRA. DRA states that Cal Water “has made significant investments in
19 plant subsequent to D.06-05-041, however, CWS has not tracked how these gains were used
20 as the primary source of capital....”⁶⁰ DRA does not articulate what such a resource-intensive
21 undertaking would yield in terms of benefits to the Commission or ratepayers. Given the lack of
22 any evident public interest in the results of the audit requested by DRA, the Commission should
23 deny this request.

24 **8.3 – Item 8: Rate Support Fund Balancing Account (“RSF”) (No Preliminary**
25 **Statement)**

26 Cal Water agrees with DRA that administrative expenses associated with the RSF
27 program should not be included in the RSF memorandum account.

28 DRA observes that Cal Water did not comply with the requirement to report certain
29 information in its GRC Application. Cal Water agreed as follows in its 2009 GRC settlement:

- 30 1) provide information separate from other accounts, such as the Low Income
31 Rate Assistance account; and

⁵⁹ *Id.* at 3-30.

⁶⁰ *Id.*

2) provide updated information for each district, on income levels, usage levels, rate base per customer, availability of public loan funds and average bills in each rate area and provide its assessment, based on this information, of whether any additional rate areas should receive subsidies from the RSF program, or if any current RSF rate areas should no longer receive RSF subsidies.

In response to a data request response, Cal Water provided the information requested in Item 1 above. Cal Water provides the following information as requested in Item 2:

- Cal Water currently offers the RSF credit to three districts, Antelope Valley (Fremont and Lake Hughes Areas), Kern River Valley, and Redwood Valley. In its Application Cal Water reviewed LIRA participation rate, income levels, typical bills, district's Tier 1 rate relative to the median Tier 1 rate across Cal Water's 23 districts, the 3/4" x 5/8" service charge relative to the median service charge for 3/4" and 5/8" service charges, and unemployment rate, to identify additional rate areas that should receive subsidies. Based on these criterias, Cal Water assessed that the Leona Valley, and Lancaster Valley areas of the Antelope Valley District as well as the Oroville District should also receive RSF credit. Based on the noted criterias, Cal Water assessed that the districts currently receiving the RSF credit should continue to receive the credit.
- Cal Water did not assess its districts using the same criteria as those noted from D.10-12-017 in its Application. The requested information as outlined in the settlement agreement in is included in the table below.

District	Median Income	Ratebase Per Customer	Usage (kccf)
AV	\$71,211.00	\$3,909	341.9
KRV	\$48,021.00	\$4,192	321
RDV	\$25,323.00		
CSP	\$25,323.00	\$9,494	6.4
LUC	\$25,323.00	\$3,056	67.8
UNI	\$25,323.00	\$3,707	26.7
BK	\$54,656.00	\$1,958	8,156.9
BAY	\$92,861.33	\$1,286	5,187.4
BG	\$250,001.00	\$2,817	4,564.4
CH	\$41,632.00	\$1,212	3,735.6
DIX	\$72,626.00	\$2,434	416.8
DOM	\$59,598.00	\$1,018	4,233.4
ELA	\$37,271.00	\$1,748	3,321.0
HR	\$102,289.00	\$1,223	2,893.0
KC	\$52,634.00	\$3,376	341.3
LIV	\$96,322.00	\$1,317	3,030.2
LAS	\$151,856.00	\$1,894	3,876.5
MRL	\$37,836.00	\$1,721	198.3
ORO	\$35,678.00	\$2,316	356.7
PV	\$159,038.00	\$968	6,260.7

SLN	\$50,568.00	\$2,113	3,386.2
SEL	\$42,459.00	\$1,773	823.1
STK	\$47,365.00	\$1,258	5,684.1
VIS	\$54,019.00	\$1,093	7,509.5
WLK	\$113,852.00	\$1,571	2,153.1
WIL	\$43,493.00	\$1,718	288.0

- 1
- 2
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- 6
- Cal Water researched potential public loans funds that it may apply for these districts. There are two potential public loans related to water utilities as noted below. The projects Cal Water proposed in this instant GRC are not eligible for public funding.

Funding Opportunities			
Program	Eligible Projects	Max Award	Matching
Integrated Regional Water Management Implementation Grants (Department of Water Resources)	Provides funding for projects that assist in meeting long term water needs of the state including the delivery of safe drinking water and the protection of water quality and the environment. *Must work through the regional IRWM process	Varies	25% match required
Delta, San Joaquin, and Sacramento River Water Quality Grants (Department of Water Resources)	Provides funding to implement Delta water quality improvement projects that protect drinking water supplies. Eligible projects are: a) Projects that reduce or eliminate discharges of salt, dissolved organic carbon, pesticides, pathogens and other pollutants to the San Joaquin River; b) Projects that reduce or eliminate discharges of bromide, dissolved organic carbon, salt, pesticides and pathogens from discharges to the Sacramento River; c) Projects at Franks Tract and other locations in the Delta that will reduce salinity or other pollutants at agricultural and drinking water intakes; and d) Projects identified in the June 2005 Delta Region Drinking Water Quality Management Plan, with a priority for design and construction of the relocation of drinking water intake facilities for in-delta water users.	Varies	Varies, 10-50%

7

8

9

8.3 – Item 9a: Stockton Litigation Memorandum Account (“SLMA”) (Preliminary Statement AD)

10 DRA agrees with continuation of this account, but expresses valid concern about Cal

11 Water’s failure to provide bi-annual reports as agreed-upon in the preliminary statement. This

12 outcome was an oversight on Cal Water’s part, and is being addressed as part of Cal Water’s

13 modifications to the management of its memo and balancing accounts.

14 At this time, Cal Water can informally provide the following report on the status of the

15 relevant litigation: SEWD and Central had a settlement meeting earlier this year at which they

16 reached a tentative settlement. Cal Water and the City of Stockton did not participate in the

17 meeting, and subsequently rejected the agreement as not being in the interests of customers. A

1 settlement meeting with all parties is scheduled for May 15th (actual discussions will be
2 confidential). If needed, a court hearing has been scheduled for early July 2013.

3 **8.3 – Item 9b: Operational Energy Efficiency Memorandum Account (“OEEMA”)**
4 **(Preliminary Statement X)**

5 DRA and Cal Water agree that this account should be closed because all projects are
6 complete. However DRA disagrees with allowing Cal Water to recover costs associated with
7 the OEEPMA projects that Cal Water had thought were already in the company’s beginning
8 plant balance for this rate case. If the projects had been completed and closed to plant by
9 December 31, 2011, which was Cal Water’s original understanding, the balance in this account
10 would be zero.

11 Through the process of responding to DRA’s data requests, however, Cal Water
12 determined that only the Chico project (PID 10950) (completed at \$143,561.40) was included in
13 the beginning plant balance. The Bakersfield project (PID 36947) was completed at a cost of
14 \$61,433.63 but did not close to plant until April 2012, while the Visalia project (PID 28649) was
15 completed at a cost of \$82,695.31 but has not yet been closed to plant.⁶¹ There are many times
16 during the course of this proceeding that Cal Water or DRA have discovered errors in data, and
17 the parties have worked reached an understanding that errors would be corrected, often to the
18 benefit of the ratepayer. As discussed in the Introduction to this chapter, Cal Water does not
19 agree with DRA’s position that a “zero” balance in an account automatically disqualifies an
20 account from potential amortization.

21 **8.3 – Item 9c: Lucerne Balancing Account (“LBA”) (Preliminary Statement T)**

22 DRA and Cal Water agree that this account should continue. DRA also recommends re-
23 filing of AL1963-A to prevent future confusion caused by current language in the filing. While
24 Cal Water is agreeable, this approach may not be the most efficient use of resources, and may
25 unnecessary cause confusion with DWA staff.

26 **8.3 – Item 9d: Department of Toxic Substances Control Memorandum Account**
27 **(“DTSC MA”) (Preliminary Statement P)**

28 DRA and Cal Water agree that this account should continue. In addition, Cal Water is in
29 conceptual agreement with the adjustment recommended by DRA.

⁶¹ Projects that are “completed” are generally considered to be “in service” and “used and useful.” Completed projects are generally not “closed to plant” by the accounting team, however, until the company determines that the invoices for all costs associated with the project are likely to have been received.

1 **8.3 – Item 9e: Wausau Insurance Litigation Memorandum Account (“WMA”)**
2 **(Preliminary Statement K)**

3 DRA and Cal Water agree that this account should continue. In addition, Cal Water
4 agrees with the adjustment recommended by DRA.

5 **8.3 – Item 9f: MTBE Memorandum Account (“MTBE MA”) (Preliminary Statement**
6 **F)**

7 DRA and Cal Water agree that this account should continue.

8 **8.3 – Item 9g: Tort Litigation Memorandum Account (“TLMA”) (Preliminary**
9 **Statement U)**

10 DRA and Cal Water agree that this account should continue.

11 **8.3 – Item 9h: PCE Memorandum Account (“PCE MA”) (Preliminary Statement V)**

12 DRA and Cal Water agree that this account should continue.

13 **8.3 – Item 9i: TCPA Memorandum Account (“TCPA MA”) (Preliminary Statement**
14 **W)**

15 DRA and Cal Water agree that this account should continue.

16 **8.3 – Item 9j: CalTrans Litigation Memorandum Account (“CTLMA”) (Preliminary**
17 **Statement AF)**

18 See Section 8.1.3 of this book.

19 **8.3 – Item 9jk: Catastrophic Event Memorandum Account (“CEMA”) (Preliminary**
20 **Statement AG)**

21 DRA and Cal Water agree that this account should continue.

22 **8.3 – Item 10: Water Contamination Litigation Memorandum Account (“WCLMA”)**
23 **(No Preliminary Statement)**

24 DRA and Cal Water agree that this account should continue.

25 **8.3 – Item 11: Water Cost-of-Capital Adjustment Mechanism (“WCCM”)**
26 **(Preliminary Statement S)**

27 DRA and Cal Water agree that this account should continue.

1 **8.3 – Item 12: D.08-08-030 Conservation Memorandum Account (“D.08-08-030**
2 **MA”) (No Preliminary Statement)**

3 DRA and Cal Water agree that this account should be closed. There is no balance in
4 this account.

5

6

CHAPTER 9: INJURIES AND DAMAGES (DARIN DUNCAN)

Injuries and damages include workers' compensation as well as general liability insurance. Cal Water uses actuarial projections from the Milliman Group for worker's compensation for the test year. DRA agrees with the Milliman Group's estimate for worker's compensation for the test year. For liability insurance, Cal Water uses the five-year average based on the most recent five years and includes a 5% annual escalation based on Cal Water's insurance provider's recommendations (Marsh) to arrive at an estimate of \$2,432,000 for the test year. **DRA agrees with using a five-year average**, but disagrees with the 5% annual escalation and recommends using inflation factors to escalate liability insurance expense. Liability insurance expense comprises of a premium fee and uninsured losses. The uninsured losses are claims that are below the deductible threshold of \$500,000, for which Cal Water is responsible. In 2012 Cal Water incurred a total of \$2,763,600 in liability insurance. DRA's recommended liability insurance estimate of \$2,176,000 grossly understates Cal Water's current liability. **Cal Water requests the Commission adopt its estimate for liability expense, to reflect a closer estimate to the true insurance liability that Cal Water has been experiencing.**

The difference in Cal Water's estimate in its Application and the Rebuttal estimate is attributable to Cal Water's removal of manual adjustments to the recorded expenses related to non-tariffed products and services. For a detailed discussion on this, please see Chapter 3 for a detailed discussion on NTPS.

For the total estimate on injuries and damages, Cal Water requests the Commission adopt its estimate of \$3,564,600.

Injuries and Damages Expense Comparison

	2014
CWS Application	3,914,018
DRA Report	3,306,768
CWS Rebuttal	3,564,647
DRA v. CWS	257,879

1 **CHAPTER 10: CUSTOMER SERVICE (DARIN DUNCAN)**

2 DRA finds CWS' customer service efforts to be acceptable. As noted our records show
3 that the company and the Consumer Affairs Branch (CAB) have received minimal service
4 complaints in 2009, 2010, 2011 relative to the number of customers served. DRA however has
5 a few recommendations, which Cal Water is agreeable to as noted below.

6
7 DRA recommends CWS initiate some system or cost-effective way to track the number
8 of calls, and type of calls in Antelope Valley, Kern River Valley, and Redwood Valley
9 Districts.

10
11 Cal Water is currently evaluating its overall IT structure regarding possible cost-effective
12 options to improve or enhance the tracking of calls received.

13
14 Further DRA recommends that CWS find a cost-effective way to track the type or
15 category of each call in all of its districts so we can better address customer complaints
16 and concerns.

17
18 Cal Water will meet and confer regarding possible cost-effective options to improve or
19 enhancing the tracking and type of calls received.

20
21 DRA recommends that due to the water quality issues and concerns in the Lucerne
22 service area that CWS monitor water quality complaints closely.

23
24 Cal Water will continue monitoring water quality complaints closely in the Lucerne
25 service area. We will also take appropriate action to resolve, eliminate, or prevent a repeat
26 water quality occurrence.

27
28 DRA's investigations did not find any industry standard for an average number of calls
29 per connection; DRA recommends that Cal Water use its company-wide average of 2
30 calls per connection as a benchmark for all its districts as a means of measuring
31 customer satisfaction with their service.

32
33 Cal Water is agreeable to using the 2-call per connection as a benchmark for
34 investigation complaints further.

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DRA recommends the Call Abandonment standard should be monitored and met going forward. CWS should report the Call Abandonment rate in the next GRC.

Cal Water started reporting this measurement in the most recent 2012 annual report to the commission. Cal Water will continue to monitor this and report back in the next general rate case.

1 CHAPTER 11: WATER QUALITY (CHET AUCKLEY)

General	Issue for correction	Page, line
Ch. 29 Cross connection	<ul style="list-style-type: none"> It is not viewing each assembly that is too labor intensive. A detailed survey of each property, to determine if an assembly is needed, is too labor intensive for customers that are very likely to need an assembly due to the nature of their business. Page 29-2 lines 14-18 state the issue accurately. CWS does conduct an assessment of each non-residential customer, and that is done on-site, however, it is not a detailed internal survey of cross-connections. An assessment is required of all connections, not just those that have a change in occupancy type. CWS cannot conduct a “comprehensive survey on all of its customers” with the current resources. Only non-residential customers, and high risk residential customers are being evaluated for installation of assemblies. 	<p>29-1, 16 to 19</p> <p>29-1, 18</p> <p>29-2, 11 to 12</p> <p>29-2, 28 to 29 and 29-3, 1 to 2</p>
Firm Capacity	Will help engineering develop response as needed.	
Nitrification BAY, LAS, LIV	<p>Response summary and reference documents provided.</p> <p>Review by WQ and Engineering management and a final draft in place for integration to the summary response forms.</p>	
TCPA BK area, VIS		
AV	No corrections needed	
BK	<ul style="list-style-type: none"> “The three water systems in CWS’s Bakersfield District serve approximately 71,800 connections...” Should be two water systems and serves 89,837 connections. 	Pg 11-1, Ln 16 to 17
BAY	None – Addressed in Tank Turnover Projects	
BG	None – Proposed projects allowed	
CH	<ul style="list-style-type: none"> Cal Water begins closely monitoring the nitrate in groundwater wells when the level reaches 50% of the MCL, or 22.5 mg/L (annual to quarterly monitoring). Corrective action begins at 80% of the MCL. Four of the nine active wells that contain PCE have levels above the MCL and are equipped with GAC treatment. No additional treatment is planned because there is no compliance issue. Typo- change perused to pursued Food grade oil is used due to the risk of pumping OIL, not water into the system. 	<p>Pg 11-1, Ln 23 to 24</p> <p>Pg 11-2 Ln 6 to 8</p> <p>Pg 11-3 Ln 19</p> <p>Pg 11-4 Ln 5-6</p>
DIX	Summary Response provided for justification of Well 4 based	

	on Water Quality risks. Reviewed by WQ Manager and in rebuttal folder awaiting incorporation into response form.	
DOM	<ul style="list-style-type: none"> • Typo – Pirnie • Misleading quote from Malcolm Pirnie report. In addition to the treatment recommendation for the use of carbon, disinfecting with chloramines would reduce the potential of a DBP Rule violation. Previous treatment was breakpoint chlorination, which resulted in higher DBPs forming. • There are nine active wells and also verified it in the DPH Inspection report that they reference. • Remove “taste” • Replace “oxidize” methane with “remove” methane • Typo – “produces water with elevated [in] hardness levels – take out [in]” • Add in manganese • Typo – should say “continuous” 	<p>Pg 7-13, Ln 10 Pg 7-13, Ln 10-15</p> <p>Pg 11-1, Ln 21 Pg 11-2, Ln 9 Pg 11-2, Ln 17 Pg 11-2, Ln 19 Pg 11-2, Ln 20 Pg 11-3, Ln 1</p>
ELA	<ul style="list-style-type: none"> • There are nine active status wells 	Pg 7-8, Ln 16
HR	<ul style="list-style-type: none"> • TDS and conductivity have ranges on the SMCL. TDS and conductivity levels at well 22-01 is above the recommended SMCL, and slightly below the Upper SMCL. 	Pg 11-2, Ln 16-17
KRV	No corrections needed	
KC	No corrections needed	
LIV	No corrections needed	
LAS	None – All WQ projects allowed	
MRL	<ul style="list-style-type: none"> • Two active wells have manganese over the SMCL and are equipped with ATEC systems. One standby well (10-01) is above the SMCL for manganese and an ATEC system is being installed. One inactive well (14-01) is above the SMCL, had an ATEC system recently installed and the well is now Active. 	Pg 11-1 Ln 21-24
ORO	<ul style="list-style-type: none"> • Nothing to add 	
PV	<ul style="list-style-type: none"> • There are three steel storage tanks and fourteen concrete reservoirs. • Not sure if want to add that lower water demand may lead to nitrification problems in the reservoirs. 	<p>Pg 11-2, Ln 7-8 Pg 11-2, Ln 9-10</p>
RDV	Lucerne – Approval for a fraction of the estimated amount for Stage 2 DBP through aeration was accepted, with pending pilot test results, extended expenses to be considered.	
SLN	<p>Four individual permits from CDPH, and one permit from Monterey County for Country Meadows Mutual. CDPH and Monterey County are primary agencies...</p> <p>The latest amendment is for the addition of ion exchange</p>	<p>Pg. 118 Ln 5 – 6</p> <p>Ln 8-10</p>

	treatment at station 103, dated July 2011. Operates one system (Foothill Estates) Ix units 6-01, not 60-01	Ln 11-12 Pg 120 ln 16
SEL	<ul style="list-style-type: none"> • There are now 14 active wells • Well 22-01 went online 1-13 	Pg. 77 ln. 2 Pg. 77 ln. 3
STK	Greensand at well 76-01, not 85-01 49-01 is not standby	Pg. 97 ln 3 Ln 4
VIS	The Visalia District has 73 active wells	Pg. 11-1, Ln 6
WLK	CWS does not operate “three water systems” in the WLK district.	Pg. 84 (11-1), Ln 4
WIL	Cal Water does not have any comments for this District.	

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1 **CHAPTER 12: RATE DESIGN (TOM SMEGAL)**

2 Cal Water is not proposing changes to the tier breaks or any other substantial
3 modifications to the rate design structure initially adopted in the settlement agreement in the
4 Commission’s Conservation OII proceeding (D.08-02-036 in I.07-7-022). Cal Water, however,
5 proposes minor adjustments to the service-charge component. The rate design adopted in I.07-
6 01-022 was calculated to recover approximately 35% of the fixed costs of a district, and
7 ministerial rate design changes since the Conservation OII decision have caused some rate
8 structures to stray from this principle. In the Application in this proceeding, Cal Water’s
9 proposed adjustments modify the average flat-rate customers’ portion of revenue recovery to
10 ensure equity between the flat-rate customers’ rates and the metered customers’ rates. The
11 adjustments also modify the service charge revenue proportions in many districts to bring them
12 closer to recovering 35% of the fixed cost in each district.

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1 **CHAPTER 13: REBUTTAL TESTIMONY IN RESPONSE TO THE**
2 **UTILITY REFORM NETWORK (“TURN”) (TOM SMEGAL)**

3 **13.1. WORKING CASH**

4 The Commission should not approve Mr. Peterson’s proposal to omit depreciation and
5 deferred taxes, and to include interest on long-term debt, run counter to the Commission’s
6 stated practice and consistently applied methodology for calculating working capital
7 requirements. In addition to unbroken past practice, there is good fundamental logic for
8 including depreciation and deferred taxes at zero lag days. Finally, if the Commission were to
9 introduce long-term debt as a component of working capital, Cal Water should be allowed to
10 introduce the seasonality of revenue as an offsetting component of working capital. I do not
11 recommend the Commission do either. The Commission should retain its standard practice.
12

13 **How has Cal Water calculated its working capital requirements?**

14 Cal Water used as its basis the principles and examples of CPUC Standard Practice U-
15 16. It is my understanding that standard practice U-16 has been used as the methodological
16 basis for substantially all working capital requirements calculations before the Commission for
17 many decades.
18

19 What does Standard Practice U-16 describe regarding depreciation?

20 “Since book depreciation expense is occurring uniformly day by day and
21 accumulated depreciation is deducted from the rate base, the practice is to
22 include depreciation provisions at zero lag days.”
23

24 **Is there good reason for the Commission to continue this approach?**

25 Yes, Mr. Peterson states,

26 ...Cal Water does not issue checks at the end of each month to investors
27 for depreciation expense, even though it recovers a depreciation allowance from
28 customers each month in rates.⁶²
29

30 Mr. Peterson is effectively incorrect because he is thinking only of the cash, not the
31 effect of the cash on rate base. By reducing the amount of authorized rate base each month by
32 the additional accrued depreciation, the Commission does assume that the investor is returned

⁶² Peterson testimony, Page 6

1 exactly the amount of depreciation required in the month. Because of that return of capital, the
2 Commission concludes that amount is no longer among the investments the utility is allowed to
3 earn a return on. By proposing that depreciation expense not be reflected as a cash item
4 payable on the day of accrual, Mr. Peterson is actually conceding that Cal Water's weighted
5 average rate base should be recalculated at a higher value. If depreciation can be returned to
6 the investor whenever it is convenient, or consistent with payment lags, then the authorized rate
7 base should be modified to reflect payment lag in the calculation of weighted average
8 depreciation reserve. Adjusting the weighted average rate base to reflect the payment lag
9 would have the same revenue requirement as removing depreciation from the working cash
10 calculation. Therefore, there is no benefit to removing depreciation.

