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Decision 04-05-023 May 6,2004

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the California-American Water Company (U210W) for an Order Authorizing it to Increase its Rates for Water Service in its Sacraments District to Increase Revenues by $8,198,700 in the Year 2003; and $31,955,000 in the Year 2004.	Application 02-09-030 (Filed September 19,2002
And Related Matters.	Application 02-09-031 (Filed September 19,2002) Application 02-09-032 (Filed September 19,2002) Application 02-09-033 (Filed September 19,2002)

Lenard G. Weiss, Attorney at Law, for California-American Water Company, applicant.
Carol Dumond, Attorney at Law, and Raymond A. Charvez, for the Commission's Office of Ratepayer Advocates, protestant.
Edward W. O'Neill, Attorney at Law, for County of Santa Cruz, and Montara Sanitary District; Jeff Almquist, Attorney at Law, for County of Santa Cruz, El Solyo Associates, and himself; interested parties.

OPINION OM GENERAL RATE CASE

TABLE OF CONTENTS

OPINION ON GENERAL RATE CASE

Summary

This decision approves a partial settlement agreement between California American Water Company (CalAm) and the Commission's Division of Ratepayer Advocates (ORA), and grants CalAm test year 2003 and test year 2004 rate increases of $254,700 (34.6%) and $70,800 (7.1%) in Felton district, $327,700 (21.1%) and $58,200 (3.1%) in Larkfield district, and $5,487,200 (33.9%) and $816,000 (3.7%) in Sacramento district. CalAm may file the test year 2003 increases immediately; the 2004 increases are deferred to 2005 in accordance with the Commission's earlier order approving CalAm's acquisition by RWE Aktiengesellschaft, Thames Water Acqua Holdings GmbH (RWE). CalAm may file advice letters seeking additional increases in Sacramento district to recover amounts in its purchased power balancing and memorandum accounts, and expenses associated with its start up costs for surface water procurement from Placer County Water Agency. CalAm's requests to combine for ratemaking purposes Larkfield district with Sacramento district, and Montara and Felton districts with Monterey district, are denied. CalAm's request to withdraw Application (A.) 02-09-033, its Montara district general rate case (GRC), is granted.

Background

CalAm and its Former Citizens Districts

CalAm provides public utility water service to approximately 106,000 customers in various areas in San Diego, Los Angeles, Ventura and Monterey counties. In January 2002 CalAm acquired the water utility assets of Citizens Utilities Company of California, adding another 60,000 customers in four districts located in Sonoma, Santa Cruz, San Mateo, Sacramento and Placer Counties. This general rate case involves CalAm's four former Citizens districts:

Sacramento, Larkfield, Felton and Montara.[1] CalAm is a California corporation and a wholly owned subsidiary of American Water Works Company, Inc., (AWW) which in January 2003 was acquired by RWE.

CalAm's Applications and the Proceeding

CalAm filed the applications on September 19, 2002,[2] and the Commission in Resolution ALJ 176-3096 preliminarily determined each to be a ratesetting proceeding expected to go to hearing. Assigned Administrative Law Judge (ALJ) James McVicar held a prehearing conference on November 20,2002 at which he consolidated the four applications. Assigned Commissioner Carl Wood's December 3,2002 scoging ruling confirmed the category and need for hearing, defined the issues, established a schedule, and designated ALJ McVicar as the principal hearing officer and thus the presiding officer. The ALJ conducted seven days of evidentiary hearing from April 21 through April 29, 2003. CalAm and the Commission's Office of Ratepayer Advocates (ORA) filed a motion on April 22 to adopt a partial settlement agreement, and filed an amended version of the motion and settlement on May 9. On April 28,2003, MSD and County of Santa Cruz (Santa Cruz) filed a motion to suspend the proceeding. This decision addresses those pending motions.

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[1] After evidentiary hearings were completed, CalAm and Montara Sanitary District (MSD) filed a joint motion for CalAm to withdraw A.02-09-033, the Montara district GRC, as a result of its pending divestiture to MSD, and for MSD to withdraw as a party from the consolidated proceeding. No party objected. This decision pants both requests.

[2] In Decision (D.) 01-09-057, the Commission ordered CalAm to make these GRC filings in January 2002. CalAm sought and obtained the Executive Director's approval of an extension under Rule 48(b) to delay filing its GRC Notices of Intent to March 2002. Those Notices of Intent were subsequently filed on June 28,2002.

After evidentiary hearings were completed, CalAm and MSD filed a joint motion for CalAm to withdraw A.02-09-033, the Montara district GRC, as a result of its pending divestiture to MSD, and for MSD to withdraw from the consolidated proceeding. No party objected, The motion is granted.

The proceeding was submitted effective November 21,2003 by an ALJ ruling. MSD and Santa Cruz filed a timely Request for Final Oral Argument before the Commission, as permitted under the Commission's Rules of Practice and Procedure, Rule 8(d). Final oral argument was held on February 25,2004.

CalAm's applications request the rate increases shown in Table 1 to compensate it for increased expenses and capital investment costs in excess of increased revenues over time. In addition, it seeks Commission approval of seven so-called Special Rate Requests (SRR) described in the Discussion section below. Some of the rate effects of CalAm's SRRs are not included in the Table 1 figures.

Table 1
Requested vs. Adopted Increases

	2003		2004	
	$ (000)	%	$ (000)	%
Felton District				
Application Requested	410.2	56.6	101.2	8.9
Adopted	**254.7**	34.6	70.8	7.1
Larkfield District				
Application Requested	512.8	33.3	96.9	4.7
Adopted	327.7	21.1	58.2	3.1
Sacramento District				
Application Requested	7,663.4	47.5	1,859.3	7.8
Adopted	5,487.2	33.9	816.0	3.7

Note: Excludes effects of proposed district consolidations and Felton district 2005 attrition year.

CalAm prepared its GRC request using an 11100% return on common equity, which it estimated would produce 7.15% and 7.20%rates of return on rate base for test year (TY) 2003 and TY2004 and, for Felton and Montara districts only, 7.25%in an attrition year 2005.

Discussion

The Partial *Settlement*

The amended partial settlement between CalAm and ORA is Appendix F to this decision. A 120-page comparison exhibit detailing the initial and final positions of CalAm and ORA with respect to revenue requirements was submitted with the settlement.3 Those positions and the adopted results are

3 Settlement Section 1.05 refers to this document as Appendix A to the settlement, while settlement Section 1.08 refers to it as the comgarison exhibit reflecting items which remain in disagreement. The two references are to the same document, the comgarison exhibit which on

Footnote continued on next page

summarized in today's decision (Appendix A, Adopted Summaries of Earnings, and Appendix D, Adopted Quantities and Calculations).

Settlement Terms

The settlement outlines and explains the areas where CalAm and QRA reached agreement through settlement; it does not address those accounts and issues for which there were no differences in CalAm's and ORA initial showings. The other parties did not advocate specific rate case numbers corresponding to those CalAm and ORA have settled. The comparison exhibit submitted at the same time as the settlement sets out an account by account analysis of CalAm's and ORA's initial and final positions, highlighting where differences remain. We address first the settlement, and then those remaining differences among CalAm, ORA and the other parties, in the sections to follow.

Settlement Discussion

CalAm and ORA have tendered an "uncontested settlement" as defined in Rule 51(f)(2), i.e., a "... settlement that ... is not contested by any party to the proceeding within the comment period after service of the ... settlement on all parties to the proceeding."

We reach this conclusion notwithstanding Santa Cruz's objection, stated on brief as, "The settlement between Cal-Am and ORA fails to meet this [Rule 51.1(e) approval] standard, particularly with respect to the recovery of the acquisition premium paid by [American Water Works] to acquire the Citizens facilities." First, Santa Cruz did not file and serve comments contesting the settlement as it was required to do by our Rules of Practice and Procedure,

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the last day of hearing the ALJ directed be admitted into evidence when late-filed May 9,2003. (RT1016).

Rule 51.4, if it desired to contest the settlement.[4] Under Rule 51.5, "Any failure by a party to file comments constitutes waiver by that party of all objections to the stipulation or settlement...." Second, the common CalAm and ORA position on the Citizens acquisition premium issue to which Santa Cruz objects on brief is not mentioned in, nor do we consider it part of, the settlement.[5] ORA evaluated CalAm's acquisition premium figures in its pre-hearing investigation, concluded that CalAm had proven that total synergies exceed the annual acquisition premium amortization cost, and recommended in its direct showing that CalAm's acquisition premium amortization expense amounts be adopted.[6] ORA went on to recommend that in future GRCs CalAm be allowed to recover its full acquisition premium amortization expense without having to demonstrate synergies savings, in exchange for all, rather than 90% of any excess synergies going to customers. We discuss and decide both the synergies savings issue and the revised sharing proposal on their merits later in this decision.

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[4] Rule 51.4: "Whenever a party to a proceeding does not expressly join in a stipulation or settlement proposed for adoption by the Commission in that proceeding, such party shall have 30 days from the date of mailing of the stipulation or settlement within which to file comments contesting all or part of the stipulation or settlement, and shall serve such comments on all parties to the proceeding. Parties shall have 15 days after the comments are filed within which to file reply comments. The assigned administrative law judge may extend the comment and/or response period on motion and for good cause."

[5] Specifically, it was CalAm's foregoing its opportunity to recover 10% of any future excess proven synergies savings, in exchange for not having to demonstrate those savings in future rate cases, that Santa Cruz objected to. (Santa Cruz Opening Brief at 26). Despite the statement to the contrary in Exhibit CA-31 that Santa Cruz cites, this joint CalAm/ORA proposal does not appear in the amended settlement.

[6] Exhibits ORA-1, ORA-2, and ORA-3 at ¶¶ 13.20.

Rule 51.1(e) requires that settlement agreements be reasonable in light of the whole record, consistent with law, and in the public interest. This settlement satisfies Rule 51.1(e), as discussed below.

This settlement represents a resolution of certain issues between CalAm and ORA, as specified. ORA's charge is to represent utility ratepayers, and it has earnestly upheld that purpose here, CalAm has vigorously pursued its interests and those of its stockholders. The settlement commands the sponsorship of both, thus indicating support from diverse interests.

CalAm's applications and supporting exhibits set out its initial position and its justification on the issues later settled. ORA in turn prepared direct evidentiary presentations t a t established and supported its position on the record, participated in evidentiary hearings, and filed briefs. The settlement defines the compromise the parties have reached on the settled issues. We have reviewed the outcomes the settling parties propose and agree that they have arrived at a reasonable agreement in light of the whole record. Where they were unable to reach agreement on other issues, they developed their positions in the evidentiary hearings, briefed them, and submitted those remaining issues to the Commission for determination.

Likewise, the record in this proceeding provides sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests.

Pub. Util. Code § 454 provides that no public utility shall change any rate except upon a showing before the Commission and a finding by the Commission that the new rate is justified. In this case, the parties have explained their initial positions and what adjustments each has made to arrive at the figures in the settlement. Those settled figures, and our adjudication below of the issues not settled, will bring CalAm's revenues up to the levels necessary for TY2003

and thereafter, We have no hesitation in finding the resulting revenue requirements reasonable and the rates they support justified. No provision of the settlement is in violation of any statute or Commission decision or rule.

We thus conclude that the settlement meets the requirements of Rule 51.1(e) in that it is reasonable in light of the whole record, consistent with law, and in the public interest. We adopt the figures CalAm and ORA have settled on; we examine the issues that remain in the sections to follow.

Summary of Earnings

CalAm and ORA have set forth their initial and final positions in detail in the 120-page comparison exhibit submitted with the settlement. We discuss here their remaining differences, and the positions Santa Cruz has taken when relevant, and show the results in the adopted summaries of earnings, Appendix A to this decision.

Operating Revenues

CalAm and ORA agree on the production, sales, customers, and consumption figures underlying their estimates of operating revenues. Where their revenue estimates differ, it is because of differences in other areas.

Operation and Maintenance Expenses

The only contested operation and maintenance expense issues remaining are ORA-proposed disallowances for tank painting in both test years: In Sacramento, for Parkside Tanks #1 and #2 and Countryside Backwash Tank; in Larkfield, for Lower Wikiup Tanks #1 and #2.[7]

In Sacramento, CalAm estimated Account 760, T&D Reservoirs and Tanks, for TY2003 and TY2004 at $53,300 and $70,300 respectively. ORA

[7] Differences shown for uncollectibles are due to differing estimates in other areas.

removed from CalAm's estimates the costs of painting the outside of Parkside Tanks #1 and #2 and Countryside Backwash Tank, yielding estimates of $36,108 and $45,268. ORA's witness visited each tank and determined that the outsides were not in need of painting, notwithstanding CalAm's stated practice of painting the outside of tanks when the insides are painted. CalAm's rebuttal witness, a licensed engineer with many years of experience, testified that these tanks have not been painted since their original construction 23, 15, and 20 years ago respectively, and failure to properly maintain a tank will substantially shorten its life and increase costs. Further, setup is a large part of painting costs, so it is typically cost-effective to paint the outside of a tank when the inside is painted. Both witnesses produced photographs that show the tanks in varied states of weathering, with areas of cracked or peeling coatings and surface corrosion. BRA on brief states, "[T]he fact that the tanks are in no structural danger shows that no additional revenue requirement should be granted at this time...," implying a maintenance standard we are loath to adopt. On balance, we find the company's presentation the more credible.[8] We will allow the amounts CalAm requests. This determination also affects the parties' figures for operational working cash.

ORA took the same approach to two concrete tanks in the Larkfield district: Lower Wikiup Tanks #1 and #2. The arguments parallel those for the Sacramento district tanks, although ORA did not brief on this disallowance. Our determination is the same: We will allow the amounts CalAm requests.

[8] In its brief, ORA misidentifies the two steel tanks as being concrete, and in its reply brief mischaracterizes CalAm's statement of CalAm's witness' qualifications.

Administrative and General Expenses

For administrative and general expenses, CalAm and ORA differ only in their in their estimates of payroll and related employee pensions and benefits in Sacramento district, and regulatory expense in all three districts.

Sacramento Payroll

For estimating purposes, CalAm and ORA showed payroll separately from the other expense accounts in the summary of earnings. CalAm's application proposed TY2003and TY2004 funding for three new positions: an operations manager to be hired in late-2002, a pump operator in 2003, and another pump operator in 2004. CalAm's direct presentation in the application noted the three new positions but gave neither details nor justification; ORA included funding only for the operations manager and likewise gave no reason in its direct presentation for excluding the two new pump operator positions. On rebuttal, CalAm provided its justification: 1500 added customers in Sacramento district since 1996 without adding operators; 1551 new connections anticipated through 2005 due to a new South Placer County development, growing to 14,000 new connections by 2012; 300 new connections annually from other, fill-in growth; heightened well-site security; wells located near potential contamination sources; and a new fluoride system required by the Department of Health services. ORA, in turn, presented on cross-examination and brief its reasons for excluding the two positions: virtually no customer growth in Sacramento district during the test years; ORA's observation that CalAm's South Placer County growth will take place beyond the test years, in 2005; ORA's disallowance of one of CalAm's proposed new wells; and operator time savings CalAm claims from its new Beloit Chlorine Depot. ORA also pointed out, and CalAm confirmed, that CalAm had kept an existing

pump operator position vacant since the beginning of 2003, and it was in fact still vacant as of the mid-April 2803 evidentiary hearings.

CalAm does not present a persuasive position. It faults ORA for not explaining its disallowance in ORA's direct presentation, yet CalAm's direct showing was also a single sentence. CalAm cites figures for the customer growth it anticipates but fails to account for efficiencies that it acknowledges on cross-examination will reduce operator time; ORA acknowledges substantial growth but puts most of it beyond the test years. CalAm's claim that well-site security, potential contamination exposure and a new fluoridation system would increase operator needs was unhelpful absent some quantitative analysis. And most important, nowhere in the record do the parties put CalAm's proposed increase in perspective, e.g., would two new operators represent a 2% increase in the number of pump operators, or 50%? We adopt ORA's payroll figures, and its related employee pensions and benefits. CalAm's next GRC for Sacramento district is currently anticipated to be tendered in 2004 for TY2005. In the meantime, we suggest that it fill the vacant operator position before it seeks funding from customers for additional positions.

Regulatory Expense

CalAm's applications requested a Regulatory Commission Expense allowance for these three districts totalling $51,000 in each test year, describing these amounts as, "based on actual prior history and known occurrences that will take place in the current case - Full amount amortized over three years." ORA estimated $47,700 in TY2003 and $47,800 in TY2004. CalAm presented this historical and estimated data with its applications:

Table 2

Regulatory Commission Expense

Thee-District Totals from Applications

1996 (actual)	$ 0
1997 (actual)	0
1998 (actual)	0
1999 (actual)	41,400
2000 (actual)	40,700
2001 (actual)	39,200
2002 (estimated)	51,100
TY2003 (requested)	51,100
TY2004 (requested)	51,100

In rebuttal testimony submitted shortly before evidentiary hearings began, CalAm more than tripled its Regulatory Commission Expense request, from $51,100 annually in TY2003 and TY2004 to $155,800 in each test year. CalAm bases its revised estimates on its GRC expenditures being higher than previously estimated through April 2003, and its projection of higher spending over the remainder of the proceeding. ORA stands by its estimate.[9]

CalAm attributes much of the increase to greater than expected legal and witness costs due to very active intervenor involvement in the proceeding and the many issues those intervenors raised.[10] In fact, many, if not most, of those issues were generated by or closely related to CalAm's acquisition of the former Citizens districts, RWE's subsequent acquisition of AWW, and delays in the Commission-ordered Montara district divestiture to MSD. We do not expect these costs to recur in future years, so they should not be embedded in

[9] ORA objected to admitting CalAm's new figures, arguing correctly that the Commission's Water Rate Case Plan prohibits such late updates. In this case, the ALJ ruled them admissible in the interest of having a complete record.

[10] CalAm brief, page 11.

future rates. Even if our policy were to allow retroactive recovery of past costs in future rates, we would not be inched to require CalAm's ratepayers to reimburse it for these double-acquisition and delayed divestiture-related costs.[11] But retroactive cost recovery is *not* our policy, CalAm's arguments on brief to the contrary notwithstanding. We explained this point recently in denying CalAm's appeal of its Monterey district TY2003 GRC Regulatory Commission Expense:

> CalAm overlooks, however, that, absent a previously authorized memorandum or balancing account, the Commissions' longstanding, consistent practice is to set rates based on forecasted expenses. In this regard, although certainly not determinative, expenses incurred in the present proceeding may be considered in the setting of future rates, along with all pertinent evidence, especially including similar expenses from prior proceedings.[12]

We are also mindful that when a utility on its own initiative submits only one or a small number of accounts for updating late in a proceeding those accounts may not be representative of expected changes in its expenses overall. In this case, CalAm acknowledges that it has chosen to update the Regulatory Commission Expense account figures (and only those figures) precisely *because* they have greatly increased. ORA and other intervenors will always be disadvantaged in cases such as this because they have very little opportunity to audit or test late-presented figures, and lack access to the most

[11] In addition to the higher costs in its late-submitted estimate, CalAm increased its TY2003 and TY2004 Regulatory Commission Expense request for its Sacramento and Larkfield districts by a further 50% by spreading those higher mounts over two years rather than three. That modified general rate case Liming was also a result that flowed directly from AWW's recent flurry of acquisition activity. See D.O1-09-057.

[12] D.03-06-036, Order Denying Rehearing,, in A.02-04-022.

recent accounting data that may show offsetting decreases in other areas.[13] Every utility has the ability and obligation to exercise reasonable restraint over its GRC spending; to the extent that CalAm claims to have spent more than it estimated, those are costs over which it had a large measure of discretion.

Here, CalAm's original estimates were, in its own words, "...based on actual prior history and known occurrences that will take place in the current case." We adopt those original Regulatory Commission Expense estimates as being muck more consistent with the historical data, less affected by the recent flurry of acquisition and divestiture activity involving Citizens, RWE and AWW, and more representative of CalAm's forward-looking, normal Regulatory Commission Expense levels.

Rate Base – Plant in Service

CalAm and ORA agree on most components of utility plant. We address their remaining differences below.

Security-Related Plant Additions

CalAm has included in its plant additions budget $792,500 in TY2003 and $527,100 in TY2004 for security-related construction in all three districts. CalAm characterizes these as basic security measures that would be commonsense to take in normal times, and all the more advisable in times of heightened security-consciousness. ORA has deleted all of them from its estimates.

Under HR 3448, the federal Public Health Security and Bioterrorism Preparedness and Response Act enacted in June 2002, CalAm must

[13] ORA asked specifically for additional information on Regulatory Commission Expenses in February 2003, as it prepared its testimony. CalAm's witness acknowledged on cross-examination that CalAm's response gave no indication of any change in its estimate. RT 685.

conduct a vulnerability assessment for its water systems and submit it to the Environmental Protection Agency by June SO, 2004. The purpose of the vulnerability assessment is to assist the EPA, local regulatory bodies, and individual water companies to identify specific high priority facilities, security risks to those facilities, and potential improvements to lower those risks. ORA argues that the Commission should not approve recovery in rates of any security-related investments until the EPA has certified CalAm's vulnerability assessment. EPA may find that CalAm's security program is already adequate, or may recommend enhanced security for some areas but not others.

We have examined the security line items CalAm proposes for each district in TY2003.[14] The largest component is fences and gates around water production, storage and treatment facilities. Lesser but still significant amounts would be spent on video surveillance and motion detection measures for those facilities, metal doors, re-keying Pocks, and other items. These appear to us to be reasonable and necessary measures under any security scenario, and even ORA's witness on cross-examination appeared to endorse adequate fencing as a minimum security need. And, as CalAm points out, these are capital investments similar to what we have previously accepted for CalAm and other Class A water utilities in their GRCs, not expense amounts of the type we have previously disallowed. We accept CalAm's estimates for security-related plant additions in TY2003 and TY2004.

[14] The details of the TY2004 security measures are not yet established, but CalAm anticipates the total amounts will be lower than in TY2003.

contamination-Related Projects

CalAm and ORA differ on the proper ratemaking treatment to be afforded to five Sacramento district capital projects undertaken to alleviate damage due to groundwater contamination caused by third parties. Those projects are: (1) Mather Booster Station; (2) Wilber Well; (3) New Suburban Service Area Well; (4) Water Treatment Improvements; and (5) Suburban Distribution System Improvements. The first, Mather Booster Station, is completed and in service while the others are planned for TY2003 and/or TY2004. ORA identifies a sixth project, Treatment for Entrained Gasses, as also being contamination-related and recommends the same ratemaking treatment for the same reasons. CalAm argues that this sixth project is not contamination-related, but also implicitly acknowledges that the gasses involved may not be naturally occurring. Accordingly we address ORA's ratemaking treatment for it here.[15]

CalAm believes that ORA has no dispute with either the prudence s f these six projects or the amounts sf the expenditures involved. We note that ORA's direct presentation does object that it was not provided with sufficient justification for several of them. Those objections were ill-defined and not pursued, however, so we consider ratemaking treatment of the projects, not their timing, cost or need, as the issue to be addressed.

ORA advocates placing the capital costs of these six projects into a deferred account for recovery from those parties eventually determined to be responsible for the groundwater contamination problems that necessitate them; ratepayers would bear none of the investment costs. CalAm would later

[15] The estimated total cost of the five projects is $4.25 million; the sixth is budgeted at $120,000 in TY2004 plus $57,000 that was expended in 2002.

be made whole through recovery of all or any portion of the costs from the contaminators, and its shareholders, not ratepayers, would suffer any recovery shortfalls. CalAm proposes the capital costs be included in rate base as any other plant investments would, and any later recoveries from third party contaminators would be treated as contributions used to reduce rate base.

ORA's arguments may be succinctly stated: Third-party contamination is a risk to be borne by shareholders, not ratepayers; contamination was a known issue when CalAm acquired the Sacramento district assets from Citizens, so it should have been reflected in the acquisition price; and, allowing CalAm to recover its costs from ratepayers would remove the company's incentive to seek recovery from those responsible. ORA rests its case on a statement of those principles and little further discussion.

CalAm criticizes ORA's recommendation:

> That recommendation protects everyone *except* CalAm and its shareholders, who had nothing to do with creating the problem but who, under ORA's approach, would have to make the investment and bear all or at least a material portion of the carrying costs on that $4.25 million for an uncertain, indefinite time determined by CalAm's uncertain success in pursuing the wrongdoers. The ORA position is patently unfair to Applicant.[16]

However, CalAm's position is the mirror-image for ratepayers: Ratepayers would be totally unprotected and bear all the risk of non-recovery. Moreover, ratepayers would have to depend on CalAm to pursue any recovery, a CalAm with limited remaining incentive to do so. Under ORA's ratemaking proposal, at least the same party carrying the risk would have the responsibility and incentive to pursue the contaminators.

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[16] CalAm brief, page 19. Emphasis in original.

The prospects of recovery are unclear. On the one hand, CalAm on brief says it is pursuing the responsible parties, none of the charges are yet resolved, some are in negotiation, some are subject to tolling agreements to prevent running of the statute of limitations while negotiations continue, and some will probably have to be litigated. On the other hand, CalAm names three major contaminators[17] but says it has yet to recover any monetary compensation and has no litigation currently underway.[18] One CalAm witness' testimony was particularly pessimistic: "[P]enalizing CalAm... when a responsible party is not yet known, may not be found, may not be subject to prosecution or may have no means to pay for the contamination! is an extreme position. CalAm should not be held hostage,..when a responsible party has not yet been determined."

Having described the issue, we turn to ORA's three main arguments stated earlier. First, contamination remediation is both a cost of business for water companies and one of those risks for which water utilities are compensated in their rates of return. That cost should be recovered from the contaminators whenever possible, and absent reasons to the contrary, any unrecovered amounts should be allocated between companies and their ratepayers considering the facts on a case-by-case basis. Second, there is insufficient evidence in the record to support a disallowance based on ORA's argument that the contamination problems were or should have been reflected in the Citizens acquisition price. Third, we are concerned about incentives. CalAm suggests it would be enough incentive for the Commission to order CalAm to file

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[17] Aerojet-General Corporation, The Boeing Company, and the U.S. Air Force.

[18] On brief, however, CalAm indicates that it has received $650,000 for Mather Booster Station from Sacramento County "as its contribution to repair the contamination caused by third parties." It did not explain the distinction.

reports on a timely basis demonstrating what action it is taking against responsible parties, and then applying penalties or other measures if, after due process, those efforts are found deficient. We don't regard a simple reporting requirement as sufficient incentive considering that the amounts at stake are nearly 10% of rate base.

CalAm's proposal gives itself 100% protection and leaves ratepayers totally dependent on CalAm to pursue recovery. ORA's proposal leaves CalAm shareholders 100% at risk for all losses. There is no ideal ratemaking mechanism for this situation. The best we can do is keep CalAm whole while at the same time giving it a strong incentive to pursue the contaminators. To do that, we accept CalAm's estimated cost and timing for all six projects, and allow them in sate base accordingly.[19] We announce our intention to order any eventual losses to be shared equally between shareholders and ratepayers by removing one-half of any remaining rate base value at the time new rates become effective in CalAm's next Sacramento district GRC, provided *that* CalAm may make an affirmative showing during the next Sacramento district GRC to demonstrate that reasonable progress has been made, and it has been and is continuing to make a good faith effort at recovery and should be allowed additional time before any final disallowance is made. CalAm shall bear the burden of proof if it chooses to make such a showing. CalAm and any other parties should at that time develop a record to define which projects and what amounts are involved. They may also present positions in support of a different

[19] The $650,000 received from Sacramento County for Mather Booster Station is to be treated as a contribution in aid of construction, consistent with our treatment of the project with which it is associated.

outcome. When we believe the issue has matured sufficiently we will make a final determination.

Flat to Metered Conversion Project

CalAm plans to convert all 46,750 flat rate, unmetered residential connections in Sacraments district to metered service over a period of years. The application includes a $2,750,000 metering project in plant additions, but leaves all details to the company'' extra-record workpapers. ORA reviewed those workpapers and summarized the plan as proposing $750,000 for the project in 2002, $500,000 in TY2003, and $500,000 in TY2004. Later information shows CalAm actually spent about $190,000 in 2002, and subsequently raised its meter conversion budget for the test years to $650,000 in TY2003 and $750,000 in 2004. ORA recommends the Commission not include the cost of CalAm's metering project in rates at this time.

ORA bases its disallowance entirely on CalAm's failure to address the standards set forth in Public Utilities Code § 781.[20] According to

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[20] § 781: The commission shall not require *any* water corporation which furnishes water for residential use through five or more service connections or which serves an average of 25 or more persons per day for at least 60 days per year, nor any residential customer of such corporation to install any water meter at any water service connection between the water system of the corporation and the customer if on January 1,1979, such service connection was unmetered except after a public hearing held within the service area of the corporation at which hearing all of the following findings have been made:

(a) Metering will be cost effective within the service area of the corporation.

(b) Metering will result in a significant reduction in water consumption within the service area of the corporation.

(c) The costs of metering will not impose an unreasonable financial burden on customers within the service area of the corporation unless it is found to be necessary to assure continuation of an adequate water supply within the service area of the corporation.