11 For a more detailed explanation of this concept, the Commission can review *"Accounting*
12 *for Public Utilities, Section 5.04(4), Matthew Bender and Co., by Robert L. Hahne and Gregory*
13 *E. Aliff."*

14

15 **Does the same principle apply to the calculation of deferred federal income taxes?**

16 Yes, deferred taxes are clearly identified as requiring zero lag days in Standard Practice
17 U-16, paragraph 45, which states:

18 For utilities which have used accelerated amortization to reduce income
19 taxes, the Commission, in fixing rates, has permitted normalization of the income
20 tax expense, thereby offsetting the reduction in the tax, but has deducted from
21 the rate base the average accumulated deferred taxes due to accelerated
22 amortization. Therefore, for those utilities where rates have been set on this
23 procedure, the lag days for the offsetting amount due to accelerated amortization
24 should be zero. The reason for this is that the adjustment is already included in
25 the rate base, and to assign the same lag days as for the actual income taxes
26 would in effect be doubling the deduction from working cash.

27

28 **Does Standard Practice U-16 also explain the treatment of periodic interest**
29 **payments on long term debt?**

30 Yes, the standard practice explains past precedent in paragraphs 31-33. To paraphrase,
31 since the 1930's the Commission has used the "cost method" instead of the "retail method" to
32 determine working capital. The cash method specifically excludes return components, such as
33 interest payments, from working capital.

34

35 **If the Commission were to consider this deviation from standard practice, are**
36 **there any potentially offsetting changes the utility might propose?**

37 Yes, as Cal Water's rates are redesigned through the flat-to-meter program with
38 increasing block residential commodity rates, much more of the company's revenue is earned in

1 the months of June through September each year. Cal Water and DRA have agreed to target
2 around 35% of fixed costs recovered through service charges, with the remainder recovered
3 through variable charges. Nevertheless, fixed costs occur by their nature more evenly
4 throughout the year. Since Cal Water's revenues in the first six months of the year are
5 (significantly ?) lower than the last six months of the year, stockholder funds are required to
6 offset any negative cash flow, neutralizing any benefit of a lag in interest payments later in the
7 year.

8

9 **Even if he were correct, is this the appropriate venue for Mr. Peterson's proposals**
10 **to be adopted by the Commission?**

11 No, since the cost-of service regulated utilities currently use the Commission's standard
12 practice to calculate working capital, it would be inappropriate for the Commission to consider
13 changes for one utility without the input and discussion of all parties. Such a change should only
14 be considered after deliberation in a cross-industry rulemaking.

15

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1 **CHAPTER 14: REBUTTAL TESTIMONY IN RESPONSE TO JEFFREY**
2 **YOUNG (DARIN DUNCAN)**

3
4 The Rate Support Fund (“RSF”) program was adopted in 2006 in Decision 06-08-011.
5 The intent of this support fund is to help mitigate the rate impact to customers in districts that
6 have a small customer base, low-income levels, and high per-unit water rates. The intent of the
7 RSF is that in each rate case, as rates increase to increase the RSF proportionately with the
8 rate increase approved. Cal Water recognizes the need for affordable water in districts such as
9 Redwood Valley since the impact on each customer is more profound when there is a small
10 customer base upon which to allocate the cost of service. Cal Water is open to discussing
11 ideas and modifications to the Rate Support Fund in an effort to make water rates more
12 affordable in those districts where there is a small customer base, low income levels, and high
13 per-unit water rates.

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1 **CHAPTER 15: WRAM AND MCBA**

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3 **15.1 SCOPE OF TESTIMONY & SUMMARY OF RECOMMENDATIONS (DAVID MORSE)**

4 The purpose of this testimony is to respond to the Testimony of DRA in the Report
5 “Company-Wide Report on the Results of operations of California Water Service Company,”
6 (“DRA Report”) dated March 1, 2013 concerning issues of Water Revenue Adjustment
7 Mechanisms and Modified Cost Balancing Accounts (“WRAM/MCBA”) and non-residential rate
8 design and the “Direct Testimony of Scott J. Rubin on Behalf of the Utility Reform Network
9 (TURN) Concerning Rate Design, dated March 22, 2013, ” (“TURN Report”) concerning a
10 proposal for a tiered WRAM surcharge. My qualifications are in my testimony that addresses
11 conservation rates for non-residential customers.⁶³

12

13 The following is a summary of this Rebuttal Testimony:

14 Cal Water has complied with the requirements of D. 12.04-048 in addressing the five
15 WRAM/MCBA options. The five options should not apply, Cal Water’s WRAM/MCBA is
16 operating as intended. The five options do not address the fundamental problem causing large
17 WRAM/MCBA balances: inaccurate sales forecasts. No party has proposed any of the five
18 options. There is no need for Cal Water to further address these five options in the next GRC.

19 Cal Water has fulfilled the requirements of D. 10-12-017 paragraph #13 addressing the
20 pros and cons of increasing block rates for non-residential customers. No party disagrees with
21 Cal Water’s conclusion that increasing block rates are not appropriate for non-residential
22 customers.

23 Collection of WRAM/MCBA surcharges should remain as an overall surcharge and not
24 allocated to individual residential tiers. Cal Water opposes this proposal: it is contrary to
25 TURN’s basic ratemaking principles: practicality, including simplicity, understandability, ability to
26 implement and public acceptability, clarity in its interpretation, and stability in revenues from
27 year to year. Furthermore the proposal is likely to create intertemporal equity issues due to
28 delays in full revenue recovery

⁶³ Please see “CWS Company Report #4,” the Direct Testimony of David Morse entitled “Non-residential Rate Design Testimony In Compliance with Ordering Paragraph 13” (“Direct Morse Report on Non-Residential Rate Design”).

1 15.2 COMPLIANCE WITH D. 12-04-048 REGARDING FIVE OPTIONS TO WRAM/MCBA

2 Cal Water’s Company Report No. 8 (“Company Report #8”) ⁶⁴ fulfills the requirements of
3 D. 12-04-048, ordering paragraph 5. DRA references the Company report #8 in its comments
4 on Cal Water’s Special Request #3 – Rate Design Pilot (“DRA”). ⁶⁵ Cal Water’s Special Request
5 #3 is addressed in GRC Testimony #1 (“Company Report #1”). ⁶⁶ Mr. Smegal’s testimony
6 supports the current Conservation Rate Design Pilot with modifications to the residential tiered
7 rate design. ⁶⁷ DRA’s recommends that “the Calculation of WRAM/MCBA amounts should
8 exclude non-revenue water, be adjusted to reflect the actual pace of meter conversions, and
9 reflect the revenue that is anticipated under any ‘phase-in’ program” and furthermore that “the
10 Commission should also preserve the options identified in Decision 12-04-048 for consideration
11 as greater experience with both full revenue decoupling and other pilot adjustments mechanism
12 is attained.” ⁶⁸

13 Cal Water agrees with the need to address residential flat rate and disagrees with
14 recommendations regarding unaccounted for water and WRAM/MCBA calculations of phased in
15 rates. The Cal Water response to each suggestion is described below. In response to DRA’s
16 recommendations regarding “preserving” the five options: Cal Water has fulfilled the
17 requirements of D. 12-04-048 ordering paragraph #5 and the five options do not address the
18 fundamental problem causing large WRAM/MCBA balances: inaccurate sales forecasts. No
19 party has proposed implementation of any of the five options.

20 ***Modify WRAM/MCBA To Address Conversion To Flat Rate Residential Customers***

21 DRA raises a concern about using the most current flat rate conversion in the
22 WRAM/MCBA for the seven districts where Cal Water has flat rate customers. ⁶⁹ This issue has
23 been addressed and resolved by the Commission in the prior GRC. ⁷⁰ As part of the annual
24 escalation filing, Cal Water adjusts the sales and customer count to reflect the actual flat-to-
25 meter conversion activity for the year. This translates to Cal Water incorporating the most recent
26 flat-rate customer count in the WRAM in its applicable districts. Cal Water agrees to add

⁶⁴ Please see “CWS Company Report #8,” the Direct Testimony of David Morse entitled “Compliance with D. 12-04-048 to Review Five Options” (“Direct Morse Report on WRAM”).

⁶⁵ DRA Company-Wide Report at Chapter 13.

⁶⁶ Direct Smegal Testimony (CWS Testimony No. 1).

⁶⁷ *Id.* at pages 3 and 4.

⁶⁸ DRA Company-Wide Report at page 13-2.

⁶⁹ *Id.*

⁷⁰ D. 10-12-017, Attachment C at page 505 (referencing Special Request #14).

1 language to its WRAM/MCBA preliminary statement to authorize Cal Water to annually update
2 the flat to metered customer conversions for applicable districts and true up the WRAM and
3 MCBA targets to be consistent with the flat to meter adjustments.

4 ***Inclusion of unaccounted-for water within the WRAM/MCBA calculation***

5 Cal Water opposes this recommendation. DRA recommends changes to the WRAM/MCBA
6 calculation to correct “the inclusion of unaccounted-for or non-revenue-water within the
7 WRAM/MCBA calculation.”⁷¹ DRA has not provided:

- 8 ○ Facts to back up its assertion that “Reducing the amount of system loss and
9 unbilled usage...can have a significant impact on total system demand.”⁷² DRA
10 has not produced any statistics or other evidence regarding Cal Water’s “losses”
11 or Cal Water’s specific efforts including programs to reduce losses.
- 12 ○ An explanation as to how unaccounted water is excluded in the WRAM or MCBA
13 calculation; or if it is included in the WRAM or MCBA, how it should be excluded?
- 14 ○ Reference to ratemaking precedent for such an adjustment. For example, DRA
15 has not addressed the Commission’s treatment of losses for recovery of energy
16 procurement costs.
- 17 ○ An actual proposal to address this issue, e.g. tariff language.
- 18 ○ Inclusion of revenue associated with actual “phased-in” rates

19 DRA references a necessary adjustment to WRAM/MCBA concerning the “phase-in” of
20 rates noting: “When calculating the difference between adopted and actual quantity with actual
21 “phased-in” rates will result in more accurate and smaller WRAM balances than if using revenue
22 requirements that do not reflect the actual rates of an authorized phase-in program.”⁷³

23 Cal Water has been incorporating rate phase-ins in its annual true-up filings. Since the
24 WRAM implementation in July 2008, Cal Water has had one district that adopted a rate phase-
25 in. In the 2009 General Rate Case, Cal Water had a modified Decision incorporating a rate
26 phase-in for the Selma District. In Cal Water’s annual WRAM true-up after the 2009 GRC test
27 year, Cal Water used the revenues collected with lower phased-in rates and the adopted
28 revenue requirement to estimate the balance upon which the surcharge is calculated. Cal
29 Water intends on continuing the phased-in rate revenue and the adopted revenue requirement
30 in its calculation of the WRAM and MCBA surcharge going forward. As noted in Mr. Smegal’s
31 testimony on the phase in: “Under the Commission’s practices, revenue which is phased-in

⁷¹ DRA Company-Wide Report at page 13-2.

⁷² *Id.*

⁷³ *Id.* at page 13-3.

1 must still be recovered, with interest at the utility's authorized rate of return."⁷⁴ Therefore, the
2 WRAM target revenue must be the annual authorized revenue requirement.

3 ***No need to "preserve" the WRAM/MCBA five options***

4 Cal Water agrees with measures to fine-tune the WRAM/MCBA mechanism. However,
5 there is no basis or evidence produced by DRA that supports elimination of the basic
6 Commission goal of the WRAM/MCBA, which was quoted by DRA: "...to sever the relationship
7 between sales and revenue to remove the disincentive to implement conservation rates and
8 conservation programs, to ensure cost savings are passed on to ratepayers, and to reduce
9 overall water consumption".⁷⁵

10
11 Cal Water agrees that the residential tier rates and the WRAM/MCBA should continue as
12 pilot programs and may be evaluated in its next GRC. However, Cal Water disagrees that it
13 should be ordered to address the five options in its next GRC. Cal Water has addressed all five
14 options and furthermore, the five options do not address the issue of inaccurate sales forecasts
15 resulting in large WRAM balances.

16 DRA argues that its referenced refinements demonstrate that the Commission should
17 "preserve" the five options. The five options do not address the problem of inaccurate sales
18 forecasts nor DRA's referenced refinements. DRA confuses its proposed refinements of the
19 WRAM/MCBA mechanism with fundamental basics of WRAM/MCBA. Three of the options are
20 substantially more than refinements since they would eliminate decoupling: elimination of the
21 WRAM/MCBA (option 4), bands on recoverable amount (option 2), and a Monterey-style
22 adjustment mechanism (option 1). Cal Water has addressed these three fundamental issues,
23 which are at odds with the Commission's fundamental decoupling objectives.

24 The five options also included two lessor changes, which Cal Water has also addressed
25 in detail:

- 26
- 27 • Increase surcharge on higher-usage customers (option 3): Cal Water
28 demonstrated that this option should be rejected because it significantly distorts
the tiered rate design and has no application for non-residential customers.
 - 29 • Tiered-rates for all customer classes (option 5): Cal Water concluding that tiered
30 rates are not useful for its non-residential customers.

31 Although DRA concludes that Cal Water should continue the current pilot programs, Cal
32 Water wishes to respond to a few erroneous statements made by DRA concerning

⁷⁴ CWS General Report (Company Report #1) at 10.

⁷⁵ DRA Company-Wide Report at page 13-1; D. 08-02-036 at 25-26.

1 WRAM/MCBA mechanism. DRA's review of the five options takes issues with a few of Cal
2 Water's arguments as to option 5, a "Monterey-style" adjustment mechanism ("M-WRAM").
3 DRA has not provided testimony disputing Cal Water's analysis of the other five options. There
4 is no need for Cal Water to further address the other five options: numbers 2, 3, 4, and 5. Cal
5 Water has fulfilled its obligation.

6 DRA makes four arguments concerning the suitability of an M-WRAM rather than a full
7 decoupling model. Cal Water will address each of these arguments.

8 Full decoupling reduces risk for variables well within the control of Cal Water.⁷⁶ The
9 DRA statement implies that the Commission has not properly addressed the risks issues
10 associated with WRAM/MCBA. In fact, the Commission addresses risks issues such as
11 WRAM/MCBA in the water utility cost of capital proceeding.⁷⁷ Thus the Commission addresses
12 risk associated with full decoupling and supports decoupling largely because full decoupling
13 eliminates the utility incentive to promote sales.

14 The M-WRAM does not remove the incentive to promote sales. As noted in my prior
15 testimony the M-WRAM does not remove risks for conservation pricing, the M-WRAM does not
16 track actual variable costs, M-WRAM does not work under situations where significant water
17 conservation is required.

18 Water utilities without WRAM/MCBA are having conservation success.⁷⁸ DRA references
19 San Jose Water as an example of a water utility that does not have a WRAM/MCBA but has
20 according to DRA "experienced a 20% reduction in residential consumption without decoupling."
21 First and foremost, the issue is alignment of incentives. Without full decoupling a utility has the
22 incentive to promote sales. Thus despite the good actions of water utilities to reduce
23 consumption under various orders by the Commission and others, the utility has an on going
24 incentive to increase sales.

25 In the case of San Jose Water, the company requested full decoupling in its latest
26 GRC.⁷⁹ Also, the M-WRAM does not provide proper incentives or risk recovery when dealing
27 with mandatory conservation measures. SJWC recently found it necessary to request a

⁷⁶ DRA Company-Wide Report at page 13-5.

⁷⁷ For example, see D.09-05-019, which addressed the issue of WRAM/MCBA risk for Cal Water, Golden State Water Company, and California American Water.

⁷⁸ DRA Company-Wide Report at page 13-5.

⁷⁹ See San Jose Water Company GRC A.12-01-003.

1 separate memorandum account to capture revenue shortfalls as a result of government
2 mandated consumption cut backs.⁸⁰

3 DRA makes the unsupported claim that “the vast majority of water utilities outside of
4 Commission jurisdiction ...must maintain budgets and capital programs without the revenue
5 protection of decoupling.” The largest California municipal water utility, the Los Angeles
6 Department of Water and Power does have a WRAM.⁸¹ Furthermore, California municipal
7 water utilities operate with a completely different set of financial requirements than Commission
8 regulated privately owned utilities. Even if DRA were correct about WRAMs and municipal
9 utilities, DRA has not produced any facts supporting its implied assumption that both private and
10 municipal utilities have comparable financial incentives. “...at least some of the causes of lower
11 utility revenues are likely causing utility customers to experience lower personal revenues.”⁸²
12 The DRA statement implies that Cal Water should not get its authorized revenue requirement if
13 sales are below the adopted levels; the statement also ignores the symmetrical aspect of the
14 WRAM. The WRAM tracks the difference between the Commission’s authorized revenues and
15 actual revenues. The mechanism adjusts revenues up or down to assure recovery of the
16 adopted level of revenues. Without a WRAM, Cal Water would not recover its revenue
17 requirement when sales are below the level used to calculate the authorized revenue
18 requirement. Likewise without a WRAM, Cal Water recovers in excess of its revenue
19 requirement when sales are above the level used to calculate the authorized revenue
20 requirement. Also the DRA statement ignores the fact that the Commission addresses the risk
21 issue including the WRAM/MCBA in the cost of capital proceedings.⁸³

22 Since the WRAM/MCBA is symmetrical, to the extent DRA’s claim is correct, it also
23 works in the other direction, thus “at least some causes of *higher* utility revenues are likely
24 causing utility customers to experience *higher* personal revenues.”⁸⁴

25 Cal Water disagrees with DRA’s misinterpretation of Cal Water’s references to water
26 demand. DRA quotes experts from my testimony and Cal Water’s “Report on Conservation

⁸⁰ See San Jose Water Company Advice Letter 419-B, and Res W-4885, authorization to recover \$5.4 million for lost revenues due to mandatory conservation.

⁸¹ LADWP website: “Los Angeles Water Rates...June 1, 1995 through March 19, 2012, “Furthermore, California municipal water utilities operate with a completely different set of financial requirements than Commission regulated privately owned utilities. Even if DRA were correct about WRAMs and municipal utilities the implied assumption that both private and municipal utilities have comparable financial incentives is without merit.

⁸² DRA Company-Wide Report at page 13-5.

⁸³ For example, see D.09-05-019.

⁸⁴ Direct Morse Report on WRAM at 17 (providing an overview of the proportion impacts and symmetry issues addressed by Cal Water and DRA in supporting the WRAM/MCBA).

1 Program Recommendations and Budget,” as “a good example of the general lack of
2 understanding for the environment in which full-decoupling mechanisms operate...”⁸⁵ A closer
3 examination of the full quotes shows that the statements in Cal Water’s testimony are
4 compatible.

5 The full quote of my testimony reference in part by DRA states:

6 Cal Water has experienced a significant reduction in total metered sales.
7 As noted in the Table 1 below, overall consumption per connection, of
8 358/CcF in 2004, has fallen to 299/CcF in 2011, which is a 16% reduction
9 in per connection usage. Residential per connection consumption is 17%
10 below the 2004 level. The decrease in demand cannot be precisely
11 attributed, however, it is likely that several factors have contributed
12 including: weather, the economy, and water conservation measures.
13 Water conservation measures include state government conservation
14 targets, increased usage of efficient water using appliances, water
15 conservation programs, water conservation prices, and greater general
16 awareness of water conservation issues. This sustained reduction in
17 consumption implies some level of permanent shift in water demand.⁸⁶

18 I attributed some level of permanent shift in demand to several factors including the
19 economy, weather and water conservation measures. Obviously weather and economic
20 conditions are cyclical and have affected demands recently. Conservation measures include
21 passive measures such as plumbing standards and active measures such as Cal Water’s water
22 conservation programs.⁸⁷ My testimony presumes that the Commission would continue to fund
23 water conservation programs at levels to meet state-mandated reduction requirements. Without
24 this funding, Cal Water’s Report on Conservation Program Recommendations and Budget
25 shows that most districts would not be expected to meet the state-mandated reduction
26 requirements.⁸⁸

27 **Increasing Block Rates for Non-residential Customers**

28 Cal Water has fulfilled the requirements of D. 10-12-017 paragraph #13 addressing the
29 pros and cons of increasing block rates for non-residential customers. No party has proposed

⁸⁵ *Id.* at page 13-4.

⁸⁶ Direct Morse Report on WRAM at page 3.

⁸⁷ Please see GRC Company Report #2, Report on Conservation Program Recommendations and Budget. This report takes into account plumbing codes and conversion to metered service in its forecast of 2020 demands. Additionally, it makes adjustments for slower rates of growth in services and overall demand. In determining appropriate levels of investment in conservation, the Report accounts for known factors expected to slow future growth in per service and overall demands. Recommended levels of investment were then pegged to the residual reductions needed to meet state per capita water use requirements in 2020.

⁸⁸ Please see Cal Water's rebuttal testimony on conservation, which discusses the notion of rebound, related to drought and economic conditions and the levels of investment needed to meet state per capital water use requirements in 2020.

1 increasing block rates for non-residential customers. There is no need for Cal Water to make
2 further proposals to implement increasing block rates for non-residential customers.

3 **WRAM/MCBA Surcharge Allocated to All Residential Tiers**

4 TURN recommends "... in those districts that have tiered residential rates, the WRAM
5 surcharge for residential customers also should be tiered."⁸⁹ Cal Water opposes this proposal:
6 it is contrary to TURN's basic ratemaking principles: practicality, including simplicity,
7 understandability, ability to implement and public acceptability, clarity in its interpretation, and
8 stability in revenues from year to year. Furthermore the proposal is likely to create intertemporal
9 equity issues due to delays in full revenue recovery.

10 Under Cal Water's approved WRAM/MCBA surcharge methodology, under collections
11 are amortized via a surcharge \$/CCF applied to all customers based on the consumption over
12 the amortization period. The methodology is consistent with DWA's Standard Practice U-27W,
13 for amortization of memorandum accounts.

14 TURN's rationale for the proposal is that "rate differential that are established ... remain
15 in effect."⁹⁰ TURN's proposal is at odds with several of TURN's stated "basic principles."⁹¹
16 TURN points out that it may not always be possible to meet all principles, where a principle
17 cannot be met, "the issue should be recognized and a valid basis should be given for the
18 analyst's or regulator's decision."⁹² However TURN has not recognized the inconsistencies in
19 its stated principles nor offered a basis for the analyst's decision. "Practicality, including
20 simplicity, understandability, ability to implement and public acceptability." The TURN proposal
21 violates this principle:

- 22 • Violates the simplicity principle. It would require Cal Water to have four different
23 surcharge values for each service area: three surcharges for residential
24 customers with three tiers and another surcharge for customers with non-tiered
25 rates.
- 26 • Violates the ability to implement principle: Under the current method, Cal Water
27 tracks revenues in at least five accounts for each district with three tier residential
28 rates. The TURN proposal would add another 3 accounts to track for a total of
29 eight different categories⁹³ creating administrative burdens on Cal Water and
30 Commission staff in reviewing WRAM/MCBA recovery accounts.