ORA, the Commission in D.90-06-030[21] found that the standards of § 781 are appropriate to use as guidelines in considering utility requests for converting Bat rate customers to metered service. Because CalAm did not do so, ORA recommends against including CalAm s meter conversion project in rates,

In the decision ORA relies on, Graeagle Water Company sought Commission authorization to mandatory convert all of its flat rate customers to meters and discontinue their flat rate service. The Commission in that case cited D.92489, Conclusion of Law #1: "The findings provided for in Section 781 of the Public Utilities Code need be made only when the Commission requires the installation of meters," to conclude that § 781 was not applicable to Graeagle's application, However, it also went on to conclude that it was appropriate to apply the standards set forth in § 781 as *guidelines* in considering Graeagle's request, and it proceeded to do so. This case is distinguishable from Graeagle by the fact that neither the Commission nor CalAm proposes through this GRC proceeding to *require* that unmetered customers generally, or any current unmetered customer, switch to metered service. Should CalAm later seek Commission authorization to impose metering on then-unmetered customers, we would consider the relevant facts and § 781 criteria at that time.

Having rejected ORA's reasoning, we turn to the plant additions amount CalAm is proposing for its metering conversion project. CalAm expected to spend $750,000 in 2002 on the project. It actually spent about $190,000. The overall program, and this project, are behind schedule. CalAm has provided ample justification for embarking on a meter conversion program, but other than the figures we have cited above, neither CalAm nor ORA has

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[21] Application of Graeagle Water Company, 36 CPUC2d *565* (1990).

provided on the record any justification for the amounts or timing that CalAm seeks in the test years. According to CalAm, this is a 20 to 30-year program under current conditions. We will include it in rates with continued annual expenditures at the recorded 2002 level, with the knowledge that the Sacramento district's TY2005 GRC decision will automatically correct CalAm's going-forward rate base for expenditures above or below the amounts we project today,

Rate Base – Other Components

The differences in rate base components other than plant in service arise from differences in CalAm's and ORA's estimates in other areas.

Taxes

The differences in taxes arise from differences in CalAm's and ORA's estimates in other areas.

General Office

CalAm and ORA agree on the proper level of general office expenses to be allocated to each district. The general office figures set forth in the comparison tables accompanying the settlement are those for four districts, and are based on the allocations we adopted in CalAm's recent Monterey district GRC (D.03-02-030, as modified by D.03-06-043). CalAm's late-filed supplemental testimony of David P. Stephenson presented changes to the general office allocations for Sacramento, Larkfield and Felton districts necessitated by CalAm's post-hearing sale of Montara district.[22] QRA has stated informally that it has no

[22] Supplemental Testimony of David P. Stephenson, dated June 12, 2003, Tab K.

objection to receiving that testimony and no other party has objected, so we accept it as valid updating for the general office figures.[23]

Acquisition Synergies

Citizens Synergies, and Future GRC Filings

CalAm and **BRA** agreed on the Citizens acquisition premium to be amortized in both test years in all three districts. Santa Cruz did not. CalAm on brief described the CalAm and ORA analysis as "a 'simplified' approach to calculating the synergy savings from the Citizens' asset acquisition while remaining true to the Commission's guidelines in D.01-09-057." ORA evaluated CalAm's acquisition premium amortization figures in its pre-hearing investigation, concluded that CalAm was correct, and recommended in its direct showing that CalAm's position on that issue be adopted.[24] The comparison tables show unexplained differences between them in the acquisition premium amortization expense amount for Larkfield district in both test years, but those figures were superseded by the figures in CalAm's late-filed supplemental testimony of David P. Stephenson on behalf of CalAm noted in the General Office section above.

Santa Cruz expressed a host of objections to CalAm's synergies savings analysis and allocation. According to Santa Cruz, CalAm's synergies analysis is fundamentally flawed, in part because even if CalAm had not acquired Citizens' properties some other entity would have, and thus many

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[23] ORA suggested in its reply brief that a day of evidentiary hearing may be needed to support the revised figures. Given ORA's earlier (June 25,2003) explicit acceptance **and** the lack of any formal protest, we view them as uncontested and admit witness Stephenson's supplemental testimony into the record.

[24] Exhibits ORA-1, ORA-2, and OM-3 at ¶¶ 13.20.

of the benefits claimed would have been realized without CalAm's involvement. Some of the synergies savings, particularly those involving financing, were actually due to the RWE acquisition, and CalAm fails to distinguish between them. CalAm's claimed savings are based on excessively hypothetical circumstances, including an assumption that CalAm's cost of capital will be lower than Citizens' for the next 40 years. Some of the claimed synergies savings come from reductions in service. And, Santa Cruz argues, CalAm has not justified allocating any of the acquisition premium to either Montara or Felton.

We have examined each allegation in light of CalAm's showing and we do not agree with Santa Cruz. Most of the synergies savings accrue from cost of capital savings, cost of investment savings, and allocation of general office costs to Arizona; savings from other sources are small by comparison.[25] Cost of capital savings are a primary contributor, and those arise in large part from CalAm's much Bower equity ratio (a topic we cover more fully in a later section).[26] We are convinced those savings do exist and came about due to CalAm's acquisition of the Citizens assets. In D.01-09-057, we approved allocating the Citizens asset purchase price among the six states involved on the basis of Citizens' gross plant. CalAm has extended that allocation method here down to the district level. Santa Cruz (and MSD with it earlier) argues that the share CalAm would allocate to Felton (and earlier, to Montara as well) is excessive, but it provides no better allocation proposal; its favored method is apparently to allocate none of the acquisition premium to Felton district, an outcome we reject as unsupported and unreasonable. We accept CalAm's

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[25] Exhibit CA-20, *gage* 34.

[26] Exhibits ORA-1A and ORA-1B.

acquisition premium amortization figures, as concurred in by ORA, for each district and test year.

We noted earlier Santa Crud's objection to relieving CalAm from having to demonstrate synergies savings in future rate cases, in exchange for foregoing its opportunity to recover 10% of any excess proven synergies.[27] That objection is aimed at a two-part modification CalAm would have us order to the alternative sharing proposal adopted in D.01-09-057. The first change would be to eliminate the second synergies savings review in the 2004 Citizens Division GRC, and the second would be to eliminate CalAm's entitlement to a 10% share of any excess synergies savings.[28] These two changes have much to recommend them, and both are supported by ORA.[29] However, under Pub. Util. Code § 1708, when the Commission considers changing the outcome of a previous decision that was determined after hearings, absent justification to the contrary it must provide parties to that earlier proceeding both notice and an opportunity to be heard.[30] We have reviewed the various notices provided to the public and parties prior to the evidentiary hearings in this proceeding and find neither mention of these two proposals nor any indication that the parties in A.00-05-015 who are not parties to this proceeding were noticed of this GRC proceeding. We conclude

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[27] Santa Cruz Opening Brief at 26.

[28] D.01-09-057, Ordering Paragraph #3, in A.00-05-015 adopted the alternative sharing proposal described in Finding of Fact #9, including the provisions requiring 10% sharing and a 2004 GRC synergies savings review.

[29] Exhibits ORA-1, ORA-2 and ORA-3, at ¶¶ 13.20.

[30] § 1708: The commission may at any time, upon notice to the parties, and with opportunity to be heard as provided in the case of complaints, rescind, alter, or amend any order or decision made by it. Any order rescinding, altering, or mending a prior order or decision shall, when served upon the parties, have the same effect as an original order or decision.

that some parties to the proceeding that gave rise to D.O1-09-057 have not been provided the notice and opportunity to be heard required by § 1708. We do not adopt CalAm's proposed modification to the alternative sharing proposal at this time, but we invite it to renew its request with proper notice, in an appropriate future proceeding.

CalAm also seeks authorization to change the next GRC filing dates for Felton district to 2005 from 2004 (i.e., to request rates effective in January 2006 for TY2006). In R.03-09-005, our Rulemaking to evaluate existing practices and policies for processing GRCs and to revise the General Rate Case Plan for Class A water companies, we are currently reviewing the GRC filing requirements for all of CalAm's districts, including its former Citizens districts. Rather than decide CalAm's Felton district GRC filing schedule request here, we will consider it in the broader context of that rulemaking and coordinate it with the schedules for its other districts and those of the other Class A water utilities.

While we are willing to consider changing the Felton district GRC filing schedule in R.03-09-005, we must ensure that ratepayers fully realize the acquisition-relatedsynergies due to them. Specifically, in D.01-09-057, we anticipated January 2004 GRC filings for rates effective in TY2005 in all of CalAm's former Citizens districts. Under the alternative rate sharing proposal we adopted in that decision, CalAm was to: recover in rates all proven synergies savings from the Citizens acquisition in 2002,2003, and 2004; file TY2005 GRCs in January 2004; and through its TY2005 rates begin sharing with ratepayers the proven synergies savings in excess of those required to cover the acquisition premium amortization amounts.[31] Denying CalAm's request here and holding it

[31] See the adopted alternative sharing proposal as described in D.01-09-057, Findings of Fact 9.b., 9.c., 9.g(2), and 9.h.

to the D.01-09-057 filing schedule would be unrealistic in light of the timing of this decision, and unwise in the larger context of R.03-09-005. However, we still intend to ensure that ratepayers receive their share of the post-2004 Citizens acquisition synergies savings as D.01-09-057 anticipated, even if CalAm's request is granted and there is no TY2005 GRC for one or more of these districts. To accomplish that, for any Citizens districts for which there is no TY2005 GRC, revenues for service rendered on and after January 1,2005 that are associated with the Citizens acquisition synergies savings in those districts will be made subject to refund pending a determination of what portion of the synergies savings are to be shared with customers.

RWE **Synergies**

By D.02-12-068 in A.82-01-036, the Commission authorized RWE and Thames Water Aqua U.S. Holdings, Inc. to acquire control of AWW, CalAm's parent. That acquisition closed on January 10,2003. In approving the transaction, the Commission approved a settlement containing the following Condition #20:

> 20. For a period sufficient to cover a single full rate cycle for each of Cal-Am's four sets of filing districts, not to exceed four years from the date of closing, RWE, Thames, American and Cal-Am will implement a mechanism to track the savings and costs resulting from the proposed merger and a methodology to allocate all net savings and will submit to the Commission in writing a detailed description of that methodology in connection with future Cal-Am general rate case filings.
>
> Commission Comment: We understand the use of the term "will" as if the parties had used the term "shall." The methodology to be developed shall allocate all net benefits to the ratepayers."

By Finding of Fact #19, the Commission interpreted Condition #20:

> 19. Through condition 20, the applicants are committed to pass through 100% of the future benefits of this transaction to CalAm's ratepayers.

Santa Cruz asserts that CalAm has failed to pass on in this proceeding those immediate and quantifiable benefits promised on the record in A.02-01-036 and required to be gassed on by the Commission in D.02-12-068. On April 28, 2003, Santa Cruz (with MSD) filed a motion to suspend this proceeding until CalAm has identified and quantified all of the ratepayer savings achieved or achievable during TY2003 and TY2004, and to allow the opposing parties to conduct discovery on the topic. ORA supported Santa Cruz's motion.[32]

CalAm's response to the motion acknowledged that there are immediate and quantifiable RWE-driven benefits that are not included in this proceeding, identified the sources of at least some of those benefits, and explained why Santa Cruz's motion should nonetheless be denied. CalAm's GRC applications were prepared during the first half of 2002 and the Notices of Intent filed on June 28,2802, whereas D.02-12-068 was issued in December 2002 and the RWE acquisition closed in January-2003. Further, by settlement Condition #20 quoted above, and D.02-12-068, Ordering Paragraphs 12 and 13, CalAm will be tracking in a memorandum account the costs and savings resulting from the acquisition, must develop a methodology to allocate all net benefits to the ratepayers, and will carry the burden of proving that it has done so. CalAm anticipates it will make that showing with its next Citizens districts GRCs.

We agree with CalAm. Our D.02-12-068 and the RWE acquisition occurred too late to be properly reflected in this proceeding. Further,

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[32] ORA Response to Motion, filed May 13,2003.

we made specific provisions in that decision to secure for CalAm's ratepayers the benefits from the transaction, including those immediate benefits which most concern Santa Cruz and ORA here, and ordered a deferral of certain attrition step increases to ensure ratepayers would receive them.[33] The ALJ's November 21, 2003 ruling denied Santa Cruz's motion to suspend and submitted the proceeding. For the reasons stated, we affirm the ruling.

Special Rate Requests

CalAm seeks approval of seven Special Rate Requests, each of which involves ratemaking treatment of some aspect of its operations. We deal with each here; the results are reflected in other areas of this decision where appropriate,

Special Rate Request #1

In 1995, Northridge Wafer District entered into a contract with Placer County Water Agency under which the District became entitled to receive up to 29,000 acre feet of water annually from the Agency. As a condition of receiving that water, Northridge was to petition the California Water Resources Control Board to change the authorized place of use to include Northridge's service area. In May 1996, Citizens Utilities Company of California entered into a cost-sharing agreement with Northridge to include Citizens' Sacramento district in the change of use petition. By Resolution W-4001, the Commission authorized Citizens "to establish a memorandum account to record the expenses associated with the start up costs for surface water procurement from Placer County Water Agency," i.e., the costs of joining with Northridge to include Citizens' service area as an authorized place of use. The petition was successful, and CalAm,

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[33] D.02-12-068, Settlement Condition #1.

Citizens' successor, now seeks to transfer the $7192,179 memorandum account balance to plant in service and close the account.

ORA opposed CalAm's request! initially because CalAm had inadvertently misstated what the memorandum account funds were used for, and later because CalAm had not yet executed a contract with Sacramento Suburban Water District, Northridge's successor, to purchase part of the available water. Our review of the evidence confirms that the bulk of the funds were expended for the purposes anticipated in Resolution W-4001, although we cannot confirm the exact amounts. CalAm's witness provided a draft of the proposed water purchase contract and predicted it would be completed in about 90 days.

While CalAm would still prefer the Commission approve transferring the memorandum account balance into 2003 plant in service in this GRC, ORA's witness and CalAm also now agree that could be done through an advice letter filing once the Sacramento Suburban Water District contract has been executed and reviewed for need and reasonableness.[34] We adopt that outcome.

Special Rate Request #2

On January 21,1998, the Commission issued Resolution W-4089 authorizing three Class A water utilities to establish memorandum accounts for water contamination litigation expenses they expected to incur as a result of lawsuits then pending against them. On March 26,1998, the Commission issued Resolution W-4094 extending memorandum account authorization to all water utilities under its jurisdiction. Resolution W-4094 explicitly noted that additional

[34] RT906-907.

lawsuits had been filed against Citizens Utilities Company of California charging groundwater, sod and air contamination in the Sacramento Valley Basin. CalAm acquired Citizens' assets effective January 15,2002, including, CalAm asserts, a deferred asset consisting of the right to recover $559,462 in Citizens' contamination litigation memorandum account. Further, although the suits against Citizens are still pending, CalAm says it bears none of the liability for the defense or possible outcome of those suits; that liability remained with Citizens following the acquisition. Thus, there were no more litigation costs to be entered into the memorandum account after the acquisition. Through SRR#2, CalAm seeks to: (a) recover the memorandum account balance in rates between now and December, 2007; (b) include the average annual remaining uncollected balance in rate base; and (c) close the account.

ORA opposes CalAm's request. First, ORA believes CalAm is premature in requesting recovery because Order Instituting Investigation (I.) 98-03-013 into water contamination is still open,[35] the Commission has yet to open the water quality investigation it anticipated in one of the decisions in that proceeding, and the contamination lawsuits against Citizens are still pending. Second, the contamination lawsuits are against Citizens, not CalAm, and the responsibility for them belongs to Citizens' shareholders, not CalAm's current ratepayers. Third, a memorandum account is not an entitlement to collect, and thus CalAm could not purchase it and classify it as a deferred asset. Fourth, the application does not present sufficient information to determine a reasonable level of expenses to be recovered from ratepayers.

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[35] D.00-11-036 closed I.98-03-013 before the evidentiary hearings in this proceeding began. None of the five decisions in that proceeding addressed contamination litigation memorandum accounts.

We deny CalAm's request, primarily for ORA's fourth reason. CalAm introduced into evidence an April 10, 1998 letter from our Water Advisory Branch to all water utilities informing them that the Commission had authorized water contamination litigation memorandum accounts and attaching copies of Resolutions W-4089 and W-4094.[36] Inexplicably, CalAm included the letter's Resolution W-4094 attachment but not the Resolution W-4089 attachment. Resolution W-4094 incorporated the provisions of Resolution W-4089 by reference and is not meaningful without it, so we take official notice of Resolution W-4089.[37] Those incorporated provisions required, among other things, that when water utilities seek authorization to recover their contamination litigation memorandum account amounts, the Commission will consider: whether the utility has "use[d] every means possible to maximize its insurance proceeds" (i.e., proceeds related to both awards for liability and defense of the lawsuit) and "aggressively pursued legal action for recompense from the original polluters"; whether the litigation ended with a settlement; whether all of the costs claimed were from after the date the Commission authorized the memorandum account; whether the amounts claimed included other costs such as public relations fees, water quality testing costs, and/or other consulting fees; and whether any of the expenses claimed were already included in rates. The utility's filing must "include a thorough and detailed explanation of the costs incurred and a justification of their reasonableness for recovery."

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[36] Exhibit CA-20, Tab B.

[37] Resolution W-4094, Ordering Paragraph 4: "All provisions and conditions in Resolution No. W-4089 will apply in this resolution."

CalAm's showing in this proceeding has been little more than an explanation of the background and a statement that it should be allowed to recover $559,462 because it "purchased all of the water utility assets of Citizens, including this deferred regulatory asset." CalAm's showing does not meet the standard we set forth in Resolutions W-4089 and W-4094. Our denial here is without prejudice; CalAm may renew its request in its next GRC.

One more aspect of this issue merits noting. Resolution W-4089 makes the following statements in reference to contamination litigation memorandum accounts:

> A memorandum account is not a guarantee of eventual recovery of expenses, *nor is it carried as a regular account under the uniform system of accounts for water utilities. It is carried 'off the books,'* as a memo account.
>
> * * *
>
> Our policy on memo account treatment has always been that the burden of proof of the reasonableness of expenses charged to the account is the responsibility of the utility requesting reimbursement of such expenses. We see no reason to deviate from this procedure in this instance. [Emphasis added].

These statements are consistent with our treatment of memorandum accounts in general. In light of this, we find CalAm's claim that the memorandum account balance is a "regulatory asset" troubling. ORA speaks disparagingly of that classification, but does not follow up to explain the accounting and ratemaking consequences.[38] Our concern stems from the fact that in D.01-09-057 we defined the Citizens acquisition premium to be amortized in rates as the excess of

[38] ORA brief, **page 23.**

purchase price over net book value of the California assets being purchased.[39] Simply stated, if the memorandum account balance is not properly accounted for as part of the net book value of the former Citizens assets, then it is part of the acquisition premium and thus the acquisition premium amortization expense already being recovered elsewhere in rates. The record in this proceeding does not allow us to make that determination. Should CalAm decide to renew its request in its next GRC, we expect it to carry the burden sf proving that the amount it is claiming was part of the $93.957 million net book value of the California assets referred to in D.01-09-057 and not part of the $64.553 million acquisition premium already accounted for in rates.

Special Rate Request #3

CalAm seeks to recover through a rate surcharge the accumulated balances in its Sacramento district purchased power balancing and memorandum accounts as of December 31,2002. ORA does not oppose the request, but believes CalAm should follow the procedures set forth in the Commission's Balancing Account Rulemaking Proceeding, Rulemaking (R.) 01-12-009. CalAm accepts ORA's recommendation.

The Commission issued D.02-12-055 defining the procedures for Class A water utilities to dispose of balancing account balances accrued before November 29, 2001. After the evidentiary hearings in this proceeding, it issued D.03-06-072 adopting procedures for Class A water utilities to dispose of balancing-type memorandum account balances accrued on or after November 29,2001. We will require CalAm to file advice letters seeking

[39] D.01-09-057 also made small adjustments for the net book value of non-regulated assets and for transaction costs.

Commission approval to recover its Sacramento district balances of both types though December 31,2002 following the procedures adopted in those two decisions. In consideration of the timing of this GRC, any deadlines set forth in those decisions for such filings are waived for this Sacramento district filing. CalAm must file its advice letter(s) within 60 days of the effective date of this decision.

Special Rate Request #4

CalAm and ORA agree that Felton district Rate Schedule No. FE-6M should be eliminated. This schedule related to a former resale customer, has been inactive for an extended time, and serves no purpose. We concur.

Special Rate Request #5

CalAm proposes to increase its after-hours reconnection charges (Tariff Rule 11.C.1) in all three districts to $50 from $15. The current charge dates back to 1973 and, CalAm believes, falls far short of covering its related expenses, thus requiring the majority of its customers to support the few who are shut off for nonpayment. ORA recognizes that CalAm's proposal has merit but has not seen sufficient cost justification that it could endorse CalAm's request as reasonable.

CalAm claims its labor expenses are at least $70 (minimum two hours overtime plus 40% benefits) to reestablish service after hours. CalAm has provided on the record its average pay rate, payroll benefits, and minimum work time for after-hours reconnections, and the resulting calculations do support an expense of greater than $50 per reconnection.[40] Further, CalAm points out that the reconnection charges authorized for other Class A water utilities range up

[40] Exhibit CA-20, pages 12 through 14; exhibit CA-24, page 2.

to $65, so CalAm's proposed charge appears supported and reasonable. CalAm notes that any additional revenue generated would be minor. We adopt CalAm's proposal.

Special Rate Requests #6 and #7

CalAm's applications propose to combine Larkfield district with Sacramento district, and Montara and Felton districts with Monterey district, for ratemaking purposes.[41]

CalAm would consolidate the Larkfield and Sacramento districts over time. Rates in Larkfield, excluding private fire protection service, would be held constant until the rates in Sacramento approximately equal (within 25%) those in Larkfield, plus a quantity rate differential in Larkfield to compensate for its higher per-unit purchased water cost. Sacramento customers' increased rates would provide the subsidy necessary to hold Larkfield customers' rates constant.[42]

Felton and Montara districts would be consolidated with Monterey district by holding Montara's rates constant and increasing Felton's sates immediately to those of Monterey's standard rate design. The resulting revenue shortfall would accumulate in a new WRAM (Water Revenue Adjustment Mechanism) balancing account to be recovered from customers of all three districts in the next GRC.[43] CalAm proposes that this new WRAM bear interest

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[41] As noted, this decision grants CalAm's late-filed request to withdraw the Montara district application.

[42] CalAm estimates the subsidy at requested rates to be $535,000 in TY2003 and $631,000 in TY2004. (Exhibits CA-2 and CA-3, Table 16-1).

[43] CalAm estimates that revenues from its proposed Felton rates would fall short by $431,000 and $440,000 in 2004 and 2005 respectively, and for Montara, $331,000 and $391,000. (Exhibits CA-4 and CA-5, Table 16-10). The shortfall would ultimately be recovered from customers of

Footnote continued on next page

and be exempt from any earnings tests or further Commission review beyond verification of the calculations in the account. Felton's current conservation discount and Safe Drinking Water Bond Act loan surcharge, and Montara's Master Plan investment surcharge, would be continued.

ORA and the other parties oppose both consolidation proposals. Jeff Almquist and Santa Cruz would instead have the Commission order CalAm to consolidate Larkfield, Montara, Felton and Sacramento by combining their revenue requirements and applying the Commission's standard rate design methodology to develop a single, uniform set of rates for the consolidated district. CalAm opposes the Almquist and Santa Cruz consolidation alternative.

ORA's opposition relies almost entirely on a set of policy guidelines developed jointly in 1992 by the Commission's Division of Ratepayer Advocates (ORA's predecessor) and the Class A water companies. Those guidelines established four criteria to be met in considering district consolidations:@

> 1. Proximity: The districts must be within close proximity to each other. It would not be a requirement that the districts be contiguous as it is recognized that present rate-making districts consist of separate systems which are not connected. It was suggested that districts within 10 miles of each other would meet the location criteria.
>
> 2. Rate Comparability: Present and projected future rates should be relatively close with rates of one district no more than 25% greater than rates in the other district or

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all three districts through the WRAM account, the bulk of it coming from Monterey customers because of their much greater numbers. The record has not been updated to reflect the effects the Montara district divestiture would have on these figures.

[44] Exhibit ORA-11.

> districts, To lessen the rate impact of combining districts it may be necessary to phase in the new rates over several years.
>
> 3. Water Supply: Sources of supply should be similar. If one district is virtually dependent upon purchased water, while another district has its own source of supply, future costs could change by a greater percent for one district versus the other. This could result in significantly different rates in the future even if present rates were quite similar.
>
> 4. Operation: The districts should be operated in a similar manner. For example, if a single district manager presently operates two or more districts and the billing system is common to the same districts, such an operation would support the combination of the districts.
>
> It was agreed that no districts would be combined for the express purpose of having one district subsidize another.

Although some of these factors remain relevant to our consideration, we note that we have previously stated in D.00-06-075:

> [W]e believe that Branch's reliance on our Water Division's 1992 guidelines for combining water utility districts is misplaced. As the testimony at hearing showed, the guidelines were intended then, and continue today, to set criteria for single tariff pricing that, when met, establish prima facie reasonableness of the proposed consolidation. A number of rate consolidations have been approved pursuant to the guidelines without opposition by the Commission's advocacy staff. The guidelines, however, implicitly permit proposals for broader rate consolidations, with the understanding that such proposals are likely to be protested by the advocacy staff in order that a full record can be developed for Commission consideration.[45]

[45] D.00-06-075.

For this reason, we cannot make a determination on the proposals' failure to meet some, or even most, of the four consolidation guidelines set forth above as ORA would have us do.

CalAm offered conflicting testimony as to whether its proposals meet the guidelines. On the one hand, "Applicant believes that this request [consolidating Montara/Felton/Monterey, and separately, Larkfield/Sacramento] satisfies the criteria set forth in the guidelines," while on the other, "[T]he Company presently meets certain of the criteria of the Guidelines for district consolidation, and will but does not currently meet others."

CalAm acknowledges that neither set of districts meets the proximity criterion.[46]

With respect to the rate comparability criterion, CalAm states, "The standard rates for the Monterey district and Felton district are essentially the same." However, it also shows that applying those then-proposed Monterey standard rates to Felton district customers would generate $810,008 in revenues in TY2004 compared to $1,241,000 in revenues that its "essentially the same" proposed Felton stand-alone rates would generate.[47] And for Larkfield/Sacramento, "The current tariffs for these two districts do not meet that [rate comparability] criterion; the current rates in the Larkfield district exceed the rates in the Sacramento district by a little over 100% for residential metered customers consuming 10 units per month."[48]

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[46] Exhibit CA-2, gages 15-6, 15-7, and 16-1.

[47] Exhibit CA-21, page 16, and Exhibit CA-2, Table 16-8.

[48] Exhibit CA-2, page 15-6.

With respect to the water supply criterion, Felton relies on ample supplies from its creeks and springs, whereas CalAm's Monterey water supply is fraught with complication and subject to great uncertainty over the coming years.[49] It would be difficult to conclude that their source of supply situations are similar under the circumstances. Larkfield and Sacramento both rely largely on well production with lesser amounts of purchased water. To allow for their differences, CalAm would establish a quantity sate differential in Larkfield to compensate for its higher per-unit purchased water cost.

The former Citizens districts do appear to be operated in a similar manner. They share common upper management, sources of capital, and billing and accounting resources. Each uses local personnel for day-to-day operations on site and relies on out-of-state personnel for customer service functions.

CalAm describes four past Commission decisions as precedent for its proposed consolidations. Three of those decisions, however, were settlements which under the Commission's Rules of Practice and Procedure, Rule 51.8, cannot be considered precedential unless the Commission expressly provides otherwise.[50] It did not do so. The fourth was a Southern California Water Company proposal to introduce single tariff pricing for eight water districts comprising a single region in the Los Angeles area.[51] There, in a single-issue proceeding, the Commission was able to examine the company's proposal and its short and long-range effects in great detail. Among other considerations, the company presented, and the decision lists, the average annual water bill at stand-

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[49] See Almquist testimony, Exhibit I-4, pages 11 and 12.

[50] D.93-01-006, D.94-11-004, and D.96-04-076.

[51] D.00-06-075 in A.98-09-040.

alone rates and at the proposed regional rate for each the eight districts for every year from 1999 through 201%. Thus, the record made very clear how customers would be affected over a long period, and the Commission was able to conclude that the advantages of single tariff pricing in the region outweighed the disadvantages.

In this proceeding, no such clear picture has been presented for either CalAm's proposed consolidations or that of the intervenors. There has been no examination of the customer effects in coming years of the very significant capital projects CalAm anticipates in Sacramento district or Monterey district. What has been presented is now out of date in that it still includes the effects of a divested Montara district. The record is further complicated by the recent Citizens and RWE acquisitions, the costs and benefits of which will continue to be sorted out and reflected in district rate proceedings over the next several years. We are also troubled by CalAm's proposal to shunt very large amounts of current revenue requirement into a proposed WRAM to accumulate as an interest-bearing obligation against Felton and Monterey customers in future years,

For these reasons, the record in this proceeding does not allow us to find that the advantages of district consolidation outweigh the disadvantages. However, because of the size of the rate increases that our authorized revenue requirements would likely produce for Felton (which are discussed below), the public interest would be better served by a timely consideration by this Commission of rate consolidation proposals with an evidentiary showing that fully addresses the issues identified above. We will therefore order that CalAm make such an application within 90 days of the adoption of this order.