⁸⁹ TURN report, page 35.

⁹⁰ Ibid.

⁹¹ Ibid, page 7.

⁹² Ibid.

⁹³ Revenue accounts for each district would include revenues collected for base rates for three residential rate tiers (3 accounts), revenues collected for the surcharge for three residential tiers (3 accounts), revenues

- 1 • Violates the understandability principle. Customers already are confused about
2 surcharge rates, imbedding the surcharge into the tiered rate would create further
3 customer confusion and issues of acceptability for surcharges and rate tiers.
- 4 • “Stability in revenues from year to year.” Increasing the surcharge in the third tier
5 creates revenue recovery uncertainty. Consumption in the third tier for many
6 customers is discretionary, that is beyond the basic indoor usage requirements.
7 Thus it is less likely that Cal Water will recover the target revenue requirement
8 from all tier three customers in the first amortization period, which would require
9 extending recovery into a second or third year. Aside from the bookkeeping
10 issues this presents for Cal Water and the Commission staff, this affects stability
11 of rates from year to year as well as intertemporal equity issues.
- 12 • “Clarity in its interpretation” Cal Water believes that customers more clearly
13 understand one surcharge rather than three surcharges imbedded in the rate
14 design.

15 Cal Water opposes this recommendation. Should the Commission agree to implement
16 the TURN surcharge proposal, Cal Water requests that it be authorized to track recovered
17 surcharges by tier to assure full recovery with interest.

18 15.3 CONCLUSIONS AND RECOMMENDATIONS

19 Cal Water has complied with the requirements of D.12-04-048 in addressing the five
20 WRAM/MCBA options. The Commission should not adopt any of the five options for any of Ca;
21 Water’s districts. Cal Water’s WRAM/MCBA is operating as intended. The five options do not
22 address the fundamental problem causing large WRAM/MCBA balances: inaccurate sales
23 forecasts. No party has proposed any of the five options. There is no need for Cal Water to
24 further address these five options in the next GRC.

25 Regarding DRA’s recommended refinements to the WRAM/MCBA:

- 26 • Modify WRAM/MCBA to address conversion to flat rate residential customers:
27 Cal Water agrees, to add language to its WRAM/MCBA preliminary statement to
28 authorize Cal Water to annually update the flat to metered customer conversions
29 for applicable districts and true up the WRAM and MCBA targets to be consistent
30 with the flat to meter adjustments.
- 31 • Inclusion of unaccounted for water within the WRAM/MCBA calculation: DRA has
32 not provided facts nor language to reference unaccounted for water inclusion or
33 exclusion in the WRAM/MCBA, thus Cal Water opposes this proposal.
- 34 • Inclusion of revenue associated with actual “phased-in” rates: Cal Water is
35 currently applying this concept in its annual amortization filings.
- 36 • Cal Water has fulfilled the requirements of D. 10-12-017 paragraph #13
37 addressing the pros and cons of increasing block rates for non-residential

collected for non-tiered customers (1 or more accounts); revenues collected from the non-tiered rate surcharge (1 account).

1 customers. No party disagrees with Cal Water's conclusion that increasing block
2 rates are not appropriate for non-residential customers. There is no need for Cal
3 Water to make further proposals to implement increasing block rates for non-
4 residential customers.

- 5 • Collection of WRAM/MCBA surcharges should remain as an overall surcharge
6 and not allocated to individual residential tiers. Cal Water opposes this proposal:
7 it is contrary to TURN's basic ratemaking principles: practicality, including
8 simplicity, understandability, ability to implement and public acceptability, clarity
9 in its interpretation, and stability in revenues from year to year. Furthermore the
10 proposal is likely to create intertemporal equity issues due to delays in full
11 revenue recovery.

12 Should the Commission agree to implement the TURN surcharge proposal, Cal Water
13 requests that it be authorized to track recovered surcharges by tier to assure full recovery with
14 interest.

15

1 **CHAPTER 16: CONSERVATION PROGRAM (KEN JENKINS)**
2

3 **16.1. INTRODUCTION**

4 This testimony is part one of a two part response to DRA’s *Report on the Conservation*
5 *Program and Expenses of California Water Service Company* (“DRA Report”). This portion of
6 the testimony has been prepared by Kenneth G. Jenkins, Conservation Manager, California
7 Water Service Company, and addresses conservation expenditures, conservation program
8 flexibility, conservation program reporting, and requested conservation positions.

9 The second part of the response to DRA’s Report has been prepared by David Mitchell
10 of M.Cubed and Gary Fiske of Gary Fiske and Associates, Inc. This portion of the response is
11 entitled *Rebuttal to DRA’s Report on the Conservation Program and Expenses of California*
12 *Water Service Company, California Water Service Company Application 12-07-007* and
13 primarily addresses methodological and analytical errors contained in DRA’s Report.

14 **16.2. CONSERVATION EXPENDITURES AND BUDGET**

15 DRA provides two main arguments to justify its recommendations to drastically reduce
16 conservation budgets and deny conservation staffing additions proposed by Cal Water. These
17 two arguments can be summarized as follows:

- 18 • Cal Water has a pattern of under spending its approved budgets for conservation
19 programming.
- 20 • Cal Water has overstated the volume of water savings needed to meet water use
21 reductions required by state law and has consequently overestimated the need for
22 additional conservation programming.

23 On page 1-16 of its report, DRA expresses this basic thesis in a single sentence: “CWS
24 has in the past consistently overestimated its conservation forecasts and underspent its
25 approved budget...”⁹⁴ As our two-part response to DRA’s report will demonstrate, both of these
26 claims are without merit. The first false claim made by DRA, that Cal Water has significantly
27 under spent the conservation budgets approved in the previous rate case, is addressed in this
28 report. The second false claim made by DRA, that Cal Water has overstated the volume of
29 water savings and hence the amount of conservation programming needed to meet water use
30 reductions required by state law, is discussed in detail in the report prepared by David Mitchell
31 of M.Cubed and Gary Fiske of Gary Fiske and Associates, Inc.

⁹⁴ DRA Report, page 1-16.

1 Cal Water recommends the Commission approve the conservation program budgets
 2 provided in Table 1 as presented in our original filing.⁹⁵ These budgets are derived from a
 3 detailed and analytically rigorous assessment of current and projected GPCD and represent the
 4 level of sustained conservation program investment necessary to meet SBx7 -7 and other
 5 regulatory requirements. As is shown conclusively in the report prepared by Messrs. Mitchell
 6 and Fiske, DRA's budget recommendations are predicated on a seriously flawed and
 7 misleading analysis of current and future district GPCD status.

8
 9 **Table 1 – Cal Water Recommended Conservation Program Budgets**

District	2014	2015	2016	Proposed 2014-16 Total Costs
AV	\$23,045	\$23,296	\$25,606	\$71,947
BG	\$590,667	\$602,787	\$605,917	\$1,799,371
BK	\$664,157	\$668,617	\$687,819	\$2,020,594
CH	\$228,980	\$229,031	\$224,914	\$682,925
DIX	\$27,910	\$27,966	\$27,487	\$83,363
DOM	\$929,795	\$951,904	\$1,002,385	\$2,884,084
ELA	\$619,395	\$633,643	\$632,661	\$1,885,698
HR	\$834,353	\$850,900	\$846,930	\$2,532,183
KC	\$33,111	\$36,224	\$39,787	\$109,122
KRV	\$27,719	\$27,510	\$26,661	\$81,890
LAS	\$363,688	\$371,071	\$378,146	\$1,112,905
LIV	\$514,445	\$526,357	\$539,137	\$1,579,938
MPS	\$1,309,328	\$1,338,671	\$1,357,446	\$4,005,444
MRL	\$18,721	\$18,955	\$18,860	\$56,537
ORO	\$37,686	\$37,888	\$37,437	\$113,011
PV	\$678,057	\$690,713	\$721,375	\$2,090,145
District	2014	2015	2016	Proposed 2014-16 Total Costs
RDV	\$19,348	\$19,642	\$19,338	\$58,329
SLN	\$1,194,129	\$1,220,401	\$1,298,710	\$3,713,240

⁹⁵ "Conservation Program Recommendations and Budgets for California Water Service Company Districts", M.Cubed, Gary Fiske and Associates, A&N Technical Services, April 2012, page 42.

SSF	\$758,745	\$775,843	\$774,260	\$2,308,848
STK	\$292,857	\$300,186	\$301,742	\$894,785
VIS	\$401,348	\$423,410	\$487,986	\$1,312,743
WIL	\$40,562	\$40,628	\$41,757	\$122,947
WLK	\$436,299	\$446,122	\$465,250	\$1,347,671
Total	\$10,089,868	\$10,307,817	\$10,614,261	\$31,011,946

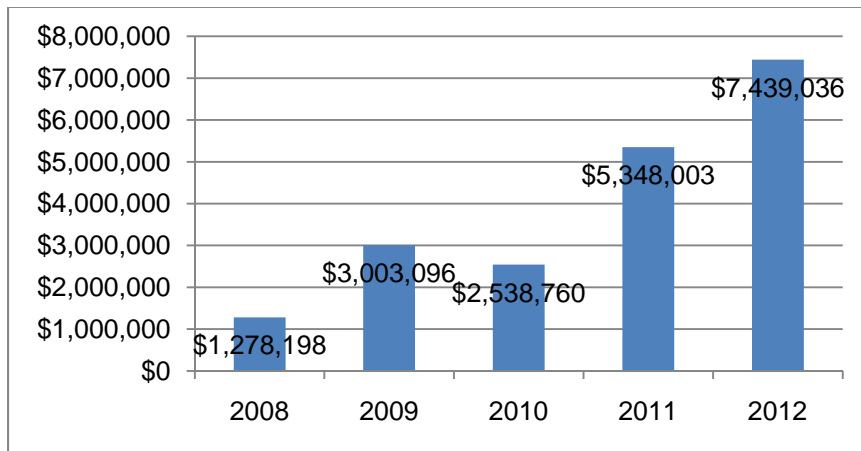
1
2

DRA Misrepresents Cal Water Recent Conservation Expenditures, Leading to an Inaccurate Representation of Conservation Program Expenditure Trends

3
4
5 Cal Water disagrees with DRA's assertion that conservation budgets that are adopted as
6 part of this proceeding should be reduced because Cal Water has a pattern of under spending
7 its approved conservation budgets. Cal Water has been actively expanding its conservation
8 programs since the implementation of the Water Revenue Adjustment Mechanism (WRAM) and
9 is on-track to utilize a significantly greater share of currently authorized expenditures than
10 claimed by DRA. Figure 1 shows the substantial growth in annual conservation expenditures
11 from 2008-2012. Annual expenditures in 2012 are nearly 6 times those in 2008. Between 2010
12 and 2012, annual expenditures nearly tripled.

13
14

Figure 1 – Cal Water Annual Expenditures



15
16
17
18

In its effort to show that Cal Water has under spent its approved budget, DRA states that "...the amount of unspent funds for 2011 and 2012 totalled (sic) 45% and 23% of the adopted budget, respectively. These percentages represent a significant increase of unspent budgets

1 when compared to the previous years.”⁹⁶ This statement ignores the expenditure framework
 2 agreed to previously by DRA and Cal Water in D.10-12-017. D.10-12-017 stated that “...funds
 3 are not transferable between districts, but may be carried forward to subsequent years within
 4 this general rate case (GRC) cycle (2011-2013).”⁹⁷ This structure was agreed upon because it
 5 provides the necessary flexibility to responsibly ramp up programs, offer new programs, and
 6 accurately match available resources with participant demand.

7 If DRA had considered the trajectory of expenditure over the full three years authorized,
 8 it would have drawn a very different conclusion. In Table 2 we compare expenditures from
 9 January – March for 2011 and 2012 to total annual expenditures in these years. Based on that
 10 comparison, we project 2013 annual expenditures from the actual January-March expenditures
 11 in 2013. In 2011 and 2012, program expenditure for January through March comprised, on
 12 average, slightly more than 20% of annual program expenditure. Applying this percentage to
 13 2013 actual expenditure for January through March yields a projected annual expenditure of
 14 approximately \$13.5 million. This projection represents an 81% increase compared to 2012
 15 expenditures which is both consistent with increases achieved in previous years and with the
 16 expenditure framework agreed-to in D.10-12-017 which anticipated ramping up programs over
 17 the three-year period.

18
 19

Table 2 – Calculation of Projected 2013 Expenditures

Year	Total Annual Expenditure	January-March Expenditure	January-March % of Total Annual
2011	\$5,348,003	\$968,859	18.1%
2012	\$7,439,036	\$1,598,729	21.5%
Total	\$12,787,039	\$2,567,588	20.1%
2013	\$13,515,159**	\$2,716,547*	
* Actual January-March 2013 program expenditures.			
** Projected Total Annual 2013 program expenditures given actual January-March 2013 program expenditures.			

20 In Table 3 we show the projected expenditures for 2011-13 compared to authorized
 21 expenditures. Contrary to the claims made by DRA, Cal Water is on a trajectory to spend the
 22 vast majority (91%) of authorized expenditures for the 2011-13 period. In addition, Cal Water
 23 has recently launched a new outdoor irrigation incentive program for commercial customers.

⁹⁶ DRA Report, page 1-17.

⁹⁷ D.10-12-017, December 9, 2010, page 8.

1 This program is expected to further accelerate expenditures in 2013. This acceleration is
 2 expected to allow Cal Water to expend even a higher percentage of the authorized 2011-13
 3 budget than we show in Table 3.

4

5 **Table 3 – Comparison of Total Annual Expenditures to Authorized Expenditures**

	2011	2012	2013 (Projected)
Total Annual Expenditures	\$5,348,003	\$7,439,036	\$13,515,159
Total Projected Expenditures (2011-13)	\$26,302,198		
Authorized Expenditures	\$29,056,000		
Total Expenditures (% of Authorized Expenditures)	91%		

6

7 DRA was made aware of this trajectory in an e-mail from Ken Jenkins to Chari Worster
 8 and Tony Tully in response to Ms. Worster’s request for information on Cal Water expenditures.
 9 It is unclear why DRA chose to seemingly ignore the information provided.

10 In our 2009 GRC settlement discussions we (Cal Water and DRA) came to an
 11 agreement that conservation programs would necessarily need to be ramped up in an orderly
 12 fashion in order to maximize their effectiveness. The structure that was put in place to facilitate
 13 this is discussed in the settlement agreement and subsequent decision. Specifically, while there
 14 are annual budget figures, the program is treated as a 3-year program with funds not used in
 15 one year being available in subsequent years. Activities in Q1 and Q2 of 2011 consisted
 16 primarily of program development both through the issuance of RFPs and through the
 17 completion of our district Conservation Master Plans in April and June of 2011. These plans
 18 provide the overall framework for program development.

19 While there were some limited programs implemented in Q1 and Q2 of 2011 program
 20 implementation began to increase in Q3 and Q4 of 2011. A significant portion of this
 21 implementation was marketing and the development of the necessary infrastructure to manage
 22 these programs. A fuller implementation of programs occurred in 2012, with continued
 23 marketing, which is expected to increase 2012 activity levels with associated expenditure
 24 increases. Additional elements of the Cal Water program are being implemented in Q1 of 2013
 25 which are expected to significantly increase overall program activity levels and associated

1 expenditures which will allow for the full utilization of the 3-year budgets authorized in the 2009
2 GRC.”⁹⁸

3 Cal Water has clearly demonstrated the ability to run a robust conservation program and
4 has further shown the ability to significantly increase program offerings while managing
5 programs effectively.

6 16.3. CONSERVATION PROGRAM FLEXIBILITY

7 DRA’s Recommendation for Limited Flexibility Will Impair Cal Water’s Ability to 8 Optimize and Adaptively Manage Programs

9 Despite its purported concern that Cal Water may under spend authorized funding for
10 conservation, DRA has made a number of recommendations that would both impair Cal Water’s
11 ability to continue ramping up its conservation programs and prevent it from adjusting its
12 program mix to the benefit of ratepayers in light of new information. These include:

- 13 • DRA’s recommendation that unspent monies be refunded to ratepayers each year
14 rather than at the end of each rate cycle as was previously agreed to by DRA in
15 D.10-12-017.⁹⁹
- 16 • DRA’s recommendation that budgets be specified for individual programs within each
17 district rather than for classes of programs as was previously agreed to by DRA in
18 D.10-12-017.¹⁰⁰
- 19 • DRA’s recommendation to implement separate spending caps for public information,
20 school education, conservation kits, and research and administration rather than
21 utilizing the spending cap structure previously agreed upon and included in D.10-12-
22 017.¹⁰¹

23 Each of these issues is addressed in turn.

24

25 ***DRA’s recommendation that unspent monies be refunded to ratepayers each year***
26 ***rather than at the end of each rate cycle as was previously agreed to by DRA in***
27 ***D.10-12-017.***

28 DRA does not provide any reasonable argument for making this significant change to the
29 current 3-year program structure agreed upon by both parties and included in D.10-12-017. The
30 only argument made by DRA for this significant change is circular in nature. “...it is
31 unreasonable for the company to hold on to any unspent funds belonging to ratepayers which

⁹⁸ E-mail response from Ken Jenkins to Chari Worster and Tony Tully, February 5, 2013.

⁹⁹ DRA Report, page 1-5.

¹⁰⁰ Please see DRA Report, Chapter 2.

¹⁰¹ DRA Report, page 1-5.

1 are earmarked to a specific year.”¹⁰² Under the agreement included in D.10-12-017 funds are
 2 identified but not earmarked for a specific year. The specific language included in D.10-12-017
 3 is, “The Settlement provides for removal of conservation expenses from escalation for 2012 and
 4 2013. Instead, it provides specific conservation budgets for each district for the 2011 test year,
 5 2012, and 2013. The funds are not transferable between districts, but may be carried forward to
 6 subsequent years within this general rate case (GRC) cycle (2011-2013).”¹⁰³ The issue of
 7 earmarking only arises due to DRA’s recommendation to earmark funds to a specific year. DRA
 8 then uses its own recommendation to justify its recommendation to return unspent funds each
 9 year.

10 It is clear that there is the potential for a significant reduction in programming and water
 11 savings, with no additional ratepayer protection, if DRA’s recommendation is adopted. To
 12 illustrate this point we will use the 2011-13 time period.

13 In Table 4 we compare authorized expenditure for 2011-13 to expenditure projected by
 14 Cal Water (from Table 3) and expenditure projected if DRA’s recommendation of refunding
 15 unspent funds to ratepayers annually were adopted. Under DRA’s annual refund proposal,
 16 projected total expenditure for 2011-13 would be 15% below the current trajectory of
 17 expenditure.

18 **Table 4 – Comparison of Projected 2011-13 Expenditures**

	2011	2012	2013
Total Annual Expenditures	\$5,348,003	\$7,439,036	\$13,515,159
2011-13 Total Projected	\$26,302,198		
Authorized Expenditures	\$9,703,600	\$9,676,200	\$9,676,200
2011-13 Total Authorized	\$29,056,000		
Total Annual Expenditures (Using DRA's Recommendation to Refund Unspent Funds Annually)	\$5,348,003	\$7,439,036	\$9,676,200
Total Expenditures Using DRA’s Recommendation	\$22,463,239		

21
 22 There are two significant issues that arise should this recommendation be adopted.

23

¹⁰² DRA Report, page 1-5.

¹⁰³ D.10-12-017, December 9, 2010, page 8.

- 1 • First, this lack of flexibility will exacerbate the very issue of under-spending of
2 authorized funds about which DRA expresses concern. As discussed above, we
3 do not agree with the argument put forth by DRA in this regard, and we have
4 demonstrated the serious flaws in DRA's argument. By now arguing for annual
5 refunds of unspent funds, DRA demonstrates an important internal inconsistency.
- 6 • Second, water savings will be lower due to the inability to utilize unspent funds in
7 a subsequent year within the rate case cycle. This lack of flexibility will increase
8 the risk of non-compliance with reductions in water use required by state law.
9 Arbitrarily limiting Cal Water's ability to meet public policy goals is imprudent.
10 The Commission can and should hold Cal Water accountable to the goals and
11 objectives of the conservation program through reporting mechanisms and one-
12 way balancing accounts. The Commission should also adopt a conservation
13 program that gives Cal Water an opportunity to meet these goals, not one
14 hobbled from the beginning by retributive, arbitrary restrictions.

15 ***DRA's recommendation that budgets be specified for individual programs within***
16 ***each district rather than for classes of programs as was previously agreed to by***
17 ***DRA in D.10-12-017***

18 In order to address the significant impact that this recommendation would have on the
19 ability to manage programs effectively it is instructive to revisit information provided by Cal
20 Water in 2009 regarding program portfolio development.

21 "These portfolios should be viewed as an initial specification of the
22 program mix that Cal Water will ultimately implement. As such, they are
23 indicative of the variety of programs and the budgets that are required to achieve
24 the savings targets. Over the next 12-18 months, Cal Water will engage in a
25 comprehensive conservation planning process that will develop and consider a
26 full set of demographic, historic, economic, and other information for each district
27 in order to detail a carefully-crafted set of appropriate conservation program
28 designs, along with recommended implementation levels, staffing requirements,
29 and budgets. The analysis reported herein, as well as the programmatic
30 recommendations that will emerge from the upcoming conservation plan are, by
31 necessity, predicated on many future uncertainties. Thus, as Cal Water
32 proceeds with program implementation, there will be an on-going need for
33 flexibility to reflect the resolution of these uncertainties and the acquisition of
34 additional information. Such nimbleness is absolutely necessary to maximize the
35 effectiveness of the company's water conservation programs."¹⁰⁴
36

37 The flexibility ultimately agreed upon by DRA and Cal Water and included in D.10-12-
38 017 is critically important as programs continue to evolve, new and existing programs are
39 analyzed, and available resources are matched with participant demand. It would be
40 counterproductive for the Commission to adopt DRA's artificial restrictions, because they would

¹⁰⁴ "Achieving Conservation Targets", M.Cubed, Gary Fiske and Associates, A&N Technical Services,
Revised October 2009, page 34.

1 impair Cal Water's ability to optimize and adaptively manage programs, thereby increasing the
2 risk of non-compliance with required reductions in water use.

3

4 ***DRA's recommendation to implement separate spending caps for public***
5 ***information, school education, conservation kits, and research and administration***
6 ***rather than utilizing the spending cap structure previously agreed upon and***
7 ***included in D.10-12-017***

8 Cal Water's proposed conservation program utilizes the program structure agreed upon
9 and included in D.10-12-017. This structure includes spending caps for four categories of
10 spending: Administration & Research, Public Information & School Education, Residential
11 Programs, and Commercial Programs. While we believe that full flexibility with no categorical
12 spending caps maximizes program effectiveness we understand the rationale behind, and agree
13 with, the current program structure included in D.10-12-017.