Cost of Capital

In order to determine a fair rate of return for a utility, we determine the proportions of long-term debt and equity in its capital structure, estimate what the effective cost of each will b e and then take a weighted average. The resulting rate of return is used to determine the revenue requirement in the summary of earnings for each test year.

Capital Structure

CalAm's application-proposed capital structure consisted of the following proportions of long-term debt and equity: for TY2003, 63.99% and 36.01%; for TY2004, 63.73% and 36.27%; and for 2005, 63.63% and 36.37%. ORA concurred. That capital structure is reflected in our adopted rate of return for TY2003 and TY2004, Table 3 below.

Cost of Debt

American Water Works completed its $161 million acquisition of the Citizens assets in California on January 15, 2002. In connection with that acquisition, CalAm issued a five-year, 4.92% note with its affiliate, American Water Capital Corporation, for approximately $104 million, and is maintaining a separate ratemaking capita1 structure for these former Citizens districts to allow it to demonstrate to the Commission the cost of capital savings that help support amortizing the acquisition premium in rates. CalAm and ORA added to the capital structure approximately $2 million in additional long term debt issuances each year from 2002 through 2005. Both estimated their projected long-term interest rates for those new debt issues by adding 150 basis points to the

forecasted 10-year Treasury bond rate. CalAm later accepted ORA's projections, and the results are shown in Table 3 below.[52]

Cost of Equity

Cost of equity is typically the most contested component of rate of return in water general rate cases. It is a direct measure of the company's after-tax return on equity investment (ROE), and its determination is by necessity somewhat subjective and not susceptible to direct measurement in the same way capital structure and embedded cost of debt are.

We have many times over the years cited the well established legal standard for determining a fair ROE. In the Bluefield Water Works case,[53] the Supreme Court stated that a public utility is entitled to earn a return on the value of its property employed for the convenience of the public, and set forth parameters to assess a reasonable return. That return should be "'...reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."

As the Supreme Court also noted in that case, a utility has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. In 1944, the Court again considered the rate of return issue in the Hope Natural Gas Company case,[54]

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[52] CalAm's higher initial interest rate forecasts were prepared at the time the applications were drafted in mid-2002. ORA's were based on DRI's February 2003 forecasts.

[53] Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia (1923) 262 US 679.

[54] Federal Power Commission v. Hope Natural Gas Company (1944) 320 US 591.

stating, "[T]he return to the equity owner should be commensurate with returns on investments in other enterprises sharing corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital,"

The Court went on to affirm the general principle that, in establishing a just and reasonable rate of return, consideration must be given to the interests of both consumers and investors.

CalAm, QRA and Santa Cruz each made a showing to support an ROE recommendation. With the principles above in mind, we first describe the methods each used, and then discuss our evaluation of them.

CalAm's Recommended Return on Equity

CalAm used a variety of analytical techniques, including DCF (discounted cash flow) and RP (risk premium) models, but ran them on different! more varied sets of data than did ORA.[55] Using data available in mid-2002, CalAm presented three DCF estimates (one said to be based on a sample of water utilities used by ORA in an earlier GRC proceeding, one based on its own sample of water utilities, and the third based on gas utilities), three RP analyses (one

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[55] The DCF model is a financial market value technique based on the premise that the current market price of a share of common stock equals the present value of the expected future stream of dividends and the future sale price of a share of stock, discounted at the investor's discount rate. By translating this premise into a mathematical equation, the investor's expected rate of return can be found as the expected dividend yield (the next expected dividend divided by the current market price) plus the future dividend growth rate,

The RP model is a risk-oriented financial market value technique which recognizes that there are differences in the risk and return requirements for investors holding common stock as compared to bonds. An RP analysis determines the extent to which the historical return received by equity investors in utilities comparable to the utility at issue exceeds the historical return earned by investors in stable, long-term bonds. This difference, or "risk premium," is then added as a premium to the estimated cost of long term debt to derive average expected return on equity for the test period.

based on water utilities and two on gas utilities), and an internal rate of return analysis. CalAm shows estimated equity costs ranging from 10.6% to 11.8% by the DCF method, and 11.4% to 11.8% for the RF method. CalAm's equity cost estimates range up to 13.1%.[56] Only one is as low as 11%, and its witness recommends it be given little weight because it was based on ORA's sample of water utilities. In addition to using more, and more varied, data sets, CalAm also relied at several points on ROE adders and adjustments intended to conform its analyses more closely to CalAm's situation, CalAm concluded that its cost of equity is in the range of 10.6% to 11.8%, and its final recommendation was an ROE no less than 11.0%.

ORA's Recommended Return on Equity

To determine the appropriate ROE, ORA performed a quantitative analysis and then assessed the level of business and financial risk CalAm faced. In its quantitative analysis, ORA also used DCF and RP models to estimate investors' expected ROE, and applied both models to a group of comparable water utilities selected based on two criteria: (1) water operations account for at least 70% of their revenues, and (2) their stocks are publicly traded. The comparable groug comprised six companies: American States Water, California Water Service, Connecticut Water Service, Middlesex Water, Philadelphia Suburban, and San Jose Water. ORA's DCF analysis yielded an average expected ROE of 8.00%. Its RP analysis produced 10.96%. It averaged the two results to produce its 9.48% final recommended ROE for CalAm.

[56] The highest ROE is found with an internal rate of return analysis and was not included in the witness' final ROE recommendation.

ORA concluded that CalAm's business risk, which ORA related primarily to regulatory risk, was low, citing the Commission's many risk-reducing mechanisms available to water utilities. Those mechanisms include balancing accounts (now redesignated as balancing-type memorandum accounts) for purchased water, purchased power, and pump taxes, memorandum accounts for catastrophic events and for Safe Drinking Water Act compliance, 50% fixed cost recovery in the service charge, and construction work in progress in rate base. ORA also evaluated CalAm under a set of benchmark financial ratios used by Standard & Poor's to assess business risk and found CalAm would merit an A rating, within the range considered "investment grade." ORA judged this to be a clear indication of CalAm's ability to attract capital.

ORA also noted that CalAm's average equity ratio during the test years will be lower than the comparable group's average. While a low equity ratio can indicate increased financial risk, ORA stopped short of drawing that conclusion for CalAm.

Santa Cruz's Recommended Return on Equity

Santa Cruds witness presented and defended the results of three different ROE models: a Value kine dividend-growth model yielding 9.02%, a refention-ratio (sustained earnings) DCF method producing 9.11% and an earned-return RP method producing 9.47%. He initially recommended the Commission adopt the average of the three results, 9.2%, and later increased that figure to 9.3%.[57] Santa Cruz characterizes its analysis as more sophisticated than

[57] On the last day of evidentiary hearing, the witness presented supplemental testimony, marked Exhibit 1-19 for identification. In it, he presented a refinement to his retention-ratio DCF method that increased the 9.11% figure to 9.39%, and thus Santa Cruz's overall averaged ROE recommendation to 9.3%. CalAm initially objected to admitting Exhibit 1-19 but did agree to rely on a set of late-filed interrogatories in lieu of cross-examination. Exhibit I-19, CalAm's

Footnote continued on next page

CalAm's, and being based on much later data that better reflects conditions at the time of the hearings.

Return on Equity Discussion

ORA and Santa Cruz attack perceived shortcomings in CalAm's ROE showing, and CalAm does likewise to ORA's and Santa Cruds showings.[58]

CalAm's primary cost of capital witness on rebuttal addressed five aspects of ORA's analysis. First, CalAm maintained that its lower than average equity ratio benefits ratepayers but also means more risk for its shareholders, and that ORA failed to impute an ROE adder to flow some of that Beverage benefit back to shareholders.[59] Second CalAm charges that ORA's DCF model produces an ROE that is less than the cost of Baa-rated investment grade bonds. Third, CalAm believes ORA's RF analysis provides a reasonable but conservative estimate for less leveraged water utilities, but CalAm merits an ROE adder (similar to the adder in the first point above). Fourth, CalAm argues that ORA should have given no weight to historical growth estimates because past growth in earnings per share, dividends per share, and retained earnings understate the growth investors currently expect. Fifth, CalAm showed that by,

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interrogatories served April 30,2003, and the answers to those interrogatories served May 2, 2003, are all now admitted into evidence.

[58] ORA and Santa Cmz generally avoided criticizing one another's showings. One exception was Santa Cruz's finding fault with the concept of single-stage DCF growth models used by ORA and CalAm, as opposed to Santa Cmz's three-stage growth model. (Exhibit 1-19, page 4)..

[59] CalAm cited its desired share of the benefit under several different methods, producing estimates for its share ranging from 22 basis points up to 130 basis points (e.g., Exhibit CA-16, page 14: 60bp; CA-22, page 2: 43bp; CA-22, page 4: 43bp; CA-22, page 19: 130bp; CA-22, page 22: 40bp; CalAm brief, page 4 0 43bp and 130bp).

e.g., changing ORA's averaging method and excluding one or more of the water utilities in ORA's sample, it could greatly increase the resulting ROE from ORA's DCF analysis. Elsewhere, CalAm criticized the spread between ORA's DCF and RP result as being too wide and urged throwing out the lower DCF figure, and took issue with ORA's rejection sf "v*s growth" in its DCF model.

CalAm was similarly critical of Santa Cruz's ROE showing for not imputing an ROE adder flowing back to shareholders some of the leverage benefits ratepayers may realize from CalAm's low equity ratio. Some of CalAm's other criticisms concerned Santa Cruz's use of growth forecasts of dividends per share rather than earnings per share in its DCF analysis; its initial omission of v*s growth in its estimate of sustainable growth in the DCF model, and the way Santa Cruz calculated v*s growth when it did later agree to include it; its use in the RP model of a 4.4% estimate for the average 10-year Treasury rate in 2003 rather than an average 5.62% Treasury rate reflecting 2003,2004, and 2005;[60] and an alleged inability of Santa Cruz's three-stage growth DCF model to accommodate growth prospects that improve over time. CalAm also faulted the opposing parties for their use of market-oriented methods to estimate investors' expected market return on their market-valued investments, rather than expected return on book value common equity. Lastly, CalAm on brief called ORA to task for its too-low recommendation in light of these recent large water utility ROE awards which it notes: San Gabriel Valley Water Company, 9.83%; Apple Valley Water Company, 9.53%; Valencia Water Company, 9.72%; CalAm's Monterey district, 10.25%; and Suburban Water Company, 9.84%.[61]

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[60] ORA later updated both figures in the record. Exhibit ORB-9 showed the 5.62% had dropped to 5.10%, and the 4.4% had dropped to 4.09%.

[61] CalAm cites D.03-05-078, Suburban Water Company's GRC, for these figures.

ORA's direct testimony took issue with seven components of CalAm's ROE presentation. First, CalAm relied too heavily in its analysis on comparisons with gas utilities, a practice the Commission has repeatedly rejected in the past. Second, CalAm's call for an ROE adder to allow it to partake in savings generated by its lower than average equity ratio runs contrary to its representations in the RWE acquisition proceeding where it and the other applicants stated that CalAm's financing costs would go down due to that acquisition and ratepayers would receive the resulting benefits. Third, ORA believes CalAm should not cite uncertainty in the weather as anything but a normal risk of doing business as a water utility, already taken into consideration by the informed investor and accounted for in the market-based models. Fourth and fifth ORA took issue with CalAm's characterization of the Commission's attrition step rate procedure and then-proposed new balancing account procedures as greatly increasing its risk by serving as de facto caps on its earnings. According to CalAm, "They create a one-way street where the earned ROE can be lower than is authorized, but not higher than authorized."[62] Sixth, ORA performed a detailed analysis of authorized water returns and bond costs, and it showed, contrary to CalAm's assertions, that no consistent relationship exists between interest rates and authorized ROEs over the past eight years. And seventh, ORA rejected CalAm's use of a v*s growth factor in calculating sustainable growth, on the grounds that the v*s factor is associated with use of issuance cost in determining ROE, a concept ORA says the Commission has previously rejected.

[62] Exhibit CA-16, page 15.

Santa Cruz took issue with CalAm's use of a single-stage growth model; a leverage-based ROE adjustment; a 2003,2004 and 2005 average of the projected 10-year Treasury rate rather than the TY2003 projection; and CalAm's reliance on unreasonably high earnings growth estimates and Value Line's Blume-method adjusted betas in capital asset pricing model work, both of which, Santa Cruz charges, improperly inflate the estimated ROE.

These charges and countercharges are too many and too technical to address here individually. In arriving at our conclusions, however, we have fully considered the parties' direct and rebuttal showings on each of them.

Commenting first on ORA's presentation, we remain concerned by the spread between its DCF and RP estimates. That is a concern we have also expressed in past GRC decisions. In this case, the initial spread narrowed with the updated DRI forecasts ORA later presented on Treasury's and Baa-rated bonds,[63] and ORA's methods and the resulting estimates seem otherwise technically correct, so we decline to reject them. CalAm would have us eliminate the spread by disregarding the lower, DCF result, but that change is no more supportable than throwing out the higher, RP result. We are impressed by ORA's straightforward, point-by-point rebuttal of this and CalAm's other criticisms.[64] ORA's resulting 9.48% ROE recommendation is lower than we will adopt here, but more realistic and closer to our final adopted ROE than is CalAm's.

[63] Exhibit OM-9.

[64] RT506-RT513.

Because a portion of its background material was stricken during hearings,[65] Santa Cruz lacked a good narrative explanation of its method in its direct showing. However, what we learned of its method through the remaining testimony and exhibits showed that Santa Cruz had taken a well thought out and balanced approach that produced results that, like ORA's, fell within a reasonable ROE range. In response to CalAm's criticisms on rebuttal, the Santa Cruz witness agreed to adjust his final estimate to include an additional 27 basis points of v*s growth in his retention-ratio DCF method ROE, producing a final 9.3%ROE recommendation.[66]

All three parties' direct ROE witnesses seemed competent and well informed on the topic. CalAm's presentation was, in fact, a technical tour de force, nearly overwhelming in its detail and complexity-. Whether it was persuasive was another matter. We find it disappointing that CalAm has relied so heavily in its analysis on comparisons with gas utilities, a practice the Commission has repeatedly rejected in the past because water utilities are less risky.[67] CalAm reduces the resulting ROE by 50 basis points when comparing water utilities with gas utilities, but that is an arbitrary and unconvincing adjustment considering that CalAm acknowledges it is based only on the witness' judgment, and in light of the Commission's specific rejection of such

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[65] That stricken material, portions of Exhibit I-5, appeared to be the witness' complete and voluminous prepared direct testimony for a proceeding before the Public Utilities Commission of Nevada. It had not been edited in any way to address the specifics of this California proceeding.

[66] Exhibit 1-19, page 2.

[67] See D.90-02-042, D.92-01-025, D.01-04-034.

comparisons in the past.[68] In any case, he later adds back 60 basis points to each of his ROE results to adjust for his belief that CalAm is more risky than the average water utility in the samples, thus more than negating the earlier reduction and generating a *higher* ROE for CalAm than his analysis indicates would be warranted for gas utilities.

We are also unimpressed by some of the other contentions CalAm advances in support of its much higher ROE recommendations. First, according to its expert rebuttal witness, "Balancing accounts [in California] have been discontinued, yet the awarded costs of common equity have still been well below national norms."[69] In R.01-12-009, our Balancing Account Rulemaking, we redesignated as "balancing-type memorandum accounts" the type of balancing account to which the witness is likely referring. What has changed, besides the designation, is that these accounts may no longer be claimed as an asset on water utilities' balance sheets.[70] What has not changed is that they continue to provide water utilities valuable protection against underearnings caused by increased costs of the types they cover. Second, CalAm's primary ROE witness describes the attrition step rate procedure and the then-proposed balancing account procedures as "treating the [authorized] ROE as a ceiling rather than a target ROE." He goes on to characterize them as making the authorized ROE the maximum ROE that can be earned and thus denying the utility a fair opportunity

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[68] Exhibit CA-16, page 12.

[69] Exhibit CA-25, page 13. This contention is repeated in CA-25, Schedule 5, footnote 1, where the witness explains that this loss of balancing account protection "involves at least another 75 basis points of common equity return...."

[70] D.03-06-072, Footnote 1.

to earn it.[71] The Commission has long applied the earnings test to which he is referring, and it has not had the effect he claims, as demonstrated by CalAm's acknowledged long, consistent history of overearning its authorized *ROE* in California.[72]

If one theme predominated in CalAm's *ROE* presentation, it was its consistent claim throughout to an *ROE* adder to reward shareholders for their low equity ratio. We do acknowledge that a low equity ratio is an important factor that lowers CalAm's cost of service.[73] In this case, however, CalAm's cost of capital is a primary contributor to the synergies savings resulting from CalAm's acquisition of the Citizens properties. The record clearly shows that CalAm's low equity ratio contributes directly to that cost of capital synergies savings.[74] To the extent thsse synergies savings exist, they go first to CalAm as

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[71] Exhibit CA-16, page 14.

[72] By its own admission on this record, CalAm's actual ROE exceeded its Commission-authorized ROE in every year between 1993 and 2001. It fell far short of its authorized ROE in 2002 primarily, it says, because of the Citizens acquisition. (Exhibit I-10)..

CalAm's overearning its ROE is confirmed as well by this statement in its applications: "The average return on ratemaking equity during the past five years has been 12.69%. Authorized return on ratemaking equity during the same period of time was between 10.17% and 10.49%. The authorized return on average ratemaking equity was 10.36%. The company's earnings were above the authorized levels due in largest part to very favorable weather conditions and the timing of Commission authorization of revenue recoveries for prior balancing account shortfalls, drought losses, and water conservation related expenditures." (Exhibit CA-1, Tab E, page 2-1).

[73] Two elements contribute to this: (1) The cost of debt financing is typically lower than the cost of equity financing; and (2) interest payments on debt financing are tax-deductible and the resulting tax savings are glowed through to ratepayers when rates are set, whereas ratepayers get no such benefit from the return they pay shareholders for equity investment. This beneficial effect of a low equity ratio may be offset to some extent by the fact that prospective debt holders could view a more highly leveraged utility as a more risky borrower.

[74] Exhibits ORA-1A and ORA-1B, and CalAm brief, gage 56.

compensation to amortize, and to pay a return on the unamortized balance of, its acquisition adjustment, and then to ratepayers.[75] Thus, the dollars associated with the ROE adder CalAm seeks as a reward for maintaining a low equity capital structure are already flowing to CalAm to amortize the premium it paid to acquire Citizens' assets

After evaluating the parties' ROE models, we find that CalAm's analyses were less credible than those of the other parties, and produce results that fail a reasonability test, In addition to the infirmities we note above, investors in today's economic climate and over the forthcoming rate case cycle will not require CalAm to earn after-tax returns at or above 11% to make equity investments in it.[76]

We turn to a combination of figures drawn from the parties' recommendations to establish an authorized ROE. First, when we set aside CalAm's results based on comparisons with gas utilities and those based on a low equity ratio adder, what remains is an ROE range of 10.0% to 11.2%.[77] The 10.6% midpoint of that range, combined with ORA's 9.48% and Santa Cruz's 9.3%, gives an overall average ROE of 9.79%. Next, CalAm on brief presents from data in the record an historical average 2.23% spread between Commission-authorized ROEs and each prior year's Baa bond interest rate, and produces an

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[75] Under the alternative sharing proposal the Commission accepted in D.01-09-057, synergies in excess of the annual acquisition premium amortization expense were to be split between ratepayers and shareholders 90%/10%.

[76] See, e.g., Exhibit I-8 for a sampling of market-based financial yields as of the April 2003 evidentiary hearings.

[77] Exhibit CA-16, Summary Table *23.* We recognize that CalAm does not recommend the 10.0% figure – We use it because it is what CalAm's evidence supports, not because it is what CalAm supports.

ROE for this proceeding by adding to it the 7.57% latest DRI projection of the average Baa bond rate for 2003, 2004 and 2005, and a low equity adder.[78] No party endorses this method as a stand-alone ROE result, nor do we, but it does provide a reasonability check in combination with other methods. Without the Pow equity adder, it produces a 9.80% result.[79] And lastly, as another reasonability check, 9.80% is very close to the 9.83% average of the five recent large water utility ROE awards CalAm notes in its brief and we list above. We adopt an ROE for CalAm of 9.79% for TY 2003 and TY 2004.

Rate of Return on Rate Base

With the capital structure, cost of debt, and cost of equity components determined above, the straightforward calculations in Table 3 derive the rates of return on rate base:

[78] CalAm brief, page 45.

[79] If the Baa bond rate for 2005 were dropped from the average, the 9.80% result would drop to 9.62%.

Table 3

Adopted Cost sf **Capital and** Rate of Return

	Adopted		
	Capital Structure	Cost	Weighted Cost
TY2003			
Long-Term Debt	63.99%	4.97%	3.18%
Common Equity	36.01%	9.79%	3.53%
Total	100.00 %		6.71%
TY2004			
Long-Term Debt	63.73%	5.00%	3.19%
Common Equity	36.27%	9.79%	3.55%
Total	100.00 %		6.74%

The extraordinarily low overall adopted rates of return on rate base, 6.71% for TY2003 and 6.74%for TY2004, are the direct result of weighting in the very large, $104 million, 4.92%interest rate note issued in connection with CalAm's purchase of the Citizens assets, as discussed in the Cost of Debt section above.

Step Rate Increase Filings

The parties raise two issues concerning the pro-forma earnings test to be applied to CalAm's 2004 step rate filing: the proper rate of return to use, and the proper sales figures to use. We previously considered both issues in CalAm's most recent GRC decision for Monterey district, D.03-02-030, and we reach the same outcomes here that we did there,

The rate of return in this proceeding is based on a different capital structure than would be used for CalAm's other, non-Citizens districts. CalAm points out that it would not be appropriate to apply the rate of return from any future GRC decision for its non-Citizens districts in the pro-forma earnings test for these Citizens districts. ORA's position is unclear because of clerical errors in that section of its exhibits. We addressed this issue in reverse in D.03-02-030 when we determined that the Monterey Division pro-forma earnings test should

not use a rate of return ordered in a Citizens district GRC. We arrive at the same conclusion today: The Citizens districts' pro-forma earnings test should use only a Citizens district rate of return.

Second, ORA recommends that the recorded sales per customer for residential and commercial customers be used instead of the adopted sales per customer for revenue calculations in the pro-forma earnings test.[80] CalAm opposes ORA's recommendation as both unfair and a change from longstanding practice. Both sides make excellent arguments! but we reject ORA's recommendation today for the same reason we did in D.03-02-030: "The current procedure for processing rate increases, including step rates, may not be perfect, but it has proven effective for a number s f years. Any change in the current procedures needs to be open to formal discussions with all water utilities and members of staff. Changes in these longstanding procedures should not be made in one company's rate case application."

In D.02-12-068 approving the RWE acquisition, we approved a settlement containing this provision as Condition #1: "Sacramento, Felton, Montara and Larkfield: Defer filing the authorized 2004 step rate increase that would have been filed in 2003. File a general rate case application in January 2004 for new rates effective January 2005." We have made a minor modification in our otherwise-standard step rate increase ordering paragraph to accommodate Condition #1 as D.02-12-068 required.

[80] ORA makes this recommendation only for Felton and Montara districts, and only for residential customer revenues. However, from the context in Exhibits ORA-3 and ORA-4, we and CalAm believe ORA to have intended the recommendation to apply to both residential and commercial customers, and to all districts.

CalAm has also requested we establish a Felton district 2005 step rate increase, but, under the requirements of D.02-12-068, any 2005 step rates could not become effective until at least January 2006.[81] We have not provided a 2005 step rate increase in this order because CalAm's next GRC for its Citizens districts will be for either TY2005 or TY2006, and 2006 should not be both an attrition year in this rate case cycle and a test year in its next rate case cycle.

Rate Design

In our discussion above of SRR#4, we agreed that Felton district Rate Schedule No. FE-6M should be eliminated, and in SRR#5 that the after-hours reconnection charges in all three districts should increase to $50 from $15. In SRR#6 and SRR#7, we determined not to allow district consolidations with their attendant subsidies and rate redesigns at this time. Those rate design issues having been decided, we follow ORA's otherwise-uncontested recommendation by applying the standards set forth in D.86-05-064 in I.84-11-041, the Commission's investigation into water sate design policy. Our policy calls for metered rates to be set to recover up to 50% of fixed costs in the service charge, and up to three quantity blocks (in this case, we use a single block). Residential flat rate service and private fire protection service are increased by approximately the overall percentage increase in each district, and the current conservation discount and Safe Drinking Water Bond Act loan surcharge are continued in the Felton district.

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[81] See D.02-12-068: "We want to ensure this [one-year rate increase deferral] proposal provides sufficient ratepayer benefit and also to guard against the possibility of 'rate shock,' or a large rate increase occurring at one time. We therefore modify condition 1 [of the RWE settlement] so that in each instance where the rate increase is deferred, it may be implemented in the following year. *However, the step or attrition year increase for that following year will also be deferred.*" (Emphasis added).

Appendix E provides a comparison of typical bills at present and authorized rates for residential metered customers in each district at various usage levels and the average usage levels.

Service Quality

ORA recommended the Commission find service to be satisfactory in all four districts. ORA tabulated the number of customer complaints received for each district between 1996 and 2001 and found that they had been resolved within a reasonable period after notification. There was no indication of what other considerations, if any-, led ORA to make its recommendation.

Almquist's prepared direct testimony on behalf of Santa Cruz[82] alleged that service in the Felton district had not been improved by the district's consolidation into CalAm's wider operations. According to Almquist,

> Numerous residents [in the Felton public participation hearing] told of how they now had to call a customer service number in some other area of the country in order to communicate with the company regarding service requests and all other business. When residents have tried this number they end up in a voice mail system that tells them that the company is experiencing a high volume of calls and is unable to serve them. They are asked to call back later.[83]

To verify this, he had an aide place three calls over a two-day period, and each time the aide was told by a machine that the company was experiencing long hold times and high call volumes and to try again later.

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[82] Almquist stated that he was also testifying on his own behalf and on behalf of his homeowners association and a local citizens organization formed to oppose the rate case and to facilitate local acquisition of the Felton system.

[83] Exhibit I-4, page 3.

A review of the Felton district public participation hearing transcript confirms that one public speaker told of having made three unsuccessful attempts to reach the company's customer service number before giving up and going to the company'' local office in person.[84] No other speakers related similar experiences.

To reach customer service, CalAm's California customers call a local number and are routed to service representatives in American Water Works' Alton, Illinois call center. CalAm's witness acknowledged that a number of customer calls were not resolved satisfactorily upon the first contact by a customer to the company, and in some cases, follow-up was too slow.[85] The witness described several measures taken recently to address those shortcomings: increased service representative authority to resolve concerns on the first call, including increased no-fault settlement limits; a modification to the system to provide better tracking of calls requiring investigation and follow-up; and revised billing system settings to more quickly identify anomalous meter readings before bills are mailed. Had these improvements been in place in 2002, CalAm believes, some 22 complaints would have been resolved on the first call instead of developing into informal Commission complaints.

In D.02-12-068 approving CalAm's acquisition by RWE, we stated,

> In order to mitigate customer concerns about lack of responsiveness due to foreign ownership, we require Cal-Am's customer call center to meet the above targets for each of the categories listed above, averaged on a quarterly basis. We require that, for five full years following the effective date of this decision, Cal-Am shall make

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[84] RT 219.

[85] Exhibit CA-22, gage 8.

> quarterly filings listing the above service quality targets, as well as the rates actually achieved. Cal-Am shall file these reports with the Director of the Water Division and ORA, on January 15, April 15, July 15, and October 15, commencing on the first quarter following the effective date of this decision. The reports shall be for the preceding three months (the January filing will be for October – December, etc.). The Commission may examine these reports in Cal-Am's general rate case or other appropriate proceeding,

No party introduced results from these reports; the first of them may or may not have been available at the time of the evidentiary hearings. Because we lack sufficient evidence, we make no finding on the quality of CalAm's service overall. We look forward to the parties' providing a more thorough evaluation in the next GRC for these districts.

Almquist's Issues

We summarize and address briefly here a number of points made by Alrnquist in his testimony.[86]

First, Almquist charged that shareholders have profited handsomely from Felton district's transfer from Citizens to CalAm followed immediately by its transfer to RWE. Ratepayers, on the other hand, have seen little if any tangible benefit despite representations made when the parties sought Commission approval. CalAm has failed to identify and quantify the cost savings, efficiencies and other economies achieved through the Citizens acquisition or the RWE acquisition, or to distinguish one set of benefits from the other, and has not passed those benefits through to ratepayers. CalAm has provided no justification for allocating any of the Citizens acquisition adjustment to Felton district rategayers. Further, CalAm's request for a rate increase is inconsistent with

[86] Exhibit I-4.

RWE's conduct in paying a $2.8 billion premium to acquire American Water Works, and its commitment not to recover any of that premium from ratepayers. In response, we note that we have discussed the Citizens and RWE transactions separately at length in two sections above. Where there are benefits that should be flowed to ratepayers in this GRC, that has been done.

Next, Almquist argues that the premium RWE paid to American Water Wsrks shareholders has fully repaid American's shareholders for the acquisition premium they paid to Citizens when they purchased Citizenskater assets. Thus, the acquisition premium amortization the Commission authorized in D.01-09-057 is no longer justified. We previously considered and rejected this argument in the RWE acquisition proceeding.[87] We decline to reconsider it here.