14 As was mentioned previously, DRA does not provide any reasonable argument for
15 making this change to the current 3-year program structure previously agreed upon by both
16 parties and included in D.10-12-017.

17 In its' report DRA states the following, "...CWS requests a total of \$10,089,871 for
18 conservation and this consists of \$7,686,007 for customer programs, \$1,204,501 for
19 administration and research (which includes salaries and benefits for conservation staff),
20 \$785,619 for public information, and \$413,743 for school education programs."¹⁰⁵ DRA's
21 representation of Cal Water proposing a separation of public information and school education
22 programs shows a lack of understanding of Cal Water's proposal and appears to be done in
23 order to bolster DRA's argument for placing these expenditures into separate categories for the
24 purpose of spending caps. It further shows a blatant disregard for correspondence provided by
25 Cal Water to DRA in response to a data request for a breakdown of these expenses. In an e-
26 mail response from Ken Jenkins to Chari Worster on November 16, 2012 providing this
27 requested breakdown of public information and school education expenses Mr. Jenkins states,
28 "Just to clarify, our proposal is that budget figures would not be broken down by these
29 categories; rather we are proposing to follow the previously agreed upon structure in the last
30 GRC to have two categories for these expenses (Administrative/Research and Public
31 Information/School Education)..."¹⁰⁶

¹⁰⁵ DRA Report, page 1-4.

¹⁰⁶ E-mail response from Ken Jenkins to Chari Worster, November 16, 2012.

1 Cal Water recommends continuing to track Public Information and School Education
2 expenditures as a single category for the following reasons:

- 3
- 4 • Public Information and School Education programs are both largely unquantifiable
5 from a water savings perspective;
- 6 • Public Information and School Education programs are similar in that they are largely
7 information-based;
- 8 • In the original filing Cal Water continues to track these programs in a single category
9 and, as such, made the assumption that the same flexibility regarding shifting of
10 funds to meet participant demand that currently exists would continue. A change in
11 this structure would likely result in a required increase of the sum of the separated
12 budgets when compared to the existing single category due to the need to ensure
13 adequate funding is available for both programs given the significant curtailment of
14 flexibility the existing single category provides.

15 ***Cost-Effectiveness of Individual Programs Should Not Be the Only Litmus Test***

16 In the development of its program recommendations DRA incorrectly uses cost-
17 effectiveness as the only litmus test for the implementation of programs.¹⁰⁷ This is done at the
18 expense of other demographic, historic, and economic factors.

19 The rebuttal report prepared by M.Cubed and Gary Fiske and Associates, Inc.,
20 referenced above discusses the arbitrariness of DRA's program recommendations and their
21 inconsistency with sound economic principles. As described in detail in Cal Water's filing, the
22 cost-effectiveness results are used in the context of a portfolio-development process for each
23 district that is designed to meet SBx7-7 requirements at minimum ratepayer costs while
24 maximizing benefits to ratepayers. Thus, while Cal Water agrees in principle to the importance
25 of utilizing cost-effectiveness as a tool in determining the appropriate mix of conservation
26 programs, it strongly takes issue with the manner in which DRA misuses the cost-effectiveness
27 results.

28 By using an overly-simplified and incorrect approach, DRA ignores program synergies
29 that are embedded within Cal Water's proposed mix of programs and are essential to the
30 development of the least-cost portfolio that will achieve required water use reductions. This
31 approach ultimately harms ratepayers by discriminating among programs that, while not equally
32 cost-effective, are nonetheless beneficial to ratepayers. Any reasonable recommendation
33 should, at a minimum, maximize all programs with benefit-cost ratios greater than one.

34 Further discussion on this topic is included in *Rebuttal to DRA's Report on the*
35 *Conservation Program and Expenses of California Water Service Company, California Water*

¹⁰⁷ Please see DRA Report, Chapter 2.

1 Service Company Application 12-07-007 prepared by M.Cubed and Gary Fiske and Associates,
2 Inc.

3 **16.4. CONSERVATION PROGRAM REPORTING**

4 Cal Water agrees with the DRA recommendation that annual reporting of conservation
5 programs be satisfied through the new requirements adopted in D.11-05-004.¹⁰⁸

6 **16.5. STAFFING REQUEST**

7 Cal Water disagrees with the DRA recommendation to disallow the two new
8 Conservation Program Analyst positions requested.¹⁰⁹ A full discussion and analysis is included
9 in rebuttal report prepared by M.Cubed and Gary Fiske and Associates, Inc.

10 Cal Water disagrees with DRA's recalculation of administrative expenses¹¹⁰ and
11 recommends that the Commission approve the full budget proposed in the original filing.

12 **16.6. REBUTTAL SUMMARY**

- 13 • Cal Water recommends the Commission approve the conservation program budgets
14 provide in Table 1;
- 15 • Cal Water disagrees with DRA's assertion that conservation budgets that are
16 adopted as part of this proceeding should be reduced due to the pattern of historical
17 expenditures¹¹¹;
- 18 • Cal Water agrees with DRA that "authorized conservation expenses continue to be
19 tracked in a capped, one-way balancing account for each district separately."¹¹²;
- 20 • Cal Water agrees with DRA "that conservation funds for each district are not
21 transferrable across districts."¹¹³;
- 22 • Cal Water disagrees with the DRA recommendation that unspent monies be
23 refunded to ratepayers each year¹¹⁴;
- 24 • Cal Water disagrees with the DRA recommendation that budgets be specified for
25 individual programs within each district¹¹⁵;

¹⁰⁸ DRA Report, page 1-5.

¹⁰⁹ Ibid, page 1-17.

¹¹⁰ Ibid, page 1-18.

¹¹¹ DRA Report, page 1-16.

¹¹² Ibid, page 1-5.

¹¹³ Ibid.

¹¹⁴ Ibid.

¹¹⁵ Please see DRA Report, Chapter 2.

- 1 • Cal Water disagrees with DRA that “the following conservation programs in each
2 district are subject to spending caps: Public Information, School Education,
3 Research and Administration, and Conservation Kits.”¹¹⁶;
- 4 • DRA incorrectly uses cost-effectiveness as the only litmus test for the
5 implementation of programs¹¹⁷;
- 6 • Cal Water agrees with the DRA recommendation that annual reporting of
7 conservation programs be satisfied through the new requirements adopted in D.11-
8 05-004¹¹⁸; and,
- 9 • Cal Water disagrees with the DRA recommendation to disallow the two new
10 Conservation Program Analyst positions requested¹¹⁹.

11 Cal Water has undertaken a careful and analytically rigorous analysis to support its
12 proposed budgets and program structures. These budgets and program structures are
13 designed to meet regulatory required water-use reductions in the most efficient manner
14 possible. DRA had made recommendations that, if adopted, will increase the difficulty of
15 achieving these regulatory requirements and will ultimately harm ratepayers. DRA wrongly
16 asserts that the only consequence of not meeting state-mandated reductions in water use by
17 2020 is ineligibility for state water grants and loans.¹²⁰ In addition to Cal Water’s ratepayers
18 losing access to state-subsidized water infrastructure funding, failure to meet state-mandated
19 reductions in water use by 2020 will be deemed a violation of state law for the purposes of any
20 state administrative and judicial proceedings, exposing ratepayers to additional possible
21 liabilities. Water supply planning efforts are also predicated on meeting these water-use
22 reduction requirements. Cal Water has proposed a plan designed to do this efficiently and at
23 lowest possible cost to ratepayers and recommends that the Commission support this proposal.
24

¹¹⁶ DRA Report, page 1-5.

¹¹⁷ Please see DRA Report, Chapter 2.

¹¹⁸ DRA Report, page 1-5.

¹¹⁹ Ibid, page 1-17.

¹²⁰ Ibid, page 1-6.

1 **CHAPTER 17: TECHNICAL CONSERVATION REBUTTAL (M-CUBED)**

2 **17.1. INTRODUCTION**

3 This rebuttal report addresses several methodological, analytical, and logical errors
4 contained in DRA’s “Report on the Conservation Program and Expenses of California Water
5 Service Company” that have a material impact on DRA’s findings, conclusions, and
6 recommendations for district water conservation budgets in reference to California Water
7 Service Company’s Application 12-07-007. This rebuttal was prepared by the primary authors of
8 California Water Service Company’s consultant report “Conservation Program
9 Recommendations and Budgets for California Water Service Company Districts,” which is the
10 main focus of DRA’s analysis.

11 **17.2. REBUTTAL OVERVIEW**

12 A significant part of our rebuttal report is devoted to DRA’s analysis of Cal Water
13 District’s GPCD status. This analysis provided the foundation for the rest of DRA’s analysis and
14 its importance to DRA’s findings, conclusions, and recommendations for Cal Water conservation
15 programs, budgets, and staffing cannot be overstated. Because DRA’s analysis of GPCD leads
16 it to (wrongly) conclude that most Cal Water districts have already met their SBx7-7 GPCD
17 targets and the districts that have not done so are on track to meet them, it is recommending
18 very substantial reductions in the scope and level of conservation programs proposed by Cal
19 Water. Because it is recommending across-the-board cuts in conservation programs for most
20 districts, it also concludes the two additional staff positions proposed by Cal Water are
21 unnecessary.

22 Unfortunately, the GPCD analysis upon which so much of DRA’s findings are based is
23 simply wrong. DRA attempts to make inferences about future GPCD based on a single data
24 observation; it completely ignores the stochastic nature of demand; and it fails to consider any
25 factors that might have made the few years of demand it considered not representative of future
26 demands. When these obvious problems are corrected, we find DRA got its assessment of
27 GPCD status wrong in 23 of 24 districts. This is of critical importance because DRA’s primary
28 consideration in recommending or disallowing programs and in setting program budgets is
29 whether it deems a district to be “on target” with its SBx7-7 requirements. The same is true for
30 its staffing level recommendation. Thus, the majority of DRA’s programmatic, budgetary, and
31 staffing recommendations are predicated on its incorrect assessment of district GPCD status.

32 There are other equally serious problems with DRA’s programmatic recommendations
33 that we expound upon below. These include basing recommendations on assertions about

1 programs that are incorrect or unsupported; making recommendations that result in inconsistent
2 or arbitrary treatment of individual districts; and including recommendations that harm
3 ratepayers overall or wrongly discriminate against subsets of ratepayers.

4 **17.3. DRA GPCD ANALYSIS**

5 *Overview of DRA GPCD Analysis*

6 DRA's recommendations regarding Cal Water's proposed conservation programming in
7 large part derive from its analysis of Cal Water district's GPCD status for the period 2008 to
8 2011. Even though DRA's analysis purports to evaluate four years of GPCD data, it in fact
9 seems to base its assessment on just one year – 2011. Using the difference between estimated
10 2011 GPCD and the 2015 and 2020 SBx7-7 GPCD targets, DRA assigns a grade (A, B, C, or F)
11 to each district to indicate its current SBx7-7 compliance status.¹²¹ These grades are
12 summarized in Table 6 of DRA's report (p. 1-15). DRA assigns a grade of A to 17 districts and
13 a grade of B to 6 districts.¹²² According to DRA's grading scheme a grade of A indicates the
14 district has met or exceeded its 2020 GPCD target while a grade of B indicates the district has
15 met or exceeded its 2015 GPCD target. Thus DRA has concluded that 17 districts have already
16 met their SBx7-7 2020 GPCD target and 6 districts are on track to meet it.

17 The following sections explain the serious flaws of DRA's GPCD analysis and the
18 incorrect conclusions regarding the likelihood of SBx7-7 compliance DRA draws from it.

19 **Critique of DRA GPCD Analysis**

20 The overriding difficulty with DRA's conservation program and expenditure
21 recommendations for Cal Water districts is that they are predicated on a seriously flawed
22 analysis of each district's GPCD status. We demonstrate the flaws of DRA's analysis in three
23 ways. First, we show that even if one were to accept the conceptual model of GPCD implied by
24 DRA's analysis (which we do not), the conclusions DRA draws from it have no statistical validity.
25 Second, we show that by ignoring the primary drivers of variability in annual GPCD, DRA has
26 systematically biased its analysis results. Third, we show that DRA's assessment of GPCD
27 compliance status is not only at odds with 2020 demand forecasts prepared by Cal Water, but

¹²¹ The grading scheme is presented in Table 5 of DRA's report (p. 1-15). The scheme is not strictly sequential. The grade of F follows the grade of C. There is no grade of D.

¹²² In its report DRA refers to 23 districts. This is because it treats the Mid-Peninsula and South San Francisco districts as a single entity. In what follows, these districts are treated separately and we therefore reference 24 rather than 23 districts.

1 also with forecasts of 2020 demand prepared by adjacent water districts with comparable
2 demographics, weather, and economic conditions.

3 **DRA GPCD Analysis Lacks Statistical Validity**

4 DRA claims to base its conclusions about the likelihood of SBx7-7 compliance in 2020
5 on historical GPCD for the period 2008-2011. As previously noted this probably overstates the
6 case, since DRA appears to have assigned grades to each district based on just one year of
7 data, 2011. That is, it appears DRA has made inferences about the likelihood of SBx7-7
8 compliance in 2020 (nine years from the year it considers) based solely on whether the GPCD
9 in 2011 less than or equal to the 2015/2020 GPCD targets.

10 The obvious problems with this approach in terms of inference generally fall into three
11 categories:

- 12 1. The approach attempts to make inferences based on a single data observation (and
13 here it is worth noting that it is not possible to make statistically valid inferences from
14 a single point of data);
- 15 2. It completely ignores the stochastic nature of demand (i.e. the fact that there is a
16 random component of the year-to-year demand variation); and
- 17 3. It does not consider any factors that might have made the demands in 2008-2011 (or
18 just in 2011) not representative of what future demands might look like.

19 If we consider just the first point by taking the obvious step of computing the average of
20 the four years as a point of comparison rather than just considering 2011, the number of districts
21 that rate a grade of “A” falls from 17 to 7; the number that would have received a grade other
22 than A or B increases from zero to 6.¹²³ Through this very simple approach to using all four
23 years of historical data, DRA’s grades are modified in 15 of the 23 districts it evaluated.

24 That DRA did not take this obvious step is telling. While DRA does not formally state a
25 conceptual model of GPCD in its report, the fact that it references four sequential years of data
26 but only considers the last year in the sequence when making statements about future GPCD,
27 plus the fact that it does not appear to have accounted for any other factors that might have
28 impacted GPCD over this period, strongly implies DRA considers GPCD to follow a simple time
29 trend process described by equation (1). In equation (1), GPCD in period t is given by y_t and is
30 determined by a constant, a time trend variable, x_t , and a random component, e_t . The inclusion
31 of the random component, e_t , allows for year-to-year deviation from trend.^{124,125,126}

¹²³ DRA reports incorrect GPCD values for CH and DIX in Table 6 of its reports. Our results are based on corrected values for these districts.

¹²⁴ While our presentation focuses on a linear trend model, our results can be generalized to other functional forms, such as log-log or log-reciprocal. Indeed, these forms may provide a more realistic model of trend over the

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$$(1) \quad y_t = \beta_1 + \beta_2 x_t + e_t$$

Given the stochastic process described by equation (1), expected GPCD in period t is given in equation (2).

$$(2) \quad E(y_t|x_t) = \beta_1 + \beta_2 x_t$$

Assuming the standard assumptions of the linear regression model hold, Ordinary Least Squares (OLS) is the Best Linear Unbiased Estimator (BLUE) of $E(y_t|x_t)$ and the 95% confidence interval of the OLS estimator is given by equation (3), where \hat{y}_t is the estimated value for the mean of GPCD in period t, $\hat{\sigma}$ is the standard error of the regression, and $t_{.025}$ is the right-tail critical value for the t-distribution (Judge, Hill, Griffiths, Lutkepohl, & Lee, 1988).¹²⁷ The right-tail critical value depends on the number of degrees of freedom in the estimator. In our implementation of equation (1) there are only two degrees of freedom and the right-tail critical value is 4.303.¹²⁸

$$(3) \quad Prob(\hat{y}_t - t_{.025}\hat{\sigma}\sqrt{x_t'(x'x)^{-1}x_t} \leq E(y_t|x_t) \leq \hat{y}_t + t_{.025}\hat{\sigma}\sqrt{x_t'(x'x)^{-1}x_t}) = 0.95$$

If one accepts the conceptual model of GPCD implied by DRA's report as valid, equations (1), (2), and (3) provide the basis for statistical inference about the expected value of GPCD over the four year period considered by DRA. In order to conclude that the low values of

long-term since, unlike the linear model, they do not imply a constant rate of change in GPCD over time which, in the case of negative trend, would eventually lead to zero or negative water consumption. The linear model, however, is more likely to support DRA's conclusions, which is why we have adopted it here.

¹²⁵ We are assuming DRA accepts that GPCD is inherently a stochastic process. Normally we would not feel compelled to state this assumption. However, the fact that DRA appears to have based its conclusions about the likelihood of compliance with SBx7-7 GPCD targets on the GPCD for a single year occurring nine years prior to the target year does not rule out the possibility that DRA does not accept this basic premise.

¹²⁶ For this part of the analysis we are assuming the standard assumptions of the linear regression model. Namely, that $e_t \sim N(0, \sigma^2)$, and $cov(e_t, e_s) = 0$. We relax the non-correlated error assumption in subsequent parts of our analysis. By using it here we run the risk of introducing a downward bias in coefficient standard errors which will provide more support to DRA's GPCD results than they may statistically merit.

¹²⁷ The 95% level of statistical significance is the generally accepted standard used in most empirical research (Bross, 1971).

¹²⁸ Specifically, the number of degrees of freedom is determined by the difference between the number of data observations and the number of parameters to be estimated in the model. In the case of the DRA conceptual model of GPCD, there are four data observations and two parameters to be estimated, leaving two degrees of freedom.

1 GPCD observed over the period are inconsistent with random fluctuations from trend and
 2 instead provide statistically valid evidence that expected GPCD over this period was below the
 3 SBx7-7 2020 target, one would want to show that the upper-bound of the calculated 95%
 4 confidence interval is less than or equal to the target. That is, one would want to show that
 5 $\hat{y}_t + t_{.025} \hat{\sigma} \sqrt{x_t'(x'x)^{-1}x_t} \leq Target\ GPCD$. If this is not the case, one cannot conclude on the
 6 basis of the data considered by DRA that expected GPCD over this period had trended below
 7 the target.

8 In Table 1, we compare the upper-bound estimate of expected GPCD¹²⁹ based on the
 9 GPCD model given by equation (1) to the 2020 SBx7-7 target. We also show the grade
 10 assigned by DRA for each district. We have highlighted in bold the districts for which DRA has
 11 assigned a grade of A even though the 2020 target is less than the upper-bound of expected
 12 GPCD for the period. Out of 18 districts for which DRA has assigned a grade of A, 12 have
 13 2020 targets that are less than the upper-bound of expected GPCD. In other words, even if one
 14 accepts the conceptual model of GPCD implied by DRA's report as valid (which we do not),
 15 DRA has violated its own grading scheme in at least 12 out of 24 districts. In fact, the problem
 16 is much worse than this. As we show in Table 2, it turns out that DRA has violated its own
 17 grading scheme in all but six districts.

18 In Table 2, we reapply DRA's grading scheme based on the estimation results for the
 19 conceptual GPCD model shown in equations (1), (2), and (3). Following Table 5 in DRA's
 20 report (p. 1-15), if the upper-bound of the 95% confidence interval is less than or equal to the
 21 2020 target, we assigned a grade of A to the district. If it is greater than the 2020 target but less
 22 than or equal to the 2015 target, we assigned a grade of B. If it is greater than the 2015 target
 23 we assigned a grade of "C or F." In the last case, it was not possible to assign a single letter
 24 grade (i.e. a grade of C versus a grade of F) based on the grading scheme in Table 5 of DRA's
 25 report because DRA does not define what it means for a district to be "on track" to meet the
 26 2015 target, which merits a grade of C, versus "not on track," which merits a grade of F.
 27 Therefore the best we can do is indicate that following some internal decision rule for gauging
 28 whether or not a district is on track, DRA would have assigned either a grade of C or a grade of
 29 F to the district if it had based its grading on the statistical evidence contained in the GPCD
 30 history it evaluated.

31 As shown in Table 2, by following the conceptual model of GPCD implied by DRA's
 32 report and making statistical inferences based on the four year GPCD history considered by

¹²⁹ Evaluated at the mid-point of the period 2008-11.

1 DRA, we find that DRA should have assigned a grade of C or F to 14 of the districts, a grade of
2 B to 4 of the districts, and a grade of A to just 6 of the districts.^{130,131} We conclude that DRA's
3 grading of GPCD status is inconsistent with a more statistically rigorous implementation of its
4 own analytical framework of GPCD in 18, or 75%, of the districts it evaluated.
5

¹³⁰ Here we want to stress the grading scheme DRA introduced into its analysis of GPCD has nothing to do with Cal Water's conservation program performance or outcomes. It is merely an ordinal indicator of where each district's GPCD during the period 2008-11 stood in relation to its 2015 and 2020 GPCD targets.

¹³¹ It is worth noting that of the ten districts that would have received an A or a B had DRA applied its GPCD grading scheme in a manner consistent with the data it looked at, Cal Water has proposed reductions in the conservation budgets for seven of them. For the three districts where this is not the case, the increases are due to opportunities to avoid higher costs of water supply by increasing the implementation of cost-effective conservation measures.