Almquist charges that Felton district rates have increased greatly over the past 12 years, a period of low inflation, and are substantially higher than those of two adjacent water districts. In response, we note that individual water systems, including systems that adjoin one another, may face differing costs, and even if their costs were the same, rates charged by Felton's neighboring municipal and district-run systems are not necessarily reflective of the costs borne by those systems. As Almquist acknowledged, those districts are not Commission-regulated, have the authority to tax, and one of them may in fact be supported in part by real estate taxes. Nevertheless, Almquist's general rate comparisons with neighboring non-regulated systems do help us to determine the range of rates that that appear reasonable in the local context. The rate increases and rate levels that our adopted revenue requirement would produce for Felton may indeed produce "rate shock." For this reason, we will not raise Felton's rates to the

[87] D.02-12-068, Section V.C.

levels set in Appendix B at this time, Instead, we will order CalAm to establish for the Felton district a balancing account to track the revenue shortfall that arises from the continuation of the current rate schedule. More specifically, CalAm shall record in the balancing account the difference between revenues generated by current rates ignoring any modifications to those rates from advice letter filings and those set in Appendix B. Such calculations shall also change consistent with the timing of changes in sates set forth in Appendix C. In addition, this balancing account will be exempt from the provisions of D.03-06-072, because the balance that arises from difference between the continuation of adopted rates that the revenues that would be generated by the rates in Appendix B are reasonable. The amortization of the balances accrued in the balancing account will be determined in conjunction with the application of CalAm is here directed to file regarding consolidation of districts for ratemaking purposes.

Almquist further believes that CalAm's parent corporation is doing exceedingly well financially and is able to pay its executives very high compensation. That should demonstrate to the Commission that CalAm is not in need sf further rate increases. In response, CalAm points out that American Water Works is a holding company with many subsidiaries, both regulated and unregulated, and maintains that no part of the executives' salaries cited by Almquist is allocated to its regulated subsidiaries. Almqluist has apparently done no evaluation and offers no recommendation of what alleged excessive amounts of executive compensation should be removed from CalAm's costs in this proceeding. Thus, we make no such adjustments.

Lastly, Almquist charges that CalAm has not explored the availability of low cost tax-exempt financing through a public agency. It should be ordered to do so, and its revenue requirement adjusted accordingly. We note that Felton

district has in fact taken advantage of public financing in the past, in the form of Safe Drinking Water Bond Act loan funds obtained through the California Department of Water Resources. ORA's witness did a thorough analysis of CalAm's capital structure and sources sf funds in this proceeding, and we have considered her recommendations in our Cost of Capital section above. No party, including ORA, Almquist or Santa Cruz, made a showing that CalAm has unreasonably foregone, or will forego during the test period, any opportunities to obtain lower cost, public-source capital. Thus no revenue requirement adjustments are justified, and no order to seek out low cost tax-exempt financing through a public agency is necessary.

Comments on Proposed Decision and Alternate Proposed Decision

The principal hearing officer's proposed decision was filed with the Commission and sewed on all parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. CalAm, ORA, and Santa Cruz filed comments; CalAm and Santa Cruz filed replies to comments.

CalAm generally supports the proposed decision, but raises three topics in its comments: Its request that the Commission set an effective date of September 1,2003 for the TY2003 rates for Sacramento, Larkfield and Felton districts; a request to clarify the decision wording that describes our intent to disallow from rate base one-half of any unrecovered contamination-related investments in Sacramento district; and error corrections needed in the figures in Table 1 and associated decision text and the appendices. We address each of those topics below.

ORA's comments take issue with the proposed decision's treatment of contamination-relatedinvestments in Sacramento district. We consider this

included in our discussion below of CalAm's three topics. BRA is satisfied with the proposed decision's treatment of all of the other issues.

Santa Cruz argues that CalAm has failed to carry the burden of proving its claimed Citizens acquisition-related synergies and should not recover the annual acquisition premium amortization cost in rates; that a major part of the claimed Citizens-related synergies should be attributed instead to the RWE transaction; and that CalAm should have been required to prove and pass through to ratepayers in this proceeding the benefits of the RWE transaction. After review, we conclude that the proposed decision adequately addresses those claims and have made no changes with respect to them.

On December 18, 2003, approximately one month after the proceeding was submitted for decision, CalAm filed a motion requesting that the Commission set an effective date of September 1,2003 for the TY 2003 results of operations and rates for Sacramento, Larkfield and Felton districts. In support, it cited two earlier Commission decisions granting interim rate relief to class A water utilities.[88] The relief it seeks, CalAm argues, is similar to that the Commission granted in those two earlier decisions. We disagree. As Santa Cruz points out in its reply comments, where the Commission has deviated from its general policy and practice of making GRC rate increases effective on or after the effective date of the GRC decision, it has done so by issuing an interim decision announcing that whatever rates were to be established in the final decision would apply prospectively, *as of or after the date of the interim decision.* That was the case with the two decisions CalAm cites. CalAm offers no instance in which the Commission's decision set an effective date for rates that was earlier than the

[88] D.02-12-063 in re Apple Valley Ranchos Water Company; and D.03-04-033 in re California Water Service Company, citing in turn D.98-12-078 in re Pacific Gas and Electric Company.

date of that decision, nor do we know of any such instance. That would, in fact, be a classic case of retroactive ratemaking and prohibited under Public Utilities Code Section 728.[89] CalAm's motion is denied.

CalAm requests we modify the proposed decision's wording to clarify our intent to disallow from rate base one-half of any unrecovered contamination-related investments in Sacrament district. Indeed, ORA's comments indicate that it may not have understood that wording the way it was intended, The last three sentences of the Contamination-Related Projects section now provide a clearer explanation.

CalAm notes that the appendices and Table 1 and associated decision text of the proposed decision contained several errors due to incorrect information inadvertently provided by CalAm and by the Water Division in its advisory capacity to the ALJ. No party has objected to CalAm's suggested corrections, and they are now incorporated into this decision.

An Alternate Proposed Decision (APD) was mailed on April 22,2004. On April 29, 2004 CalAm and Santa Cruz filed comments on the APD.

CalAm expressed general support for the APD and proposed a series of textual clarifications, which we have incorporated.

Santa Cruz argues that the APD is superior to the PD, but renews its objections to the findings common to both. We have addressed these objections above. Its motion to file reply comments is denied.

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[89] The California Supreme Court has repeatedly affirmed the prohibition against retroactive ratemaking. See, *e.g.,* Pacific Tel. & Tel. Co. v. Public Utilities Commission (1965) 62 Cal. 2d 634, 655; and City of Los Angeles v. Public Utilities Commission (1972) 7 Cal. 3d 331,357. More recently, the Legislature has provided in newly-added Section 455.2(b) a specific, more limited remedy for situations in which the Commission's water GRC decision does not become effective on the first day of the test year. CalAm has not sought to avail itself of that relief.

Assignment of Proceeding

Carl Wood is the Assigned Commissioner and James McVicar is the assigned ALJ in this proceeding.

Findings of Fact

1. CalAm and ORA have filed a motion to adopt an amended, partial settlement agreement.

2. The settlement outlines and explains the areas where CalAm and ORA reached agreement through the settlement; it does not address those accounts and issues for which there were no differences in CalAm's and ORA initial showings.

3. No party filed and sewed comments contesting the settlement as they were required to do by our Rules of Practice and Procedure, Rule 51.4, if they desired to contest the settlement.

4. Santa Cruz objected on brief to CalAm's foregoing any opportunity to recover 10% of any proven Citizens acquisition synergies savings in exchange for not having to demonstrate those savings in future rate cases. The CalAm and ORA common position on this issue is not included in the settlement.

5. The record in this proceeding provides sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties and their interests.

6. No provision of the settlement is in violation of any statute or Commission decision or rule.

7. The adopted summaries of earnings presented in Appendix A, and the adopted quantities and calculations included as Appendix D which underlie them, are reasonable for ratemaking purposes.

8. The capital structure, cost of debt, rate of return on equity, and rate of return on rate base shown in Table 3 are reasonable for ratemaking.

9. Some of the parties in A.00-05-015 may not have received notice of this proceeding or the proposal to revise the Citizens synergies sharing method established in D.01-09-057.

10. The RWE acquisition occurred too late to be properly reflected in this proceeding. Provisions ordered in D.02-12-068 will nonetheless secure for CalAm's ratepayers the benefits from the transaction, including those immediate benefits which most concern Santa Cruz and ORA here.

11. CalAm's showing to support recovery of amounts recorded in Citizens' Sacramento district water contamination litigation memorandum account does not meet the standard required by Resolutions W-4089 and W-4094.

12. The rate increases and rate levels that our adopted revenue requirement would produce for the Felton District may lead to "rate shock" for Felton ratepayers.

13. The record in this proceeding does not support a finding that the advantages of consolidating any set of CalAm's districts outweigh the disadvantages,

14. The TY2003 rates and the TY2004 step increases in Appendices B and C have been designed to produce revenues consistent with the summaries of earnings adopted in this order.

Conclusions of Law

1. Santa Cruz and Almquist's failure to file comments on the proposed settlement constitutes their waiver of all objections to it.

2. CalAm and ORA have tendered an uncontested partial settlement as defined in Rule 51(f)(2).

3. The settlement is reasonable in light of the whole record, consistent with law, and in the public interest.

4. The settlement should be adopted.

5. The revised rates and step increases set forth in Appendices B and C are justified.

6. CalAm should be authorized to implement the rate changes set forth in this order, except as to the Felton District. Felton District rates should be deferred into a balancing account until after a decision consistent with this decision on the consolidation of districts for ratemaking purposes.

7. Section 728 does not allow, and past Commission precedent does not support, the retroactive rate relief CalAm seeks in its December 18,2003 motion.

8. CalAm's December 18,2063 motion for retroactive rate relief should be denied.

9. For any Citizens districts for which there is no TY2005 general rate case, revenues for service rendered on and after January 1,2005 that are associated with the Citizens acquisition synergies savings in those districts should be made subject to refund pending a determination of what portion of the synergies savings are to be shared with customers.

10. This decision should be made effective immediately to allow CalAm an opportunity to earn a reasonable return for its Citizens districts in TY2004.

O R D E R

IT IS ORDERED that:

1. The joint motion of California-American Water Company (CalAm) and Montara Sanitary District for CalAm to withdraw Application (A.) 02-09-033 and Montara Sanitary District to withdraw from the consolidated proceeding is granted.

2. The amended settlement between CalAm and the Commission's Office of Ratepayer Advocates, Appendix F to this order, is adopted. Settlement Section 3, Montara District, shall be disregarded.

3. **3.** CalAm's December 18,2003 motion for retroactive rate relief is denied.

4, CalAm is authorized to file in accordance with General Order 96, and make effective on not less than five days' notice, the revised tariff schedules for 2003 included as Appendix B to this order for all districts except Felton. Felton district Rate Schedule No. FE-6M shall be canceled, The revised tariff schedules shall apply to service rendered on and after their effective date.

5. Consistent with the deferred step rate filing provisions adopted in Decision 02-12-068, on or after November 5, 2004, CalAm is authorized to file an advice letter in conformance with General Order 96, with appropriate supporting workpapers, requesting the 2004 step rate increases authorized in Appendix C to this order. If the rate of return on rate base for Sacramento or Larkfield district, taking into account the rates then in effect and normal ratemaking adjustments for the twelve months ending September 30, 2004, exceeds the lower of (a) the rate of return found reasonable by the Commission for any of those districts for the corresponding period in the most recent decision, or (b) the rate of return found reasonable in this order, then CalAm shall file for a lesser increase in that district. The requested rates shall be reviewed by the Commission's Water Division and shall go into effect after Water Division's determination that they conform to this order. Water Division shall inform the Commission if it finds that the proposed rates do not conform to this order or other Commission decisions. The revised tariff schedules shall be made effective no earlier than January 1, 2005, and shall apply to service rendered on and after their effective date.

6. For the Felton district, CalAm should establish a balancing account to track the difference between revenues produced by current rates and those that would arise from the difference between revenues generated by current rates, ignoring any modifications to current rates resulting from advice letter filings, and those set in Appendix B. Such calculations shall also change on January 1,2005 consistent with the timing of changes in rates set forth in Appendix C. In addition, this balancing account will be exempt from the provisions of D.03-06-072, because the balance that arises from the difference between the continuation of adopted rates and the revenues that would be generated by the rates in Appendix B is reasonable. Step increases for the sake of these calculations shall proceed consistent with Brdering Paragraph 5, with the shortfall in the balancing account imputed as revenues.

7. The summaries of earnings presented in Appendix A, and the quantities and calculations included as Appendix D to this order which underlie them, are adopted.

8. CalAm is authorized to file an advice Better seeking Commission authorization to transfer to its Sacramento district rate base and offset in rates the reasonable expenses associated with the start up costs for surface water procurement from Placer County Water Agency and recorded in the memorandum account authorized by Resolution W-4001. CalAm may file the advice letter only after it has executed a contract with Sacramento Suburban Water District securing access to the water.

9. Within 60 days of the effective date of this decision, CalAm shall file an advice letter seeking Commission authorization to recover through a rate surcharge, or to refund through a rate surcredit if appropriate, the accumulated balances in its Sacramento district purchased power balancing account and purchased power memorandum account as of December 31,2002. CalAm's

request shall follow the procedures established in the Commission's Balancing Account Rulemaking Proceeding, Rulemaking 01-12-009.

10. For any Citizens districts for which there is no test year 2005 general rate case, revenues for service rendered on and after January 1,2005 that are associated with the Citizens acquisition synergies savings in those districts are made subject to refund pending a determination of what portion of the synergies savings are to be shared with customers.

11. CalAm's requests in A.02-09-030, A.02-09-031, and A.02-09-032 are granted as set forth above, and in all other respects are denied.

12. CalAm shall file an application proposing consolidation of districts for the purpose of ratemaking within 90 days of adoption of this order. The filing shall address the consolidation issues identified herein. In addition, the filing should propose how to amortize the balances accrued in the balancing account set up for the Felton district pursuant to Ordering Paragraph 6.

11. A.02-09-030, A.02-09-031, and A.02-09-032 are closed. A.02-09-033 is dismissed.

This order is effective today.

Dated May 6,2004, at San Francisco, California.