1 Table 1. Comparison of Upper-Bound Estimate of 2008-11 Expected GPCD to 2020 GPCD Target

District	E(y x) + 95% CI	2020 Target	Less Than Target	DRA GRA DE	District	E(y x) + 95% CI	2020 Target	Less Than Target	DRA GRADE
AV	297	281	No	A	MPS	123	124	Yes	A
BG	248	190	No	B	MRL	199	200	Yes	A
BK	287	239	No	B	ORO	360	268	No	A
CH	263	229	No	A	PV	300	225	No	B
DIX	159	164	Yes	A	RDV	131	157	Yes	A
DOM	216	171	No	A	SEL	245	215	No	A
ELA	108	115	Yes	A	SLN	143	117	No	A
HR	128	126	No	A	SSF	138	124	No	A
KC	157	142	No	B	STK	169	165	No	A
KRV	169	179	Yes	A	VIS	227	194	No	B
LAS	234	193	No	A	WIL	223	198	No	B
LIV	192	158	No	A	WLK	503	393	No	A

2
3 Table 2. Reapplication of DRA GPCD Grading Scheme to Be Consistent with DRA Conceptual Model of GPCD

District	DRA GRADE	Grade Consistent with DRA Conceptual Model of GPCD	District	DRA GRADE	Grade Consistent with DRA Conceptual Model of GPCD
AV	A	B	MPS	A	A
BG	B	C or F	MRL	A	A
BK	B	C or F	ORO	A	C or F
CH	A	C or F	PV	B	C or F
DIX	A	A	RDV	A	A
DOM	A	C or F	SEL	A	C or F
ELA	A	A	SLN	A	C or F
HR	A	B	SSF	A	B
KC	B	C or F	STK	A	B
KRV	A	A	VIS	B	C or F
LAS	A	C or F	WIL	B	C or F
LIV	A	C or F	WLK	A	C or F

4
5 **DRA GPCD Analysis Ignores Primary Drivers of Year-To-Year Variation in GPCD**

6 Now we consider the effect DRA's failure to consider other factors impacting GPCD had
7 on its results. It is well known that omitting important explanatory variables leads to biased
8 estimates of regression model coefficients (Hill, Griffiths, & Judge, 2001). The conceptual
9 model of GPCD implied by DRA's GPCD analysis laid out in the previous section suffers from
10 this because it only considers the temporal trend in GPCD over a brief span of time. It omits
11 other factors known to strongly influence year-to-year variation in GPCD (Baumann, Boland, &
12 Hanemann, 1998). The inadequacy of making inferences about future water demand based

1 solely on time trend is well documented. In reviewing the temporal trend model as an approach
2 to forecasting water demand, Baumann, et al., write:

3 The approach is highly subjective, using very little data. It attempts to
4 explain water use in terms of a variable, time, which by itself explains
5 nothing. The implicit assumptions regarding explanatory variables other
6 than time are demonstrably incorrect. The method is much too simplistic
7 for virtually any application, and is highly sensitive to changes in the
8 structure of water use (p.85).

9 Two obvious factors that affect year-to-year variation in GPCD are weather and the level
10 of economic activity. DRA does not consider either factor in its analysis, even though
11 extraordinary economic change and unusual weather conditions were both present over the
12 period upon which it based its analysis. As we demonstrate in this section, omitting these
13 important variables from its analysis of historical GPCD causes a serious bias in its results and
14 leads DRA to conclusions that are not supported by the data.

15 In Figure 1, we plot GPCD against the unemployment rate over the period 1995-2012 for
16 four Cal Water districts to illustrate how GPCD and economic activity correlate. In Figure 2, we
17 do the same thing with GPCD and total spring rainfall. In Figure 3, we show how GPCD
18 fluctuates with spring average daily maximum temperature. Our weather indicators focus on the
19 spring months because this is the period of the year that has the most impact on variation in
20 annual outdoor water demand. All else equal, cooler wetter springs delay the start of the
21 irrigation season and result in overall lower GPCD for the year. Likewise, warmer, dryer springs
22 advance the start of the irrigation season and result in higher GPCD for the year. Figures 2 and
23 3 clearly illustrate this relationship.

24 To demonstrate the bias inherent in the conceptual model of GPCD implied by DRA's
25 analysis we estimate the model shown in equation (4) using data for the period 1995-2012 for
26 each Cal Water district.¹³²

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$$28 \quad (4) \ y_t = \beta_1 + \beta_2 x_t + \beta_3 Temp_t + \beta_4 Rain_t + \beta_5 Uempl_t + e_t$$

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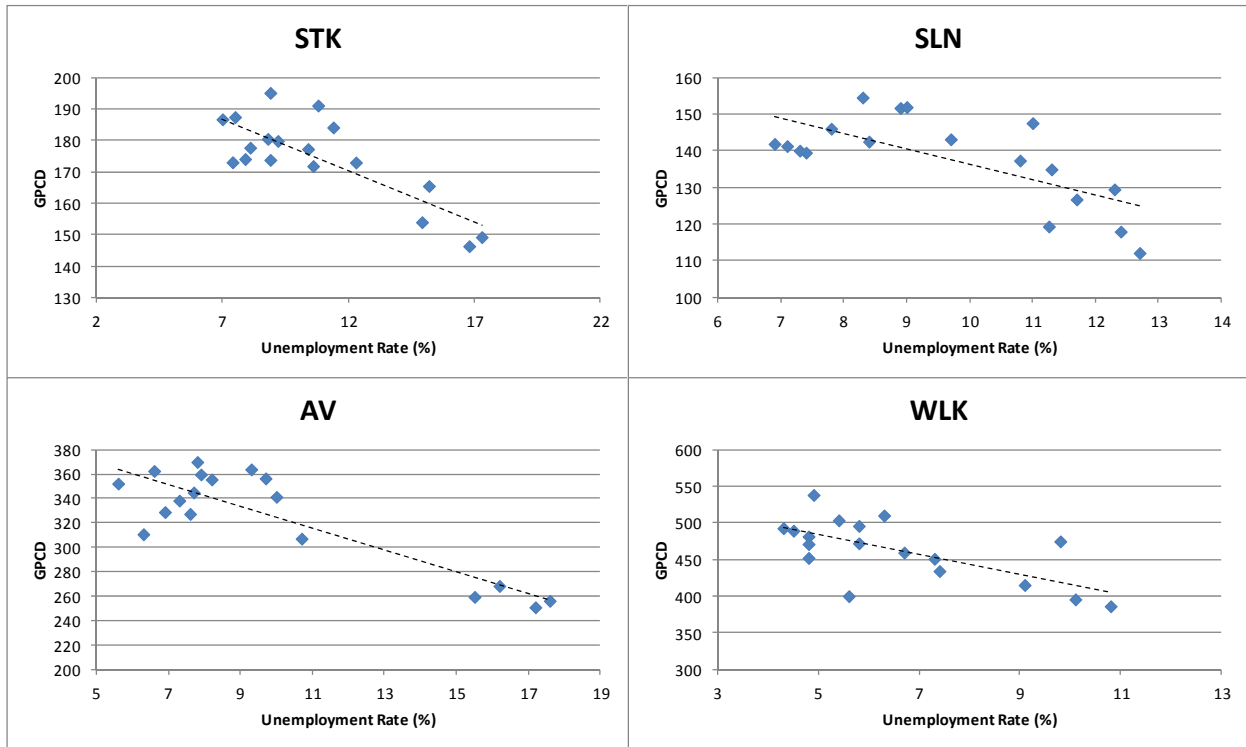
30 As before, y_t represents GPCD in year t and x_t is a time index variable. The variable
31 $Temp_t$ is the average daily maximum temperature for the months April – June in year t , $Rain_t$ is
32 total rainfall for the months March – June in year t , and $Uempl_t$ is the average annual rate of

¹³² In the cases of KRV and RDV the model is estimated for the periods 1997-2012 and 2000-2012, respectively, because estimates of GPCD were not available in earlier years for these districts. District GPCD models were estimated with SHAZAM Econometrics Software Version 10.

1 unemployment in year t .¹³³ *A priori* we expect the sign for the temperature coefficient, β_3 , to be
 2 positive and the sign for the rain coefficient, β_4 , to be negative. We also expect the sign for the
 3 unemployment coefficient, β_5 , to be negative. We expect the sign for the trend coefficient, β_2 ,
 4 also to be negative, but acknowledge this may not be the case for every district.

5
 6

Figure 1. GPCD v. Unemployment Rate (1995-2012) for Four Cal Water Districts

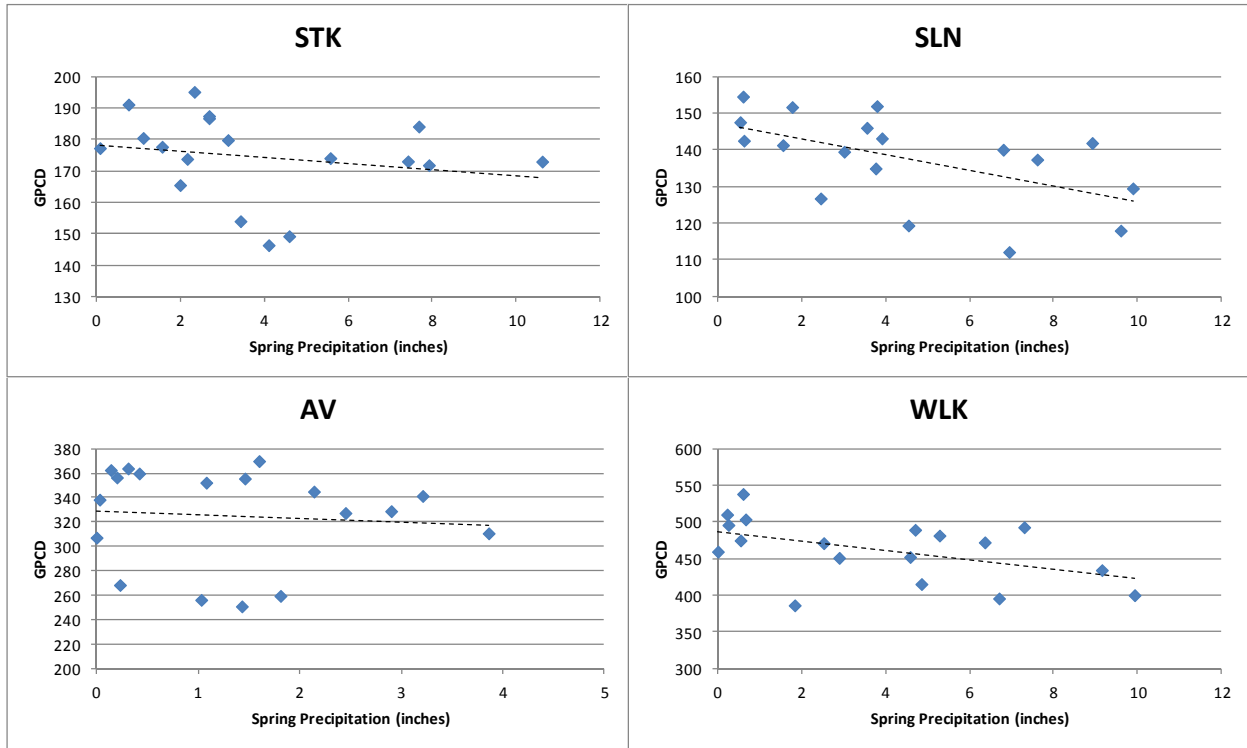


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¹³³ Because we are working with time series data we allow for the possibility of correlated errors. That is, we relax the assumption that $\text{cov}(e_t, e_s) = 0$ and instead allow for the possibility of an autocorrelated error process of the form $e_t = \rho e_{t-1} + v_t$ where $v_t \sim N(0, \sigma^2)$. We use the Durbin-Watson statistic to test for the presence of first-order autocorrelated errors and if detected with 95% statistical confidence implement the model using Generalized Least Squares (GLS) techniques rather than OLS.

1

Figure 2. GPCD v. Spring Precipitation (1995-2012) for Four Cal Water Districts

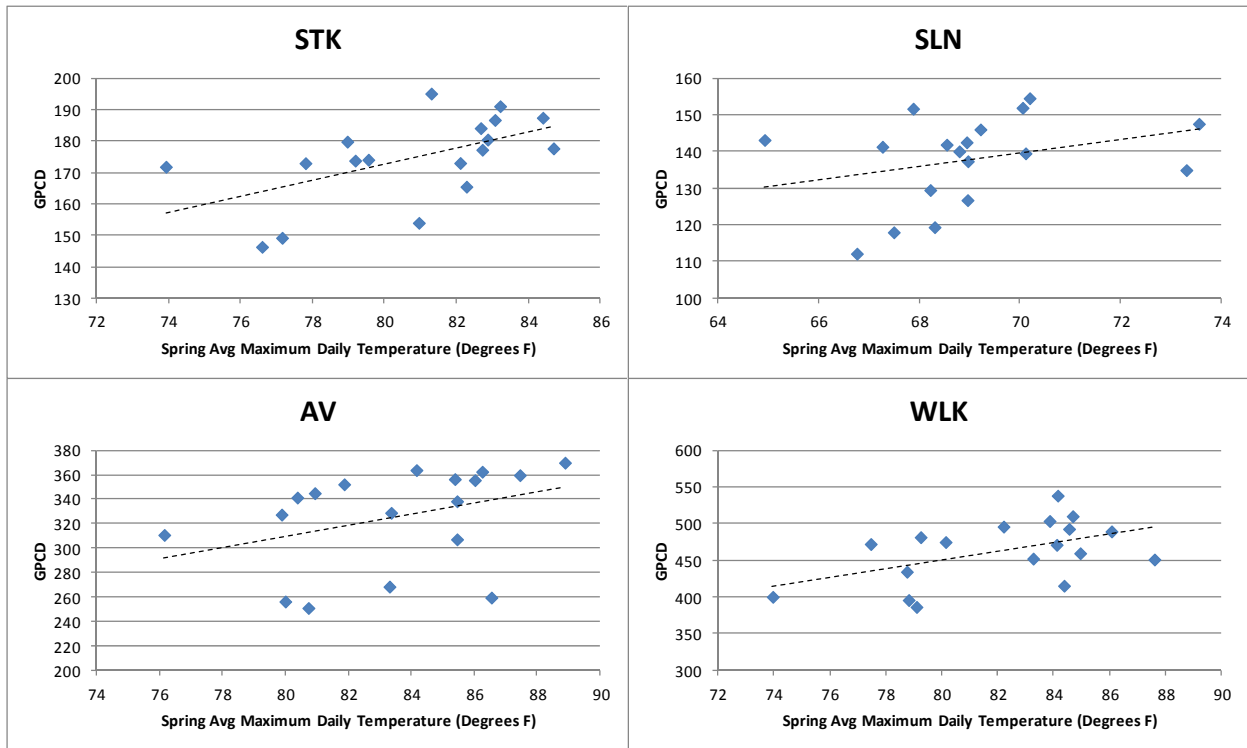


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Figure 3. GPCD v. Spring Avg Maximum Daily Temperature (1995-2012) for Four Cal Water Districts



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1 Estimation results for Cal Water's 24 districts are summarized in Table 3. Coefficient
 2 signs are consistent with *a priori* predictions in almost all cases. Where coefficient signs differ
 3 from expectation the coefficient estimates are not statistically significant. Despite its simplicity,
 4 for most districts the model explains more than 80% of the variation in annual GPCD.
 5 Estimation results confirm the critical influence that weather and economic effects have on
 6 annual GPCD. In Figure 4, we show plots of actual GPCD and values predicted by the model for
 7 four Cal Water Districts selected at random.¹³⁴

8 The simple time trend model of GPCD implied by DRA's analysis discussed in the
 9 previous section is a restricted version of the GPCD model given by equation (4). The simple
 10 time trend model from equation (1) implicitly adopts the joint hypothesis that $\beta_3 = \beta_4 = \beta_5 = 0$.
 11 We test this hypothesis using a joint F-test (Hill, Griffiths, & Judge, 2001) and find that the model
 12 of GPCD implied by DRA's analysis is rejected in favor of the unrestricted model we have
 13 estimated in every district but one.¹³⁵ In other words, omitting weather and economic effects
 14 from the model of GPCD is likely to lead to significantly biased estimation results and incorrect
 15 inferences.

16
 17 **Table 3. Estimated Parameters for GPCD Model Including Weather and Economy Effects**

District	Trend	Temp	Rain	Uempl	Constant	R-Square
AV	-3.355	2.834 **	-4.902 **	-4.157 **	159.308 *	0.9435
BG	0.661	1.009	-2.806 **	-2.821	170.602	0.7683
BK	-1.777 **	2.937 **	-1.774	-2.243 **	91.878	0.7703
CH	-3.391 **	1.065	-1.714 **	-2.944	255.169 **	0.8827
DIX	-1.518 *	1.044	-1.161 *	-1.887	107.802 *	0.8021
DOM	-0.408	-1.258	-0.848	-3.430 **	347.270 **	0.6200
ELA	-1.547 **	-0.616	-0.937 **	-2.464 **	199.889 **	0.9636
HR	-1.410 **	0.033	-0.841 **	-2.371 **	166.215 **	0.9446
KC	-2.029 **	1.113 **	-1.179 **	-1.715 **	121.629 **	0.9398
KRV	-2.258	-1.041	-1.627 **	-6.078 **	369.663 **	0.8162
LAS	-1.468	2.392	-1.797	-1.775	79.529	0.8144
LIV	-0.344	0.656	-1.780 *	-4.109	163.587 **	0.7294
MPS	-1.363 **	0.177	-1.048 **	-0.604	138.579 **	0.8925
MRL	-5.609 **	1.816 **	-1.398	-1.505 *	155.796 *	0.9582
ORO	-1.144	4.800 **	1.187	-4.395 **	-8.418	0.6979
PV	0.063	-0.598	-3.677 *	-3.540 *	350.745 **	0.4825
RDV	-5.364	1.602	0.106 **	-2.205 **	113.909 **	0.8189
SEL	-2.233 **	-1.231	-4.218 **	-6.247 **	468.855 **	0.8474
District	Trend	Temp	Rain	Uempl	Constant	R-Square

¹³⁴ We selected the districts at random to avoid any potential for selection bias in presenting graphical depictions of modeling results.

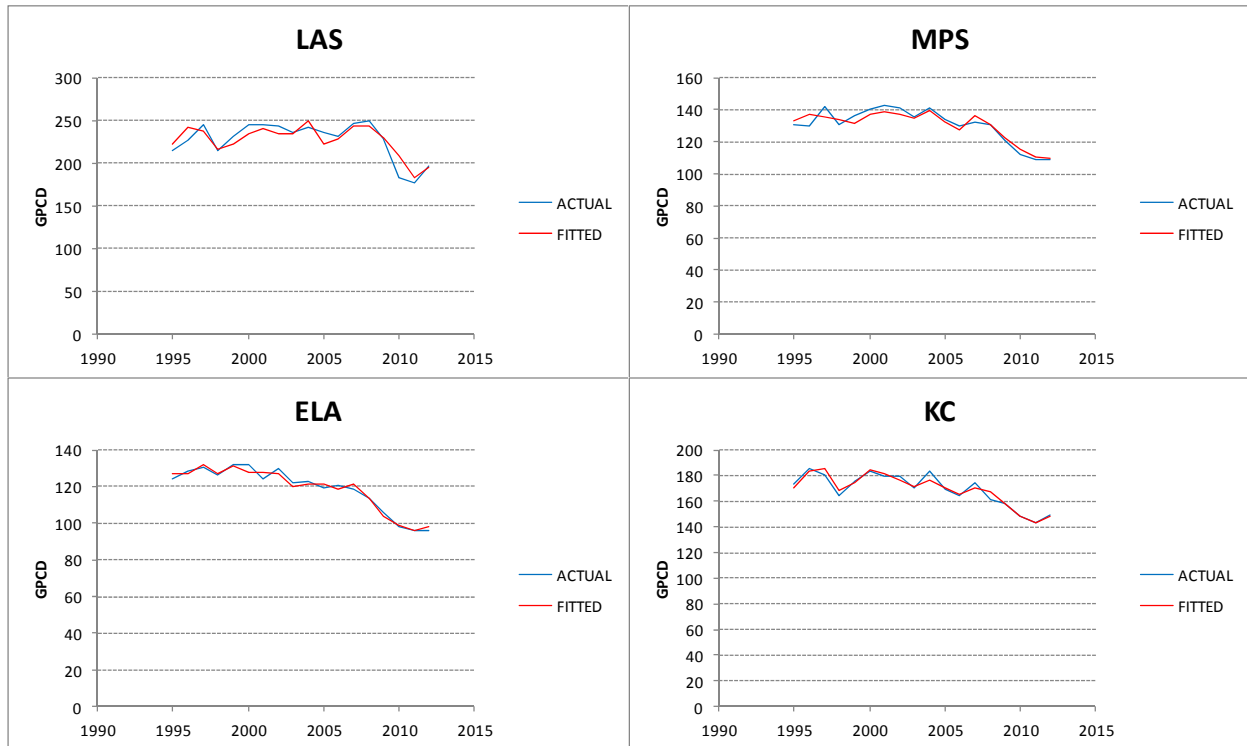
¹³⁵ The one exception is RDV for which we have the least amount of observations and for which the quality of the data is most uncertain.

SLN	-1.017 **	0.057	-1.300 **	-3.490 **	182.963 **	0.8050
SSF	-1.079 **	-0.273	-0.889 **	-1.233	182.798 **	0.8898
STK	-1.498 **	1.232 **	-1.078 *	-1.534 **	109.846 **	0.8913
VIS	-2.472 **	0.480	-2.922 **	-2.167 **	257.210 **	0.8873
WIL	-3.600 **	1.960 **	-1.778 **	-4.558 **	171.446 **	0.9453
WLK	1.333	0.374	-6.545 **	-15.683 **	546.987 **	0.7545

** Statistically different from zero at 95% level of confidence.
 * Statistically different from zero at 90% level of confidence.
 R-Square between observed and predicted GPCD.

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Figure 4. Actual v. Estimated GPCD (1995-2012) for Four Cal Water Districts



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To illustrate the inherent bias in DRA's GPCD analysis caused by ignoring economic effects, we use our estimation results to calculate the expected effect of unemployment on GPCD during the period considered by DRA, which coincides with the largest economic downturn in California history since the Great Depression. We do this by applying the unemployment elasticity derived from our model results to the percentage increase in 2010 unemployment (the year in which unemployment peaked in most districts) from the average rate of unemployment for the period 1995-2007, which we use as a proxy of the pre-recession

1 average rate of unemployment.¹³⁶ The results are shown in Table 4. The last column of the
 2 table shows the negative effect on GPCD of the sharp increase in unemployment after 2007.
 3 This effect ranges from a low of about 3.5% to a high of more than 20%. The average effect
 4 across all 24 districts is 10%. These results clearly illustrate the bias implicit in DRA's analysis
 5 of GPCD. By ignoring the effect of the economic downturn on water demand, DRA has wrongly
 6 attributed a large percentage of the recent change in GPCD to secular trend when in fact it
 7 should have been associated with transitory economic effects.

8 To further illustrate the significant bias implicit in DRA's analysis we normalize GPCD for
 9 weather and economic effects over the period 1995-2012 by replacing observed values for the
 10 two weather variables and the unemployment variable with their long-term average values.¹³⁷
 11 Examples of normalized GPCD for the four randomly selected districts are shown in Figure 5.
 12 In Figure 6 we compare the trend in GPCD normalized for weather and economic effects to the
 13 trend estimated using the simple time trend model implied by DRA's analysis. The large
 14 negative bias in the simple time trend model is clearly evident. Next we consider the
 15 consequences of this bias on DRA's assessment of GPCD status.

16
 17

Table 4. Effect of Economic Downturn on GPCD

District	Unemployment Elasticity	% Increase in 2010 Unemployment Rate Over Pre-Recession Average Rate	Expected % Change in GPCD
AV	-0.126	126.8	-16.0
BG	-0.078	123.0	-9.6
BK	-0.087	54.4	-4.7
CH	-0.095	84.6	-8.0
DIX	-0.055	111.9	-6.2
DOM	-0.105	105.6	-11.1
ELA	-0.145	105.6	-15.3
HR	-0.122	105.6	-12.9
KC	-0.098	40.2	-3.9
KRV	-0.358	54.4	-19.5
LAS	-0.049	123.0	-6.0
District	Unemployment Elasticity	% Increase in 2010 Unemployment Rate	Expected % Change in GPCD

¹³⁶ The unemployment elasticity measures the percentage change in GPCD given a one percent change in the unemployment rate, all else equal. The elasticities shown in Table 4 are measured at the sample means for GPCD and unemployment. That is, $\varepsilon = \beta_5 \frac{U_{empl}}{\bar{y}}$.

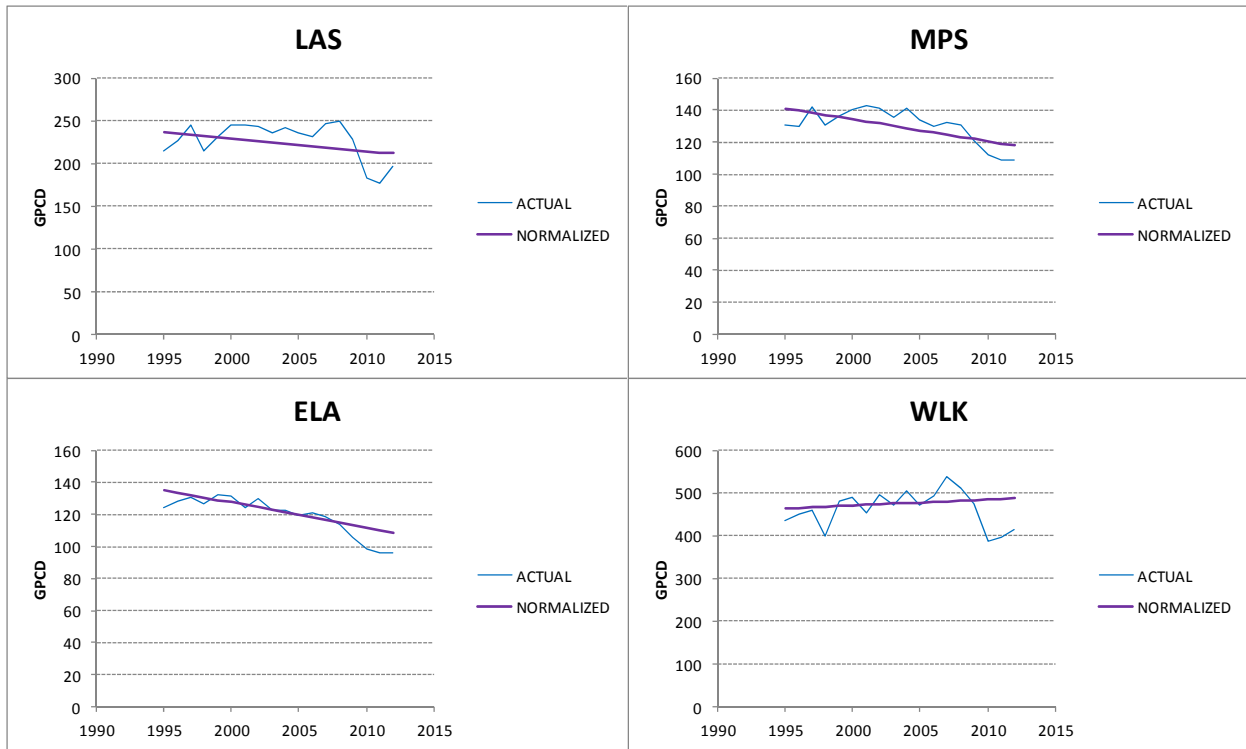
¹³⁷ In the case of the two weather variables, we use the long-term climate normals associated with the weather station from which the data was obtained. In the case of the unemployment variable, we use the average rate of unemployment for the period 1995-2007.

		Over Pre-Recession Average Rate	
LIV	-0.090	124.2	-11.2
MPS	-0.029	123.0	-3.6
MRL	-0.088	66.4	-5.8
ORO	-0.181	66.4	-12.0
PV	-0.091	105.6	-9.6
RDV	-0.084	146.8	-12.3
SEL	-0.307	46.1	-14.2
SLN	-0.245	40.2	-9.8
SSF	-0.049	124.7	-6.1
STK	-0.095	89.3	-8.5
VIS	-0.124	32.7	-4.1
WIL	-0.230	46.7	-10.7
WLK	-0.223	94.7	-21.1

1

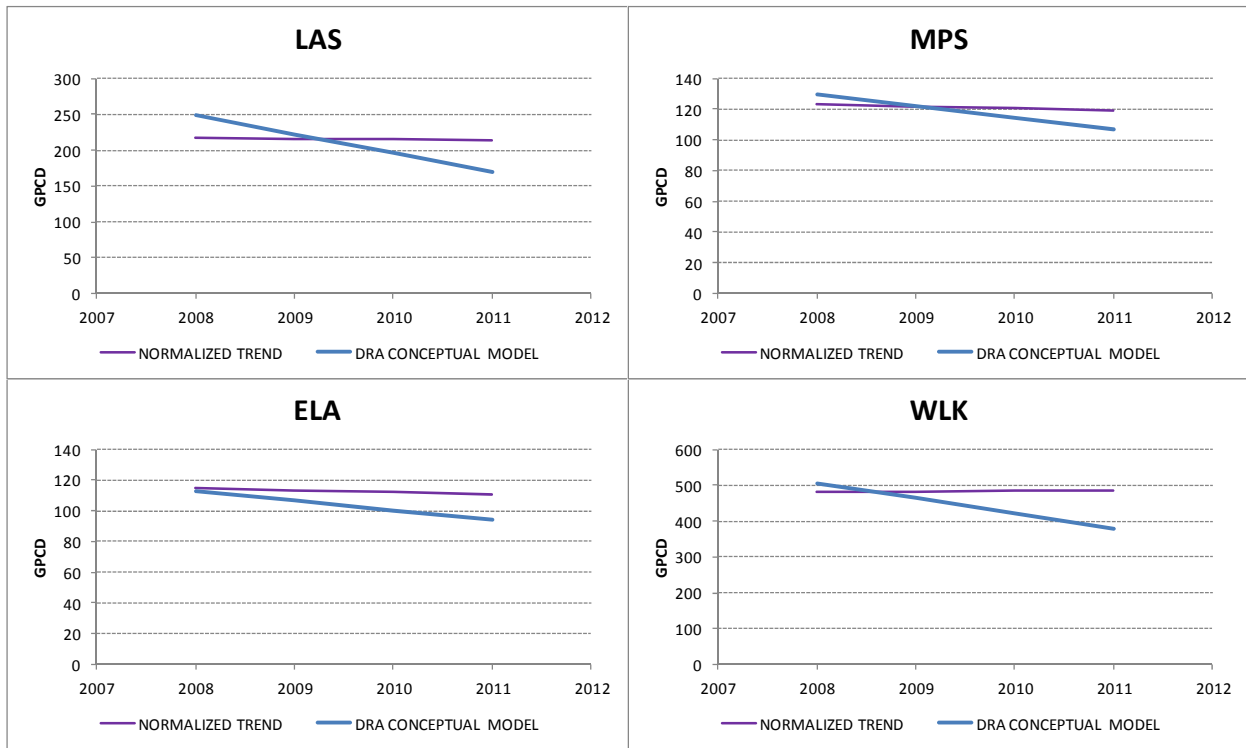
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Figure 5. Normalized GPCD (1995-2012) for Four Cal Water Districts



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1 **Figure 6. GPCD Trend Normalized for Weather and Economic Effects v. Simple Time Trend Model**



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4 We reapply DRA's grading scheme of GPCD status using GPCD normalized for weather
5 and economic effects. As before, we test the targets against the upper-bound of the 95%
6 confidence interval for expected GPCD.¹³⁸ If the upper-limit for normalized GPCD is less than
7 or equal to the 2020 target, we assigned a grade of A to the district. If it is greater than the 2020
8 target but less than or equal to the 2015 target, we assigned a grade of B. If it is greater than
9 the 2015 target we assigned a grade of "C or F." Our results are compared to the grade
10 assigned by DRA in Table 5. In 14 cases we find DRA assigned a grade of A when the data
11 support a grade of C or F.¹³⁹ In 6 cases we find DRA assigned a grade of B when the data
12 support a grade of C or F. In 3 cases we find DRA assigned a grade of A when the data support
13 a grade of B. Overall, we find that DRA misapplied its grading scheme in 23 of 24 cases.

14 Contrary to claims about GPCD status made by DRA in its report, there is not a single
15 instance where the upper-bound for average GPCD for the period 2008-11, after normalizing for

¹³⁸ The upper-bound of expected GPCD normalized for weather and economic effects is calculated as $\hat{y}_t + t_{.025} \hat{\sigma} \sqrt{\bar{x}_t' (x'x)^{-1} \bar{x}_t}$ where $\hat{\sigma}$ is the standard error of the regression, \hat{y}_t is estimated normalized GPCD, and \bar{x}_t is the vector of normalized explanatory variables.

¹³⁹ Again we want to stress the grading scheme DRA introduced into its analysis of GPCD has nothing to do with Cal Water's conservation program performance or outcomes. It is merely an ordinal indicator of where each district's GPCD during the period 2008-11 stood in relation to its 2015 and 2020 GPCD targets.

1 weather and economic effects, is less than the 2020 target and only one instance where it is
2 equal to the target. The amount that the upper-bound of average GPCD over this period
3 exceeds the 2020 target ranges from 0% to 28%. Across all 24 districts, after normalizing for
4 weather and economic effects, it exceeds 2020 target GPCD by 13%.¹⁴⁰ We note that Cal
5 Water has proposed conservation programs and budgets predicated on the need to reduce
6 aggregate 2020 demand by only an additional 6% from its baseline forecast.¹⁴¹ This is
7 significantly less than the level by which current normalized GPCD exceeds the targets.¹⁴²
8 Given that DRA has based its program level and budget recommendations on current expected
9 GPCD, if DRA had implemented its analytical framework in a statistically rigorous manner and
10 followed it to its logical conclusion, it should be concerned that Cal Water's proposed budgets
11 may not be sufficient to achieve the 2020 targets and it should be recommending an increase
12 not a decrease in the conservation budgets Cal Water has proposed.
13

¹⁴⁰ We are reporting the population-weighted average where 2011 district population has been used for weighting.

¹⁴¹ See Tables 3-6 and 3-7 of Cal Water's report "Conservation Program Recommendations and Budgets for California Water Service Company Districts."

¹⁴² This is expected because our analysis of 2020 GPCD accounts for anticipated improvements in water use efficiency between now and 2020 due to plumbing codes, conversion of flat rate customers to metered service, past investment by Cal Water in conservation, and impacts of 2011-13 rate adjustments.

1 **Table 5. Reapplication of DRA GPCD Grading Scheme to Be Consistent with Normalized GPCD**

District	2008-11 Upper-Bound Normalized GPCD	2015 SBx7-7 GPCD Target	2020 SBx7-7 GPCD Target	Amount that Upper- Bound Normalized GPCD Exceeds 2020 Target	Grade Consistent with Normalized GPCD	DRA GRADE
AV	314	312	281	33	C or F	A
BG	242	217	190	52	C or F	B
BK	292	267	239	53	C or F	B
CH	266	256	229	37	C or F	A
DIX	164	168	164	0	B	A
DOM	239	197	171	68	C or F	A
ELA	116	118	115	1	B	A
HR	134	129	126	8	C or F	A
KC	162	157	142	20	C or F	B
KRV	187	186	179	8	C or F	A
LAS	229	217	193	36	C or F	A
LIV	200	179	158	42	C or F	A
MPS	126	131	124	2	B	A
MRL	200	225	200	0	A	A
ORO	336	303	268	68	C or F	A
PV	294	255	225	69	C or F	B
RDV	167	166	157	10	C or F	A
SEL	253	241	215	38	C or F	A
SLN	139	131	117	22	C or F	A
SSF	143	138	124	19	C or F	A
STK	173	171	165	8	C or F	A
VIS	228	216	194	34	C or F	B
WIL	223	222	198	25	C or F	B
WLK	508	448	393	115	C or F	A

2

3 **Comparison of Cal Water 2020 Demand Projections to Adjacent Water Districts**

4 In this section we show that DRA's assessment of GPCD compliance status is not only
5 at odds with 2020 demand forecasts prepared by Cal Water, but also with forecasts of 2020
6 demand prepared by adjacent water districts with comparable demographics, weather, and
7 economic conditions. As we showed in the previous section, DRA's conceptual model of GPCD
8 implies that future expected GPCD will not be greater than currently observed GPCD. From this
9 basic (but incorrect) premise, DRA concludes that all but six Cal Water districts have met their
10 2020 targets and the six that have not met them are on track to do so (DRA Report, p. 1-16).
11 Using this assessment for justification, DRA recommends significant reductions in Cal Water's

1 proposed levels and budgets for conservation programs.¹⁴³ The implication is that Cal Water
2 has significantly overstated its forecasted 2020 district water demands. If this is in fact the case
3 we would expect to see evidence of it in the demand forecasts of adjacent water districts with
4 similar demographic, weather, and economic conditions. That is, we would expect to see an
5 upward bias in Cal Water projected 2020 demand relative to neighboring water suppliers. What
6 we actually see is just the opposite.

7 We examined 2020 forecasts of population, GPCD, and aggregate water demand for 27
8 water districts that are adjacent to Cal Water districts.¹⁴⁴ The data are provided in Attachment A
9 of this report. We find that over the full sample, the expected rate of increase in GPCD between
10 2010 and 2020 is the same, 9%, as the average rate of increase across the 24 Cal Water
11 Districts. However, ten of the districts we sampled have based their forecast of 2020 demand
12 on full compliance with SBx7-7. That is, they have simply set their 2020 GPCD to their 2020
13 target. Seventeen of the sampled districts included both baseline and compliance forecasts of
14 GPCD in 2020. The baseline forecasts include adjustments to 2020 GPCD for expected effects
15 of plumbing codes, passive conservation, and past investment in active conservation programs,
16 but do not include on-going active conservation program activity, which makes these forecasts
17 directly comparable to the approach used by Cal Water. Baseline GPCD for these districts is
18 forecast to increase an average of 23% between 2010 and 2020. This is more than twice the
19 average rate of increase forecast for Cal Water districts. Thus, rather than confirming DRA's
20 assessment that Cal Water has systematically biased upward its 2020 forecast of demand, data
21 from adjacent water districts shows the opposite case. Cal Water is consistently more
22 conservative in its long-range baseline demand forecast than comparable districts.

23 Our comparative analysis also reveals something else of significance. All of the sampled
24 districts that included baseline GPCD forecasts in their UWMPs predict an increase in baseline
25 GPCD in 2020 from its 2010 level. That is, anticipating economic recovery and in the absence
26 of continued investment in active conservation programs, they all expect some level of rebound
27 in demand over the long-run. Thus the GPCD analysis DRA has used to support its
28 conservation program and budget recommendations is not only at odds with Cal Water's

¹⁴³ DRA is explicit about this in its analysis and recommendations for each district contained in Chapter 2 of its report. For example, in the case of Antelope Valley DRA writes: "AV has shown a continuous reduction in customer usage since 2007 and its 2011 GPCD usage exceeded its SBx7-7 target for 2015 and 2020. CWS's objective for its AV district should be to, at a minimum;(sic) maintain its current GPCD levels through 2020." (p. 2-3) In the case of Bear Gulch, it writes: "The BG district in its 2011 usage exceeded its SBx 7-7, 2015 GPCD target by 5.8% or 12.5 GPCD. Over the period of 2008-2011, the BG district reduced its overall GPCD by 19.3%. However, the BG district's 2011 GPCD total has not yet reached its 2020 target level. In order to meet its 2020 target, BG will need to further reduce its GPCD by a total of 7.6% over the course of the next seven years." (p. 2-7)

¹⁴⁴ We obtained these forecasts from the sample districts' 2010 Urban Water Management Plans.

1 assessment of 2020 water demand for its districts, it is also contradicted by the assessment of
2 2020 water demand made by every comparable water district we could identify.

3 **Conclusions on DRA GPCD Analysis**

4 DRA has put forward a deeply flawed and misleading analysis of GPCD. It uses this
5 flawed analysis to draw incorrect conclusions regarding the likelihood of Cal Water compliance
6 with SBx7-7 requirements and to shape its recommendations for Cal Water district conservation
7 programs and budgets. We have demonstrated the inconsistencies and bias inherent in DRA's
8 methodology and conclusions in three different ways.

9 First, by following the simple time trend model of GPCD implied by DRA's analysis and
10 making statistical inferences based on the four year GPCD history considered by DRA in
11 its report, we have shown that DRA's assessment of district GPCD status is inconsistent
12 with its own grading scheme in 18, or 75%, of the districts it evaluated.

13 Second, we have shown that when economic and weather effects on GPCD are correctly
14 controlled for, DRA's assessment of district GPCD is inconsistent with its own grading
15 scheme in 23 out of 24 cases. We have also shown that after normalizing for weather
16 and economic effects, the upper-end of the range for expected GPCD across all 24 Cal
17 Water districts over the period DRA evaluated exceeds 2020 target GPCD by 13%, with
18 exceedences for individual districts ranging from 0% to 28%.

19 Third, we have shown that Cal Water's long-range forecasts of 2020 GPCD are consistently
20 more conservative than forecasts prepared by other comparable urban water suppliers.
21 Moreover, we have shown that the GPCD analysis DRA has used to support its
22 conservation program and budget recommendations is not only at odds with Cal Water's
23 assessment of 2020 water demand for its districts, it is also contradicted by the
24 assessment of 2020 water demand made by every comparable water district we could
25 identify.

26 We believe the approach used by Cal Water to forecast its 2020 district demands from
27 which it determined levels of conservation programming needed for SBx7-7 compliance is both
28 conservative and defensible. We do not find any convincing evidence in the GPCD assessment
29 DRA has put forward in its report to indicate otherwise.

30 **17.4. DRA PROGRAM RECOMMENDATIONS**

31 **Overview of DRA Program Recommendations**

32 DRA's recommendations regarding Cal Water's proposed conservation programming
33 substantially reduce both the scope of the programming for most districts and the activity levels
34 for those programs that are retained. As shown in Table 3 of the DRA report, the overall DRA-
35 recommended programmatic budget across all districts reduces Cal Water's proposal by more

1 than 70%, with impacts varying by district. The budgets and activity levels of different programs
2 are affected differently by DRA's recommendations, with some programs being unchanged and
3 others being completely eliminated.

4 The following section describes DRA's program recommendations and explains their
5 serious flaws.

6 **Critique of DRA Program Recommendations**

7 The overriding difficulty with DRA's recommendations is that they are predicated on a
8 seriously flawed analysis of the Cal Water districts' GPCD status. As demonstrated in Section
9 2.2, if the DRA program recommendations were adopted, there is little chance of most districts
10 complying with SBx7-7 requirements. Since the DRA recommendations are so dependent on its
11 flawed GPCD analytical results, on that basis alone the recommendations lose their credibility.

12 However, beyond that critical issue, there are other major difficulties with the DRA
13 program analysis. While these will be discussed in detail below, there are three overriding
14 issues that transcend individual programs. Specifically:

15 ***DRA's recommendations harm ratepayers.***

16 As explained in the Cal Water report, one of the decision rules used in developing
17 conservation program portfolios was:

18 *If a program is cost-effective (i.e. BCR \geq 1), implementation is set to the*
19 *program's maximum activity level. This rule ensures that implementation of*
20 *programs that can reduce overall water supply cost to ratepayers is maximized.*
21

22 In other words, long-run costs to utility ratepayers are reduced by maximizing the activity
23 levels for those programs for which long-term benefits exceed long-term costs.

24 DRA appears to disregard this benefit to ratepayers for those districts that it
25 (erroneously) deems to have achieved its SBx7-7 target. Even if one ignores the flawed DRA
26 GPCD analysis, not taking maximum advantage of these economically beneficial programs
27 does a serious disservice to ratepayers.

28 ***DRA's recommended program activity levels are arbitrary.***

29 In many instances, DRA program levels are unsupported and have little or no analytical
30 basis. For instance, for virtually all districts, DRA points out that the bulk of demand comes from
31 residential customers. DRA uses this fact to conclude that conservation programs for those
32 customer classes should be preferred over those for non-residential customers. This is
33 incorrect. Decisions on programming should be based on SBx7-7 compliance and economic

1 criteria. Since most water utilities' demands are primarily residential, DRA's logic would have
2 almost all utilities favoring residential over non-residential programs. This is unjustified.

3 ***DRA's program recommendations are discriminatory.***

4 On page I-20 of its report, DRA states: "In some districts however, CWS proposes
5 offering only one HECW rebate. Even if centrally administered, DRA does not agree that it is
6 cost effective to market a rebate program when only one or two rebates are budgeted to a
7 particular district. The Commission should require CWS to focus its marketing efforts to only
8 those programs that target more customers." DRA has confused results from the analytical
9 modeling done by Cal Water to determine expected program levels with a proposal to offer only
10 one or two rebates within a district. This is obviously wrong. Cal Water centrally administers its
11 programs and generally makes them available to all of its districts.¹⁴⁵ The overall program level
12 depends on demand expected from all of the districts. This overall expected level was
13 determined through the analytical modeling process described in Cal Water's conservation
14 filing. While this modeling does show small levels of participation for some programs in some
15 districts that is irrelevant to Cal Water's programmatic costs because the programs are centrally
16 administered and jointly marketed.¹⁴⁶ In the case of the HECW rebate program referenced by
17 DRA, Cal Water has budgeted for nearly 17,000 rebates across the 24 districts over the three-
18 year period. DRA's recommendations would restrict access to this and other programs only to
19 customers residing in large districts. Customers in small districts would simply not have access
20 to these programs. The only justification DRA provides for this discrimination is its fallacious one
21 about implementation cost.

22 ***Other problematic DRA program recommendations are discussed below.***

23 **■ *Rebate Programs***

24 DRA recommends "allowing *most* UHET rebates programs CWS proposed" (italics
25 added) because "the UHET rebate programs are cost effective compared to the HET or UHET
26 direct install programs." The word "most" apparently results in the Cal Water recommended

¹⁴⁵ There are some exceptions caused by logistical or program partnering constraints. But most programs are available to all districts.

¹⁴⁶ Consider for example a centrally-administered direct mail campaign where Cal Water expects a 1 in 1,000 response rate. Its unit costs are the same whether it implements the campaign in a district with 1,000 connections or a district with 50,000 connections. In the former case it may expect only 1 participant while in the latter it may expect 50. Overall, it expects 51 participants and that is the number that matters most for program design and budgeting. Actual participation will certainly diverge from this expectation. In the small district participation reasonably could be several rebates in one year and none in the next. Similarly, in the large district actual participation will likely turn out to be more or less in any given year than the expected level.

1 budget for these rebate programs in some districts (e.g. Dominguez) being unchanged. For
2 other districts (e.g. Chico), DRA totally eliminates these programs. There appears to be no
3 explanation for these divergent treatments. DRA also states that the rebates are “\$9 or less in
4 all districts but Los Altos and Livermore.” We do not understand this statement. More
5 importantly, as we explain below, DRA’s decision to recommend UHET rebate programs but
6 disallow direct install programs favors medium and high income customers over low income
7 customers.

8 **■ Direct Install Programs**

9 DRA’s reasoning in rejecting all direct install programs is particularly problematic. DRA
10 states that, since the rebate programs are more cost effective than the corresponding direct
11 install programs, the latter are disallowed for all districts.

12 Almost by definition, direct install programs will be more expensive to the utility than a
13 rebate or voucher program for the same fixture, since the rebate only pays for a portion of the
14 cost of purchasing and installing the fixture. This despite the fact that, for large programs such
15 as the centrally-administered program proposed by Cal Water, utilities will be able to secure
16 significant bulk discounts for their direct install program. According to DRA’s logic, such
17 programs would be inadvisable for any water utility to undertake because they are more costly
18 than their rebate counterparts.

19 This, of course, is not correct. Direct install programs, despite their added costs, target
20 customers that are often not reached with rebates or vouchers, thereby allowing these
21 customers to take advantage of these water-saving technologies. Importantly, these customers
22 are often low- and fixed-income families and/or residents of multi-family dwellings. The added
23 savings from these programs benefit water utilities and their ratepayers. In the case of Cal
24 Water and other water utilities in California, these savings also contribute to achieving SBx7-7
25 targets. As with Smart Controllers (discussed below), DRA has based its recommendations on
26 an incomplete understanding of the customer base and targeting strategy in which the program
27 operates. In the case of the direct install programs, doing so not only harms ratepayers
28 generally, it puts out of reach of low- and fixed-income customers conservation programs that
29 would enable them to both use water more efficiently and reduce their water bill.

30 As the Cal Water report explained, direct install programs are integrated into the
31 recommended program portfolios in accordance with a set of explicit decision rules designed to
32 comply with SBx7-7 at minimum cost to ratepayers. DRA offers no such analytical rigor in
33 rejecting these programs out of hand.

34 *High Efficiency (“HE”) Pop-Up Nozzle Voucher*

1 DRA allows this program in all districts on the strength of its annual savings and high
2 benefit-cost ratios. However, it recommends limiting the program levels to those estimated in
3 the Conservation Master Plans. Cal Water is engaged in a program shift from one focused on
4 indoor savings to one that more aggressively targets outdoor water use. Due to this shift and
5 anticipated customer demand for the program, Cal Water has increased activity levels. This
6 increase in activity levels is supported by the newly designed commercial outdoor incentive
7 program which now includes spray bodies with integrated pressure regulation/check valves and
8 rotating nozzles which provides a comprehensive solution for improving outdoor efficiency when
9 combined with the nozzle voucher program.

10 **■ Smart Controllers**

11 DRA acknowledges that “smart controllers can reduce irrigation water consumption by
12 up to 50%.” But it argues that “while a smart controller may be one of the most cost effective
13 solutions to reducing landscape water use for single family homes, it would be impractical to
14 think that a low to medium income user would purchase a smart controller when devices, such
15 as a digital water timer which costs between \$30 to \$90 each are available in the market.”

16 DRA provides no support for this assertion. DRA also appears to have overlooked Cal
17 Water’s description of the program which states that “this program will target residential and
18 non-residential customers with high landscape water use.” These customers correlate with
19 higher income customers, so even if DRA’s comment about low to medium income users were
20 correct (and they provide no evidence to support it one way or the other), it is irrelevant to this
21 program as designed. DRA’s rationale here and for other programs we discuss below
22 demonstrates its general lack of understanding of the customer base and targeting strategy in
23 which Cal Water’s conservation programs operate. As a consequence, its recommendations
24 generally ignore important demographic and economic factors that are essential to program
25 performance. In this case, it has based its recommendation on what it thinks “low to medium
26 income” customers will do, even though these customers are not the target group for this
27 program and are not the key to its effectiveness.

28 **■ Audits and Surveys Including Large Landscape Audits and Reports**

29 This section of DRA’s report addresses two distinct program groupings, one targeting
30 large landscape customers and one that targets residential and commercial customers. The
31 discussion that follows considers these two groupings separately. It is worth noting once again
32 that DRA’s recommendations for both categories stand or fall depending on the quality of DRA’s
33 GPCD analysis.

1 ■ **Large Landscape Programs**

2 Cal Water is proposing two programs that are directed specifically at Large Landscape
3 customers (i.e. those with dedicated irrigation meters and/or large irrigated landscape area),
4 namely the Water Use Report and the Survey. As described in Cal Water's report, these
5 programs are assumed to be sequential. That is, Large Landscape customers are assumed to
6 first get a water use report, which includes a landscape water budget. Customers who have
7 received such a report and need additional help staying within their water budget are the
8 primary target for the survey. Cal Water's savings estimates for the survey assume that the
9 customer has already received a water use report. The savings estimates from the two
10 programs are thus additive, and do not double count.

11 DRA recommends that both of these programs be disallowed for districts that are "on
12 target" to comply with SBx7-7 GPCD requirements. DRA does not explicitly state its program
13 recommendations for those districts that are "off target," and it is difficult to discern what they
14 are. Thus, for example, DRA deems the Bakersfield district to be "off target." Yet, DRA is
15 recommending that both the Large Landscape Water Use Report and Survey programs be
16 eliminated.

17 Cal Water acknowledges that the BCRs for both the Water Use Report and the Survey
18 are low in some districts. If program economics were the only consideration, Cal Water would
19 have proposed implementation of these programs in fewer districts. However, in many districts,
20 these programs are needed as part of a cost-minimizing strategy to comply with SBx7-7
21 requirements. As we showed in the previous section, there is only one district, MRL, for which
22 the data support DRA's definition of being "on target." Yet DRA would also disallow these
23 programs in the 16 other districts it has wrongly identified as being "on target." DRA's
24 recommendation to eliminate these programs in so-called "on-target" districts can only be
25 considered correct if: (a) sound analytically-based projections indicated that those districts
26 would meet SBx7-7 requirements without those programs; and (b) the programs were not cost-
27 effective in each of those districts. Whereas DRA provides no such evidence of this being the
28 case, the program decision rules used by Cal Water ensure that the only districts in which these
29 programs are implemented are those where either they are needed to comply with SBx7-7
30 and/or their BCR exceeds one.

31 We are also concerned that, even for districts designated by DRA as "off target", it
32 appears that DRA is still cutting back Cal Water's proposed activity levels and, in some districts,
33 eliminating the programs entirely. DRA offers no justification for doing so.

1 ■ **Residential and Commercial Programs**

2 Cal Water is proposing Audit/Survey programs for single family, multi-family, and
3 commercial customers. As described in the Cal Water report, these audits/surveys evaluate
4 both indoor and outdoor end uses; they are also intended to provide an entry point to relevant
5 rebate and/or direct installation programs by providing information and screening customers
6 regarding their suitability for these programs. It should be noted that Cal Water is proposing that
7 these programs do not start in any district until 2016.

8 In addition, Cal Water is proposing a Web-Based Home Survey program for single-family
9 customers. This program “will provide households diagnostic information on their recent and
10 historical water use, guide single-family customers through an indoor and outside water use
11 check, teach them how to check for and repair leaks, make water saving recommendations, and
12 link them to Cal Water conservation incentives and special offers.”

13 As is the case for the Large Landscape programs, DRA recommends that these
14 programs, with the exception of the web-based survey, be disallowed for districts that it has
15 wrongly concluded are “on target” to achieve their SBx7-7 GPCD targets. It is unclear what
16 DRA’s activity level recommendations are for so-called “off target” districts, since activity in
17 these programs is not proposed to start until 2016, and the DRA report only shows district-
18 specific activity level recommendations for 2014 and 2015.

19 DRA recommends that, because of its higher BCRs, that the web-based survey be
20 retained at substantially the same activity levels proposed by Cal Water.

21 We believe DRA’s recommendations to eliminate the Audit and Survey programs for
22 single-family, multi-family, and commercial customers for its “on target” districts are faulty for the
23 same reasons as laid out above for the large landscape programs.

24 Since Cal Water has proposed that implementation of the residential and commercial
25 programs begin in 2016, and DRA’s report only presents its recommendations for 2014 and
26 2015, we do not know what DRA is recommending for its “off target” districts, and therefore
27 cannot comment.

28 DRA’s recommendations for audits of residential and non-residential customers rely
29 heavily on the single-family web-based surveys. While Cal Water sees these as a useful entry-
30 level component of a comprehensive audit program, it would be inadvisable to rely solely on
31 these self-administered audits as the only way in which customers can receive conservation
32 advice specific to their situation. The web-based survey program lacks the personal contact with
33 professionals representing Cal Water that is critical to induce customers to change behaviors,
34 invest in conservation fixtures and equipment, and take advantage of other Cal Water
35 conservation offerings.

1 Finally and of key importance, the web-based program is only for single-family
2 customers. Making it the only water use survey option leaves multi-family and commercial
3 customers without any audit/survey option. This is another instance where following DRA
4 program recommendations would lead to discriminatory program implementation.

5 **■ Conservation Kits**

6 For this program, DRA reduces Cal Water’s proposed activity levels to the average of
7 2010 and 2011 activity. This makes little sense, as past activity is a poor indicator of future
8 activity here. Past program levels were constrained by staffing limitations rather than by a lack
9 of interest on the part of customers. In fact, customer response rates were and continue to be
10 high. This program is important in its own right and is critical for cross-marketing of many of the
11 rebate programs. Part of the proposed increase in staffing is to enable the higher proposed
12 levels of kit distribution. This will be accomplished, in part, by shifting some marketing and
13 outreach efforts from existing Conservation Coordinators to the requested positions of
14 Conservation Program Analyst. This will allow the Conservation Coordinators to more efficiently
15 manage day-to-day management of programs including, but not limited to, the conservation kit
16 program.

17 **■ School Education**

18 DRA recommends that the Cal Water budget for school education be cut in half to avoid
19 what it sees as duplication in targeting both fifth and sixth graders. Once again DRA
20 misunderstands the program that Cal Water is proposing. Cal Water participates in two separate
21 school education programs administered by Resource Action Programs. The first is WaterWise
22 which is targeted to 5th grade. The second is LivingWise which is targeted to 6th grade. Only
23 one of these programs is offered in a participating service area so there is no redundancy. The
24 LivingWise program is a joint program with energy utilities and it is offered in the districts where
25 there is a partnering energy utility (currently these are SCE and the Gas Company). The
26 WaterWise program is offered in districts where Cal Water does not have a partnering energy
27 utility.

28 **Conclusions on Program Recommendations**

29 At their core, DRA’s program recommendations derive from its deeply flawed analysis of
30 GPCD status. DRA’s primary consideration in recommending or disallowing programs and in
31 setting program levels is whether it deems a district to be “on target” with its SBx7-7
32 requirements. As we showed in Section 2.2., DRA got this assessment wrong in 23 out of 24

1 districts. Thus, DRA’s recommended cuts in Cal Water’s proposed conservation programs
2 have as their foundation an incorrect assessment of district GPCD status. In addition to this:

- 3 • DRA’s program recommendations are often based on assertions about programs
4 that are either incorrect or unsupported.
- 5 • DRA’s program recommendations are often arbitrary.
- 6 • DRA’s program recommendations frequently demonstrate poor understanding of
7 how the programs will be implemented and ignore important program synergies.
- 8 • DRA’s program recommendations often make little economic sense.
- 9 • DRA’s program recommendations are harmful to ratepayers and frequently
10 discriminatory.

11 The scope and level of conservation programming proposed by Cal Water is based on a
12 rigorous analytical framework, best available data, and defensible assumptions. It provides a
13 reasonable plan for ensuring compliance with SBx7-7 at minimum cost to ratepayers. DRA has
14 failed to show otherwise.

15 **17.5. DRA CONSERVATION STAFFING RECOMMENDATIONS**

16 **Overview of DRA Staffing Level Recommendations**

17 DRA acknowledges in its report the staffing plan put forward by Cal Water is appropriate
18 given the level of conservation programming Cal Water has proposed. But since DRA
19 recommends substantially reducing both the scope of the programming for most districts and
20 the activity levels for those programs that are retained, it concludes the two additional staff
21 positions proposed by Cal Water are unnecessary. DRA states:

22 DRA recommends disallowing the two new Conservation Program
23 Analyst positions requested. While DRA agrees with CWS that the
24 expansion of conservation programs, such as high-efficiency pop-up
25 nozzle vouchers require management and oversight, DRA found several
26 of CWS’s other proposed programs to be unnecessary and recommends
27 CWS not establish these programs ... Therefore, the two new positions
28 are unnecessary and CWS’s existing conservation staff can more than
29 adequately handle all of the conservation programs recommended. (p. 1-
30 17 to 1-18)

31 **Critique of DRA Staffing Level Recommendations**

32 As with its program recommendations, at its core DRA’s recommended staffing level is
33 based on its flawed analysis of the Cal Water districts’ GPCD status. DRA does not challenge
34 the need for the additional staff positions given the scope and level of programming proposed
35 by Cal Water. Rather, it challenges the scope and level of the programming itself and, as we
36 have documented already, this challenge is based on its flawed analysis of GPCD. Additionally,
37 in making its staffing level recommendation, DRA does not address at all the shift in program

1 emphasis from fixture rebates to landscape management and retrofits, which requires different
2 knowledge and skill sets to effectively implement. Lastly, while DRA asserts that “existing
3 conservation staff can more than adequately handle all of the conservation programs
4 recommended,” it fails to provide any analysis or data to support this assertion. We address
5 each of these issues in turn.

6 **DRA Acknowledges Need for Additional Staffing Given Requested Program Levels**

7 As made clear by the quote above from its report, DRA does not find fault with the
8 staffing levels proposed by Cal Water given the scope and level of program implementation Cal
9 Water has also proposed. Instead, DRA is challenging the scope and level of conservation
10 programming Cal Water has proposed for most districts. Since DRA recommends across-the-
11 board cuts in programs and activity levels, it concludes additional conservation staffing is
12 unnecessary.

13 The reasonableness of DRA’s staffing level recommendation depends entirely on the
14 reasonableness of its GPCD analysis and the program recommendations that follow from it. As
15 we have already shown conclusively, neither DRA’s GPCD analysis nor its program
16 recommendations that follow from it are reasonable. DRA misapplied its own methodology for
17 determining GPCD status in 23 out of 24 districts. Moreover, we showed, despite what DRA
18 claims in its report, that current GPCD levels, after being normalized for weather and economic
19 effects, are not at or below 2020 GPCD targets for most districts. Across all 24 Cal Water
20 districts over the period DRA evaluated we found the statistical upper-bound of normalized
21 GPCD exceeded the 2020 target GPCD by 13%, on average, which is considerably more than
22 was assumed by Cal Water for determining programming levels needed for SBx7-7 compliance.

23 Moreover, we do not finding anything in DRA’s report to indicate it disagrees with the
24 basic analytical framework Cal Water employed to derive proposed program levels for each
25 district. In fact, DRA relies heavily on Cal Water’s analytical results for its own district-by-district
26 assessment of conservation programming needs. Where the difference lies is with the baseline
27 assumptions of demand in 2020 and, given this baseline, the volume of water savings from
28 conservation programming that will be needed for SBx7-7 compliance. In Section 2.2 we
29 showed that DRA’s assessment of baseline 2020 demand is not only at odds with Cal Water’s; it
30 is at odds with every other comparable urban water supplier we could identify. If the
31 Commission determines that the scope and level of program implementation Cal Water has
32 proposed is reasonable, then there is nothing DRA has put forward to indicate that the staffing
33 levels proposed by Cal Water are not also reasonable.

1 **DRA Ignores Key Rationale for New Staff Positions**

2 Overtime, Cal Water is proposing to shift its conservation programs from being focused
3 primarily on indoor water savings to being focused on landscape water savings. As Cal Water
4 states in its report:

5 The portfolios recommended for SBx7-7 compliance shift emphasis to
6 and greatly expand landscape conservation programs. Nearly three-
7 quarters of modeled water savings in 2020 are expected to come from
8 landscape programs. Effective management, coordination, and oversight
9 of these programs will be paramount to the realization of expected water
10 savings. Two programs in particular are critical to realization of expected
11 water savings. These are the pop-up nozzle voucher program and the
12 smart controller rebate program.

13 While DRA mentions this intended shift in its report (DRA Report, p. 1-17), it does not
14 appear that it comprehends the significance of it on staffing needs. Of the two additional
15 positions proposed by Cal Water, one would be exclusively focused on the implementation and
16 management of the expanded landscape conservation programs. As anyone that has worked in
17 urban water conservation knows, landscape conservation programs are fundamentally different
18 from rebate and survey programs addressing indoor water use and fixture replacement.
19 Implementing successful landscape programs requires specific technical knowledge about
20 landscape design, plant biology, irrigation systems, weather, and many other factors that simply
21 do not apply to indoor conservation. DRA’s staffing recommendation ignores this reality. DRA
22 simply assumes current staff will take on the task of implementing and managing expanded
23 landscape programs without inquiring about the technical capacity to do so.

24 DRA fails to recognize that Cal Water’s proposed staffing plan is designed to address
25 two different issues. First, it is designed to address a simple labor capacity issue by proposing
26 an additional two positions. As we demonstrate in the next section, Cal Water operates its
27 conservation programs in a highly-efficient, bare-bones manner relative to sector norms.
28 Existing staffing level is a critical constraint on Cal Water’s ability to expand its conservation
29 programs for SBx7-7 compliance purposes. Second, it is designed to address a technical
30 capability issue by dedicating one of the two new positions to the implementation and
31 management of its expanded landscape programs. The person hired in this position will have
32 the educational background and technical knowledge necessary for the task.

33 **Cal Water Conservation Staffing Level is Low Relative to Sector Norms**

34 In its report, DRA blithely asserts that “existing conservation staff can more than
35 adequately handle all of the conservation programs recommended.” DRA does not provide any
36 analysis or empirical evidence to support this assertion. If DRA had taken a more empirical

1 approach to this question, as we do below, it would have realized that Cal Water’s current
2 conservation program staffing level is significantly below what one would expect given the
3 number of districts and total population it serves.

4 We compiled data on service area population, number of accounts, annual deliveries,
5 conservation program expenditure (excluding in-house staff expenditure), and conservation
6 program staff level for 154 retail water suppliers that reported to CUWCC in 2008.¹⁴⁷ We then
7 regressed conservation program staffing levels (in full-time equivalents) against population,
8 accounts, deliveries, and program expenditure (excluding in-house labor and related costs) to
9 determine functional relationships between conservation staff level and these service area
10 variables. We use the regression results to calculate “expected” conservation staff level for Cal
11 Water districts for two scenarios.

12 The first scenario considers the expected total number of FTE conservation staff
13 assuming each Cal Water District is operated as a standalone utility enterprise – i.e.
14 the level of staffing that would be expected if conservation programs were not
15 centrally administered by Cal Water but rather were run independently by each
16 district.

17 The second scenario treats Cal Water’s 24 districts as a single mega-district, and
18 estimates the level of conservation program staffing that would be expected for this
19 mega-district.

20 Neither scenario reproduces Cal Water’s situation exactly. The first scenario does not
21 account for economies of scale and scope that Cal Water can realize by centrally administering
22 its conservation programs and therefore provides an extreme upper-bound of the level of
23 conservation program staffing one would expect given the total population, number of accounts,
24 and water deliveries administered by the 24 districts. The second scenario treats Cal Water’s
25 districts as a single very large district – about 30% larger in population than either East Bay
26 Municipal Utilities District or City of San Diego, two of the largest retail water suppliers in the
27 state – and by doing so does not account for the geographic dispersion and very heterogeneous
28 demand and supply characteristics of the 24 districts served by Cal Water. It therefore provides
29 a lower-bound of the level of conservation program staffing one would expect for these
30 circumstances. Considering both the advantages of centrally administering Cal Water’s
31 conservation programs as well as the geographic dispersion and heterogeneity of its districts,
32 we conclude a level of program staffing, consistent with staffing levels reported by the majority
33 of urban retail water suppliers implementing BMPs, would be bracketed by these two estimates.

34 The estimated staffing level model is given in equation (5).

¹⁴⁷This is the most recent year for which this data is available from the CUWCC website.

$$(5) FTE_i = \beta_1 + \beta_2 ACCT_i + \beta_3 DEL_i + \beta_4 PROG_i + \beta_5 (PROG_i)^2 + e_i$$

In equation (5), FTE_i is the full-time equivalent conservation program staff in 2008 for water supplier i , $ACCT_i$ is the number of accounts in 2008 served by water supplier i , DEL_i is the average delivery per account in 2008, and $PROG_i$ is the non-staff conservation program expenditure in 2008. Estimation results are summarized in Table 6.¹⁴⁸ All estimated coefficients have the expected signs and, with the exception of β_3 , are statistically significant at the 95% level or better. The p-value for β_3 is 0.079, indicating that it is statistically significant at better than the 90% confidence level. The model explains approximately 52% of the observed variation in conservation staffing level across the sample of water suppliers.

Table 6. Conservation Staff Level Model Results

Variable	Coefficient Estimate	t-ratio	p-value
ACCT	0.14955	3.622	0.000
DEL	0.12436	1.771	0.079
PROG	-0.10009	-3.303	0.001
(PROG) ²	0.011983	4.893	0.000
CONSTANT	-0.86742	-2.336	0.021
R-Square	0.5229		

Scenario 1 Estimated Staffing Level for Cal Water Districts

We used the model results in Table 6 with 2010 service area variables and proposed 2014 district conservation program budgets to estimate expected conservation staffing level (in full-time equivalents) for each Cal Water District. Results are shown in Table 7. Note that this scenario assumes that each Cal Water District operates as a standalone utility enterprise responsible for implementing its own conservation program. Under this assumption, Cal Water's 24 districts would be expected to have cumulative conservation staffing of 46.73 full-time equivalent positions.

Table 7. Scenario 1 Conservation Program Staff Levels by District

District	2010 Accounts	2010 Deliveries (AF)	2010 Delivery/Acct (AF)	2014 Proposed Program Budget (in 2008 Dollars)	Expected Conservation Staff Level (FTE)
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¹⁴⁸ Log transformations were applied to each variable prior to estimation. For staffing and program expenditure, the transformations are $\ln(1+FTE)$ and $\ln(1+PROG)$, respectively, to handle observations with zero values for these variables.

District	2010 Accounts	2010 Deliveries (AF)	2010 Delivery/Acct (AF)	2014 Proposed Program Budget (in 2008 Dollars)	Expected Conservation Staff Level (FTE)
AV	1,364	944	0.691615866	16,266	0.38
BG	18,176	12,907	0.710141241	430,756	2.58
BK	66,166	77,177	1.166418327	458,962	3.69
CH	27,378	26,572	0.970546111	154,675	2.23
DIX	2,805	1,503	0.535821655	19,650	0.53
DOM	32,653	33,543	1.0272554	668,073	3.50
ELA	25,929	16,592	0.639927538	441,745	2.75
HR	26,195	12,446	0.475150286	607,567	2.88
KC	2,490	1,724	0.692374388	22,269	0.58
KRV	4,275	1,105	0.258595135	19,640	0.49
LAS	18,248	11,648	0.638300913	258,132	2.19
LIV	17,868	10,260	0.574217717	370,650	2.37
MPS	35,458	15,956	0.449989623	963,329	3.47
MRL	3,644	2,365	0.648904025	9,764	0.49
ORO	3,462	3,020	0.872399282	25,056	0.73
PV	23,838	19,083	0.800530674	493,841	2.90
RDV	1,951	424	0.217126319	13,687	0.23
SEL	6,098	6,000	0.983921228	29,023	0.96
SLN	27,341	16,940	0.619564769	858,297	3.36
SSF	16,208	8,465	0.52226524	558,083	2.58
STK	41,829	27,218	0.650692104	185,054	2.39
VIS	39,539	31,762	0.803319038	272,122	2.72
WIL	2,331	1,937	0.830944776	28,584	0.66
WLK	6,894	7,758	1.125468523	319,624	2.09
Total	452,138	347,349	0.768235204*	7,224,847	46.73
*Average delivery per account for all 24 districts.					

1

2 Scenario 2 Estimated Staffing Level for Cal Water Districts

3 In scenario 2, Cal Water districts are treated as a single large integrated utility. Staffing
4 level is estimated using total accounts, deliveries, and program expenditures summed across all
5 24 districts (i.e. the account, delivery per account, and program expenditure totals shown in the
6 last row of Table 7 are used with the regression model). This produces an estimated staffing
7 level of 10.66 FTEs.

8 Table 8 compares the estimated staffing level from Scenario 2 to the average staffing
9 levels for retail water suppliers grouped by population served. Of the districts reporting 2008

1 data to CUWCC, 19 had populations between 200,000 and 500,000. The average reported
 2 staffing level for these districts was 5.42 FTEs. Seven of the districts reporting 2008 data to
 3 CUWCC had populations between 500,000 and 1,000,000. The average reported staffing level
 4 for these districts was 9.29 FTEs. Only three districts reporting to CUWCC served populations
 5 in excess of 1,000,000. For these districts, average conservation program staffing level was
 6 14.67 FTE positions.¹⁴⁹ Cal Water's 24 districts collectively served about 1.7 million people.
 7 Thus the Scenario 2 estimate of 10.66 FTEs derived from the regression model is about 4 FTEs
 8 less than the average staffing level for districts of comparable size. From this, we conclude the
 9 Scenario 2 estimate provides a very conservative lower-bound estimate of staffing level that
 10 would be consistent with other very large retail water suppliers implementing conservation
 11 programs in California.

12
 13 **Table 8. Conservation Staff Level by Population Served**

Retail Utilities Serving Populations Greater Than	Staff Level (FTE)
Avg Staffing Level of Districts with Populations between 200,000 and 500,000 (n = 19)	5.42
Avg Staffing Level of Districts with Populations between 500,000 and 1,000,000 (n = 7)	9.29
Avg Staffing Level of Districts with Populations greater than 1,000,000 (n = 3)	14.67
Estimated Staffing Level for Cal Water under Scenario 2*	10.66
* Population served by Cal Water Districts in 2010 was approximately 1.7 million people.	

14
 15 Our analysis demonstrates that Cal Water's current conservation program staff level of 4
 16 FTE positions is significantly less than the level of staffing expected given the population and
 17 number of accounts served by its 24 districts. If these districts were operated independently
 18 and were responsible for fielding their own conservation programs, we estimate the districts
 19 would collectively staff 46.73 FTE conservation positions. Assuming centralized conservation
 20 program administration, the analysis conservatively estimates a staffing level of 10.66 FTE
 21 conservation positions, which is more than twice Cal Water's current staffing level. We
 22 consider this to be a lower-bound estimate for the appropriate level of staffing consistent with
 23 sector norms since it does not take into account the geographic dispersion and very
 24 heterogeneous demand and supply characteristics of the 24 districts, which would be expected

¹⁴⁹ The maximum staffing level was 21 FTE positions.

1 to impose greater demands on conservation staff services than would be the case for a single
2 large contiguous region.

3 **Conclusions on DRA Conservation Staffing Recommendations**

4 DRA does not dispute the staffing plan put forward by Cal Water given the level of
5 conservation programming Cal Water has proposed. However, because DRA recommends
6 substantially reducing both the scope of the programming for most districts and the activity
7 levels for those programs that are retained, it concludes the two additional staff positions
8 proposed by Cal Water are unnecessary. We have demonstrated in three ways why DRA's
9 staffing level recommendations are unfounded:

10 First, we have shown that if the Commission determines that the scope and level of program
11 implementation Cal Water has proposed is reasonable, then there is nothing DRA has
12 put forward in its report to indicate that the staffing levels proposed by Cal Water are not
13 also reasonable.

14 Second, we have shown that DRA failed to account for the fact that Cal Water's proposed
15 staffing plan is designed to address two different issues. Not only is it designed to
16 address a simple labor capacity issue by proposing an additional two positions, it is also
17 designed to address a technical capability issue by dedicating one of the two new
18 positions to the implementation and management of its expanded landscape programs.
19 DRA's staffing level recommendation completely ignores the criticality of this second
20 objective.

21 Third, our analysis demonstrates that Cal Water's current conservation program staff level of
22 4 FTE positions is significantly less than one would expect based on industry norms
23 given the population and number of accounts served by its 24 districts. If these districts
24 were operated independently and were responsible for fielding their own conservation
25 programs, we estimate the districts would collectively staff 46.73 FTE conservation
26 positions. Assuming centralized conservation program administration, we very
27 conservatively estimate a staffing level of 10.66 FTE conservation positions, or more
28 than twice Cal Water's current staffing level.

29 The staffing level proposed by Cal Water is both conservative and defensible. We do not
30 find any convincing evidence in the staffing level analysis DRA has put forward in its report to
31 indicate otherwise.

32 **17.6. DRA ANALYSIS OF PROGRAM BENEFIT-COST RATIOS**

33 **Overview of DRA Analysis**

34 DRA states that "the district specific benefit cost ratios (BCR) for each conservation
35 program presented in the M-Cubed Report have substantially changed with some conservation
36 programs showing a BCR increase of over 700% when compared to the district's 2011 Master

1 Plans. CWS did not provide any explanation for this significant difference.” DRA then shows a
2 table (Table 4) that purports to compare the rate case and master plan BCRs for one district
3 (Hermosa-Redondo).

4 **Critique of DRA Analysis**

5 DRA’s analysis is flawed and misleading for several reasons:

- 6 • It ignores the explanation provided by Cal Water for updating the benefit-cost analysis.
- 7 • The table presented by DRA which it calls an “example” of the discrepancies in BCRs for
8 one district is incomplete.
- 9 • DRA’s characterization of the BCR changes as “substantial” is misleading, and ignores
10 the most important question of the degree to which and the manner in which the
11 differences in the master plan and rate case BCRs will change the programmatic
12 recommendations.

13
14 Each of these issues will now be addressed.

15 **■ Cal Water Explains the Changes**

16 Despite DRA’s statement to the contrary, Section 1.3 of Cal Water’s report, which is
17 titled “Relationship to Conservation Master Plans,” explicitly recognizes that some of the
18 underlying cost and savings assumptions have changed since the master plans were
19 developed. It states that “the analyses in this document use those plans as starting points on a
20 path to meet the ultimate 2020 savings targets” and that “the current analysis incorporates
21 knowledge about those programs that has been garnered from Cal Water program
22 implementation experience since the preparation of the master plans, and therefore adjusts
23 some of the program savings and cost assumptions.”

24 When the master plans were developed, Cal Water used the best assumptions that were
25 available at the time, based on Cal Water’s own experience to that point and on the experience
26 of other water utilities with similar programs. Between the preparation of the master plans and
27 the development of this General Rate Case application, Cal Water was able to learn from its
28 own program implementation as well as from information that became available from other utility
29 programs. Cal Water would have been remiss if it had ignored this added information, and
30 would have done a disservice to its ratepayers. The state of knowledge about water utility
31 conservation programs is constantly evolving. The changes in assumptions between the master
32 plans and the rate case reflect that evolution.¹⁵⁰

¹⁵⁰ For a few districts, the avoided costs also changed, again based on updated information.

Cooling Tower pH Cont: Cust Reb, Inc	Industrial	5.30	5.92	0.62
Industrial Process: Audits & Incentives	Industrial	4.13	4.42	0.29

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Of the 31 comparisons, the rate case BCR is higher than that of the master plan for 14 programs and lower in 17.

At the bottom of its table, DRA calculates the average BCR difference across its partial list of programs as 0.82. We believe that such an average has no analytical utility. That said, the average across all of the programs for Hermosa-Redondo, as shown above in

Table 9, is 0.28.

If we examine a broader sample of districts, the results are much the same. Thus, an analysis of 11 districts¹⁵¹ shows that the number of programs for which the difference between the master plan and rate case BCRs is positive is almost exactly equal to the number for which the difference is negative. In other words, the BCRs increase half the time, and decrease half the time. There is no systematic bias.

■ ***DRA’s Characterization of BCR Changes is Misleading***

DRA says that the BCRs “have substantially changed” between the master plans and the rate case. In support of this assertion, it cites some very large percentage increases. It is important to understand that changes of this magnitude are very rare; DRA is citing outliers.

More importantly, the appropriate measure of the significance of the BCR changes is the degree to which they cause changes in the mix of program recommendations. The likelihood of a program being included in a proposed portfolio will only be affected if the master plan BCRs and the rate case BCRs are on opposite sides of 1.0. That is:

If the master plan BCR for a program is less than 1.0 and the rate case BCR is greater than 1.0, the change will result in a higher likelihood of the program being included.

If the master plan BCR for a program is greater than 1.0 and the rate case BCR is less than 1.0, the change will result in a lower likelihood of the program being included.

In

Table 9, there are no programs of Type 1, and 3 programs of Type 2. That is, there are no programs in the Hermosa-Redondo district for which the change in BCR increases the likelihood of inclusion in the proposed portfolio for that district; there are 3 programs for which the change decreases that likelihood.

¹⁵¹ These districts are those whose master plans included all programs.

1 When we expand our analysis to cover a broader sampling of districts, we find that 5%
2 of the BCR changes are Type 1, and an identical 5% are Type 2. For the remaining 90% of the
3 programs across districts, the change in BCR has no effect on whether the program is or is not
4 included in the proposed portfolio.

5 In short, if the development of Cal Water’s proposed program portfolios had been based
6 on the master plan BCRs, those portfolios would have changed very little. The changes in BCRs
7 that concern DRA are virtually irrelevant.

8 **Conclusions on DRA BCR Concerns**

9 DRA expresses concern about the changes in BCRs between the Cal Water
10 Conservation Master Plans and the General Rate Case application. Our responses to this are
11 summarized as follows:

- 12 • DRA fails to note the explanation offered by Cal Water for the differences. The
13 changes reflect the ongoing process of acquiring and incorporating new and better
14 information into the analytic process. That evolution of savings and cost assumptions
15 are a reflection of Cal Water’s accumulation of experience with often-innovative
16 programs as well as added information from similar programs run by other water
17 utilities. The incorporation of this better information in successive analytical efforts
18 reflects sound analytical practice and a desire to ensure that the company’s
19 implementation of conservation programs is maximally beneficial to ratepayers.
- 20 • When the proposed programs of a broad and representative sample of Cal Water
21 districts are examined, the number of programs for which the rate case BCRs have
22 increased is almost identical to the number for which the BCRs have decreased.
23 There is no bias in the changes. As indicated above, they are only reflective of more
24 recent information.
- 25 • The BCR changes that DRA calls “substantial” are such that, had the master plan
26 BCRs been used to develop Cal Water’s proposed district-specific program
27 portfolios, the portfolios would have been substantially unchanged.

28 **17.7. SUMMARY AND CONCLUSIONS**

29 We do not find any compelling evidence in DRA’s “Report on the Conservation Program
30 and Expenses of California Water Service Company” to warrant modifying conservation
31 programs, budgets, and staffing proposed by Cal Water. The scope and level of conservation
32 programming proposed by Cal Water is based on a rigorous analytical framework, best
33 available data, and defensible assumptions. It provides a reasonable plan for ensuring
34 compliance with SBx7-7 at minimum cost to ratepayers. We cannot say the same for DRA’s
35 analysis.

36 With regard to DRA’s analysis of GPCD status we conclude:

- 1 • First, by following the simple time trend model of GPCD implied by DRA’s
2 analysis and making statistical inferences based on the four year GPCD history
3 considered by DRA in its report, we have shown that DRA’s assessment of
4 district GPCD status is inconsistent with its own grading scheme in 18, or 75%, of
5 the districts it evaluated.
- 6 • Second, when economic and weather effects on GPCD are correctly controlled
7 for, DRA’s assessment of district GPCD is inconsistent with its own grading
8 scheme in 23 out of 24 cases. We have also shown that after normalizing for
9 weather and economic effects, the upper-end of the range for expected GPCD
10 across all 24 Cal Water districts over the period DRA evaluated exceeds 2020
11 target GPCD by 13%, with exceedences for individual districts ranging from 0%
12 to 28%.
- 13 • Third, Cal Water’s long-range forecasts of 2020 GPCD are consistently more
14 conservative than forecasts prepared by other comparable urban water suppliers.
15 Moreover, we have shown that the GPCD analysis DRA has used to support its
16 conservation program and budget recommendations is not only at odds with Cal
17 Water’s assessment of 2020 water demand for its districts, it is also contradicted
18 by the assessment of 2020 water demand made by every comparable water
19 district we could identify.

20 With regard to DRA’s program recommendations we conclude:

- 21 • At their core, DRA’s program recommendations derive from its deeply flawed
22 analysis of GPCD status. DRA’s primary consideration in recommending or
23 disallowing programs and in setting program levels is whether it deems a district
24 to be “on target” with its SBx7-7 requirements. As we have shown, DRA got this
25 assessment wrong in 23 out of 24 districts. Thus, DRA’s recommended cuts in
26 Cal Water’s proposed conservation programs have as their foundation an
27 incorrect assessment of district GPCD status.
- 28 • Moreover, we find DRA’s program recommendations are frequently based on
29 assertions about programs that are incorrect or unsupported; result in
30 inconsistent or arbitrary treatment of individual districts; and would harm
31 ratepayers overall or wrongly discriminate against subsets of ratepayers.

32 With regard to DRA’s staffing level recommendations we conclude:

- 33 • If the Commission determines that the scope and level of program
34 implementation Cal Water has proposed is reasonable, then there is nothing
35 DRA has put forward in its report to indicate that the staffing levels proposed by
36 Cal Water are not also reasonable.
- 37 • DRA’s staffing recommendation fails to account for the fact that Cal Water’s
38 proposed staffing plan is designed to address two different issues. Not only is it
39 designed to address a simple labor capacity issue by proposing an additional two
40 positions, it is also designed to address a technical capability issue by dedicating

1 one of the two new positions to the implementation and management of its
2 expanded landscape programs. DRA's staffing level recommendation
3 completely ignores the criticality of this second objective.

- 4 • DRA fails to support its assertion that Cal Water's current conservation program
5 staff level of 4 FTE positions is more than adequate to operate all of its
6 programs. As we have shown, the current staffing level is significantly less than
7 one would expect based on industry norms given the population and number of
8 accounts served by its 24 districts. If these districts were operated independently
9 and were responsible for fielding their own conservation programs, we estimate
10 the districts would collectively staff 46.73 FTE conservation positions. Assuming
11 centralized conservation program administration, we very conservatively estimate
12 a staffing level of 10.66 FTE conservation positions, or more than twice Cal
13 Water's current staffing level.

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Attachment A

Comparative Analysis of Water Supplier Forecasted 2020 Population, GPCD, and Demand

		2010-2020 Population Growth (%)	2010-2020 GPCD Growth (%)	2010-2020 Demand Growth (%)	
Cal Water District:	Antelope Valley	0%	17%	17%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	Palmdale Water District	79%	13%	102%	Unknown conservation assumptions
Cal Water District:	Bear Gulch	0%	10%	10%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Sunnyvale	4%	-6%	-2%	2020 based on full SBx7 compliance
	City of Palo Alto	9%	22%	33%	Baseline before active conservation
	Redwood City	6%	4%	10%	2020 adjusted for plumb. Codes
	Average	7%	7%	14%	
Cal Water District:	Chico	0%	6%	6%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	Paradise Irrigation District	9%	4%	13%	2020 based on full SBx7 compliance
Cal Water District:	Dixon	0%	6%	6%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Davis	8%	7%	15%	2020 based on full SBx7 compliance
	Vacaville	8%	6%	15%	2020 adjusted for plumb. Codes
	Average	8%	7%	15%	
Cal Water District:	Dominguez	0%	-5%	-5%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Lomita	5%	10%	15%	2020 based on full SBx7 compliance
	City of Torrance	5%	4%	9%	2020 adjusted for plumb. Codes
	Average	5%	7%	12%	

PUBLIC VERSION

		2010-2020 Population Growth (%)	2010-2020 GPCD Growth (%)	2010-2020 Demand Growth (%)	
Cal Water District:	East Los Angeles	0%	10%	10%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	GSWC Bell/Bell Gardens	1%	15%	17%	Unknown conservation assumptions
	Montebello	2%	6%	8%	Unknown conservation assumptions
	Average	1%	11%	12%	
Cal Water District:	Hermosa-Redondo	0%	4%	4%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Lomita	5%	10%	15%	2020 based on full SBx7 compliance
	City of Torrance	5%	4%	9%	2020 adjusted for plumb. Codes
	Average	5%	7%	12%	
Cal Water District:	King City	1%	4%	5%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Soledad	35%	8%	46%	Unknown conservation assumptions
	Hollister Urban Area	34%	10%	47%	2020 based on full SBx7 compliance
	City of Watsonville	5%	1%	6%	2020 based on full SBx7 compliance
	Average	24%	6%	33%	
Cal Water District:	Los Altos	0%	26%	26%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Mountain View	8%	23%	32%	2020 adjusted for plumb. codes
	City of Sunnyvale	4%	-6%	-2%	2020 based on full SBx7 compliance
	Average	6%	8%	15%	
Cal Water District:	Livermore	0%	25%	25%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Livermore	18%	-8%	8%	2020 based on full SBx7 compliance
	City of Pleasanton	9%	-5%	3%	2020 based on full SBx7 compliance
	Average	14%	-7%	6%	
Cal Water District:	Mid Peninsula	0%	11%	11%	Adjusted baseline; no active cons.

PUBLIC VERSION

		2010-2020 Population Growth (%)	2010-2020 GPCD Growth (%)	2010-2020 Demand Growth (%)	
Comparison Retail Agency(s):	City of Mountain View	8%	23%	32%	2020 adjusted for plumb. Codes 2020 based on full SBx7 compliance Unknown conservation assumptions 2020 adjusted for plumb. Codes
	City of Menlo Park	4%	-4%	0%	
	City of Palo Alto	9%	22%	33%	
	Redwood City	6%	4%	10%	
	Average	7%	11%	19%	
Cal Water District:	Marysville	0%	2%	2%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	Linda County WD	16%	10%	28%	Baseline; no active cons. 2020 based on full SBx7 compliance
	Yuba City	34%	-10%	21%	
	Average	25%	0%	25%	
Cal Water District:	Salinas	0%	20%	20%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Soledad	35%	8%	46%	Unknown conservation assumptions 2020 based on full SBx7 compliance 2020 based on full SBx7 compliance
	Hollister Urban Area	34%	10%	47%	
	City of Watsonville	5%	1%	6%	
	Average	24%	6%	33%	
Cal Water District:	South San Francisco	0%	3%	3%	
Comparison Retail Agency(s):	City of Daly City	10%	31%	43%	2020 adjusted for plumb. Codes
Cal Water District:	Selma	0%	17%	17%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Hanford	34%	6%	42%	Baseline; no active cons.
Cal Water District:	Stockton	0%	9%	9%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Lodi	10%	-6%	4%	2020 based on full SBx7 compliance Baseline; no active cons.
	City of Stockton	18%	12%	32%	

PUBLIC VERSION

		2010-2020 Population Growth (%)	2010-2020 GPCD Growth (%)	2010-2020 Demand Growth (%)	
	Average	14%	3%	18%	
Cal Water District:	Visalia	8%	-4%	3%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Hanford	34%	6%	42%	Baseline; no active cons.
	City of Tulare	49%	31%	95%	Baseline; no active cons.
	Average	42%	18%	69%	
Cal Water District:	Westlake	0%	17%	17%	Adjusted baseline; no active cons.
Comparison Retail Agency(s):	City of Thousand Oaks	1%	21%	23%	2020 adjusted for plumb. codes
	GSWC Simi Valley	7%	36%	46%	Baseline; no active cons.
	Average	4%	29%	34%	
Average % Growth in GPCD 2010-2020:					
	Cal Water Districts*		9%		
	Full UWMP Sample		9%		
	Excluding suppliers assuming full SBx7-7 compliance		23%		
<p>*Based on all 24 Cal Water Districts Regional comparisons were not made for the following Cal Water districts due to absence of comparable nearby retail water supplier(s). Bakersfield Kern River Valley Oroville Palo Verdes Redwood Valley Willows</p>					

1 **CHAPTER 18: CONSOLIDATION OF DISTRICTS (TOM SMEGAL)**

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3 In compliance with the Minimum Data Requirements, Cal Water indicated in Direct
4 Testimony submitted by Mr. Smegal that the consolidation may make sense in two sets of Cal
5 Water districts: Selma and Visalia, and Chico and Marysville. Neither DRA nor Intervenors
6 provided testimony on these proposals.

7 Cal Water has had substantive discussions with the cities of Selma and Visalia, who
8 have indicated that they would not support district consolidation. Cal Water agrees with the
9 cities that rate consolidation does not make sense at this time.

10 With respect to the Chico and Marysville Districts, however, Cal Water believes that the
11 Commission should consider the benefits of rate consolidation.

12