MICHAEL R. PEEVEY
President

GEOFFREY F. BROWN
SUSAN P. KENNEDY
LORETTA M. LYNCH
CARE W. WOOD
Commissioners

APPENDIX A
PAGE 1
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Test Year 2003
Summary of Earnings

	(At Present Rates)		ADOPTED	
	Cal-Am	ORA	At Present Rates	At Authorized ROR
	(Dollars in Thousands)		(Dollars in Thousands)	
Operating Revenues				
Water	736.1	736.1	736.1	990.8
Operating Expenses				
Purchased Water	-	-	-	-
Purchased Power	64.2	64.2	64.2	64.2
Uncollectibles	0.4	0.4	0.4	0.6
Other Operation & Maintenance	89.0	89.0	89.0	89.0
Payroll	228.5	228.5	228.5	228.5
Pensions & Benefits	27.7	27.7	27.7	27.7
Franchise Fees	-	-	-	-
Other Administrative & General	28.2	27.0	27.0	27.0
Acquisition Premium	51.3	51.3	51.0	51.0
General Office Pro-rated Expense	91.3	91.3	91.3	91.3
Depreciation & Amortization	122.9	121.2	123.2	123.2
Ad Valorem Taxes	50.1	48.3	49.1	49.1
Payroll Taxes	18.0	18.0	18.0	18.0
State Income Tax	(12.3)	(11.7)	(11.7)	7.5
Federal Income Tax	(34.3)	(31.8)	(31.8)	57.3
Total Expenses	725.0	723.4	725.9	834.4
Net Operating Revenues	11.1	12.7	10.2	156.4
Rate Base	2,329.6	2,272.9	2,331.7	2,331.7
Rate of Return	0.48%	0.56%	0.44%	6.71%

APPENDIX A
Page 2
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Test Year 2004
Summary of Earnings

	(At Present Rates)		ADOPTED		
	Cal-Am	ORA	At Present Rates	At 2003 Rates	At Authorized ROR
	(Dollars in Thousands)		(Dollars in Thousands)		
Operating Revenues					
Water	729.8	737.0	**737.0**	**992.2**	**1,063.0**
Operating Expenses					
Purchased Water	-	-	-	-	-
Purchased Power	64.3	64.3	**64.3**	**64.3**	**64.3**
Uncollectables	0.4	0.4	**0.4**	**0.6**	**0.6**
Other Operation & Maintenance	93.7	93.7	**93.7**	**93.5**	**93.5**
Payroll	235.3	235.3	**235.3**	**235.3**	**235.3**
Pensions & Benefits	29.7	29.7	**29.7**	**29.7**	**29.7**
Franchise Fees	-	-	-	-	-
Other Administrative & General	28.8	27.6	**27.6**	**27.6**	**27.6**
Acquisition Premium	58.1	58.1	**54.6**	**54.6**	**54.6**
General Office Pro-rated Expense	93.5	93.5	**93.4**	**93.4**	**93.4**
Depreciation & Amortization	134.4	130.6	**133.7**	**133.7**	**133.7**
Ad Valorem Taxes	59.3	57.4	**58.8**	**58.8**	**58.8**
Payroll Taxes	18.6	18.6	**18.6**	**18.6**	**18.6**
State Income Tax	(16.8)	(16.0)	**(15.7)**	**3.6**	**8.9**
Federal Income Tax	(57.5)	(51.9)	**(51.0)**	**31.6**	**56.3**
Total Expenses	741.8	741.3	**743.4**	**845.3**	**875.3**
Net Operating Revenue	(12.0)	(4.3)	**(6.4)**	**146.9**	**187.7**
Rate Base	2781.10	2685.80	**2783.00**	**2783.00**	**2783.00**
Rate of Return	-0.43%	-0.16%	**-0.23%**	**5.28%**	**6.74%**

APPENDIX A
Page **3**
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Test Year 2003
Summary of Earnings

	(At Present Rates)		ADOPTED	
			At Present	At Authorized
	Cal-Am	ORA	Rates	ROR
	(Dollars in Thousands)		(Dollars in Thousands)	
Operating Revenues				
Water	1551.3	1551.3	1551.3	1879.0
Operating Expenses				
Purchased Water	154.3	154.3	154.2	154.2
Purchased Power	108.8	108.8	108.8	108.8
Uncollectables	2.2	2.2	2.2	2.6
Other Operation & Maintenance	138.7	136.1	138.7	138.7
Payroll	188.9	188.9	188.9	188.9
Pensions & Benefits	29.5	29.5	29.5	29.5
Franchise Fees	-	-	-	-
Other Administrative & General	46.7	42.5	42.7	42.7
Acquisition Premium	92.0	92.0	91.5	91.5
General Office Pro-rated Expense	163.6	163.6	163.6	163.6
Depreciation & Amortization	367.9	367.1	368.5	368.5
Ad Valorem Taxes	48.6	48.1	48.3	48.3
Payroll Taxes	15.0	15.0	15.0	15.0
State Income Tax	(0.4)	0.3	2.0	26.8
Federal Income Tax	0.6	4.0	11.7	126.3
Total Expenses	1356.4	1352.4	1365.7	1,595.4
Net Operating Revenue	194.9	198.9	185.6	373.6
Rate Base	5578.0	5520.8	5571.8	5571.8
Rate of Return	3.49%	3.60%	3.33%	6.71%

APPENDIX A
Page 4
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Test Year 2004
Summary of Earnings

	(At Present Rates)		ADOPTED		
	Cal-Am	ORA	At Present Rates	At 2003 Rates	At Authorized ROR
	(Dollars in Thousands)		(Dollars in Thousands)		
Operating Revenues					
Water	1,563.7	1,563.7	1,564.3	1,894.3	1,953.0
Operating Expenses					
Purchased Water	164.6	164.6	154.3	154.3	154.3
Purchased Power	109.8	109.8	109.8	109.8	109.8
Uncollectables	2.2	2.2	2.2	2.7	2.7
Other Operation & Maintenance	126.3	121.2	126.3	126.3	126.3
Payroll	195.0	195.0	195.0	195.0	195.0
Pensions & Benefits	31.6	31.6	31.6	31.6	31.6
Franchise Fees	-	-	-	-	-
Other Administrative & General	34.9	30.7	30.9	30.9	30.9
Acquisition Premium	105.1	105.1	98.8	98.8	98.8
General Office Pro-rated Expense	167.6	167.6	167.4	167.4	167.4
Depreciation & Amortization	398.4	395.0	398.5	398.5	398.5
Ad Valorem Taxes	52.8	51.6	52.1	52.1	52.1
Payroll Taxes	15.4	15.4	15.4	15.4	15.4
State Income Tax	(3.7)	(2.3)	(0.9)	24.0	28.4
Federal Income Tax	(16.9)	(10.6)	(5.0)	101.8	122.2
Total Expenses	1,383.1	1,376.9	1,376.4	1,508.6	1,533.4
Net Operating Revenue	180.6	186.8	187.9	386.2	419.6
Rate Base	6236.00	6077.50	6229.10	6229.10	6229.10
Rate of Return	2.90%	3.07%	3.02%	6.20%	6.74%

APPENDIX A
Page 5
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Test Year 2003
Summary of Earnings

	(At Present Rates)		ADOPTED	
	Cal-Am	ORA	At Present Rates	At Authorized ROR
	(Dollars in Thousands)		(Dollars in Thousands)	
Operating Revenues				
Water	16,192.8	16,192.8	**16,192.8**	**21,680.0**
Operating Expenses				
Purchased Water	496.1	496.1	**510.2**	**510.2**
Purchased Power	2,381.8	2,381.8	**2,381.8**	**2,381.8**
Payroll	1,639.3	1,600.7	**1,600.7**	**1,600.7**
Uncollectables	50.2	50.2	**50.2**	67.2
Other Operation & Maintenance	1,340.0	1,322.9	**1,289.1**	**1,288.3**
Pensions & Benefits	290.0	284.1	**284.1**	**284.1**
Franchise Fees	25.0	25.0	**25.1**	**33.6**
Other Administrative & General	578.3	475.6	**528.9**	**528.9**
Acquisition Premium	2,185.7	2,185.7	**2,174.0**	**2,174.0**
General Office Pro-rated Expense	3,883.5	3,883.5	**3,883.5**	**3,883.5**
Depreciation & Amortization	3,966.0	3,808.3	**3,941.5**	**3,941.5**
Ad Valorem Taxes	462.5	434.1	**449.3**	**449.3**
Payroll Taxes	129.0	126.1	**126.1**	**126.1**
State Income Tax	(213.3)	(164.9)	**(186.8)**	**226.1**
Federal Income Tax	(909.1)	(685.1)	**(786.5)**	**1,125.1**
Total Expenses	16,305.1	16,224.2	**16,271.3**	**18,620.4**
Net Operating Revenue	(112.3)	(31.4)	**(78.5)**	**3,059.6**
Rate Base	45,936.9	40,909.0	**45,608.1**	**45,608.1**
Rate of Return	-0.24%	-0.08%	**-0.17%**	**6.71%**

APPENDIX A
Page 6
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Test Yeas 2004
Summary of Earnings

	(At Present Rates)		ADOPTED		
	Cal-Am	ORA	At Present Rates	At 2003 Rates	At Authorized ROR
	(Dollars in Thousands)		(Dollars in Thousands)		
Operating Revenues					
Water	16,366.4	16,366.3	**16,366.4**	**21,611.0**	**22,715.0**
Operating Expenses					
Purchased Water	567.1	567.1	**563.3**	**563.3**	**563.3**
Purchased Power	2,396.3	2,396.3	**2,396.3**	**2,396.3**	**2,396.3**
Payroll	1,731.0	1,651.1	**1,651.1**	**1,651.1**	**1,651.1**
Uncollectables	50.7	50.7	**50.7**	**67.0**	**70.4**
Other Operation & Maintenance	1,383.1	1,361.8	**1,339.4**	**1,323.1**	**1,339.4**
Pensions & Benefits	319.2	305.5	**305.5**	**305.5**	**305.5**
Franchise Fees	25.3	25.3	**25.4**	**33.5**	**35.2**
Other Administrative & General	574.6	469.3	**540.2**	**540.2**	**540.2**
Acquisition Premium	2,491.6	2,491.6	**2,341.9**	**2,341.9**	**2,341.9**
General Office Pro-rated Expense	3,979.4	3,979.4	**3,973.7**	**3,973.7**	**3,973.7**
Depreciation & Amortization	4,282.1	3,994.9	**4,203.8**	**4,203.8**	**4,203.8**
Ad Valorem Taxes	520.5	467.3	**491.7**	**491.7**	**491.7**
Payroll Taxes	135.7	129.8	**129.8**	**129.8**	**129.8**
State Income Tax	(313.0)	(249.5)	**(244.6)**	**150.0**	**233.1**
Federal Income Tax	(1,369.4)	(1,092.5)	**(1,067.1)**	**622.6**	**1,007.2**
Total Expenses	16,817.5	16,599.6	**16,701.1**	**18,793.5**	**19,282.6**
Net Operating Revenue	(451.2)	(233.3)	**(334.7)**	**2,817.5**	**3,432.4**
Rate Base	51,694.9	44,159.5	**50,896.9**	**50,896.9**	**50,896.9**
Rate of Return	-0.87%	-0.53%	**-0.66%**	**5.54%**	**6.74%**

(END OF APPENDIX A)

APPENDIX B
Page 1

California-American Water Company
Schedule No. FE-1
Felton Tariff Area
GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Felton and vicinity, Santa Cruz County.

RATES

Quantity Rates:	Per Meter Per Month
For all water delivered, per 100 cu.ft.	$3.617 (I)

	Per Meter Per Month Service charge	Per Meter Per Month SDWBA Surcharge 1/
For 5/8 x ¾-inch meter	24.86 (I)	$11.50
For ¾-inch meter	37.30 (I)	17.26
For I-inch meter	62.16 (I)	28.76
For 1½-inch meter	124.32 (I)	57.52
For 2-inch meter	198.92 (I)	92.03
For 3-inch meter	372.97 (I)	172.55
For 4-inch meter	621.62 (I)	287.59

The service charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the quantity rates.

Conservation Discount

The following conservation discounts will be applied to the service and quantity charges.

Bi-Monthly Consumption	Discount
0-10 CCFs	20.00%
11-20 CCFs	15.00%
21-30 CCFs	10.00%
Over 30 CCFs	0.00%

(Continued)

APPENDIX B
Page 2
California-American Water Company
Schedule No. FE-1
Felton Tariff Area
GENERAL METERED SERVICE (continued)

Service Reestablishment Charge:

For each reestablishment of water service **$4.10**

SPECIAL CONDITIONS

1. The service reestablishment charge is in addition to the charges calculated in accordance with this schedule and will be made each time an account is reopened for a customer at the time water service is to be restored after discontinuance at that customer's request.

2. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

METERED SERVICE SURCHARGE 1/

NOTE:

This surcharge is in addition to the regular monthly metered water bill. The total monthly surcharge must be identified on each bill. This surcharge is specifically for the repayment of the California Safe Drinking Water Bond Act loan as authorized by Decision 96-12-061,

APPENDIX B
Page 3

California-AmericanWater Company
Schedule No. FE-4
Felton Tariff Area
PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished to privately owned fire protection purposes.

TERRITORY

Felton and vicinity, Santa Cruz County

RATES

	Per Meter Per Month	
For each 4-inch connection, or smaller,	$28.47	(I)
For each 6-inch connection.....	42.74	(I)
For each 8-inch connection.....	56.94	(I)
For each 10-inch connection.....	114.21	(I)
For each 12-inch connection.....	160.79	(I)

SPECIAL CONDITIONS

1. The customer will pay without refund the entire cost of installing the service connection.

2. The maximum diameter of the main to which the service is connected.

3. The customer's installation must be such as to effectively separate the fire sprinkler system from that of the customer's regular water service. As a part of the sprinkler service installation there shall be a detector check or other similar device acceptable to the utility which will indicate the use of water. Any unauthorized use will be charged for at the regular established rate for general metered service, and/or may be grounds for the utility's discontinuing the fire sprinkler service without liability to the utility.

(continued)

APPENDIX B
Page 4

California-American Water Company
Schedule No. FE-4 (continued)
Felton Tariff Area
PRIVATE FIRE PROTECTION SERVICE

4. There shall be no cross-connection between the fire sprinklers system supplied by water through the utility's fire sprinkler service to any other source of supply without the specific approval of the utility. This specific approval will require, at the customers expense, a special double check valve installation or other device acceptable to the utility. Any such unauthorized cross-connection may by the grounds for immediately discontinuing the sprinkler system without liability to the **utility.**

5. The utility will supply only such water at such pressure as may be available from time to time as a result of its normal operation of the system.

6. All bills are subject to the reimbursement fee set forth on Schedule No. U.F

APPENDIX B
Page 5

California-AmericanWater Company
Schedule No. LW-1
Larkfield Tariff Area
GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The unincorporated areas known as the Larkfield and Wikiup subdivisions and the community of Pulton, three miles north of Santa Rosa, Sonoma County.

RATES	Per Meter Per Month	
Quantity Rate:		
For all water delivered, per 100 cu.ft.	$ 2.607	(I)
Service Charge:		
For 5/8 x ¾ inch meter	$ 12.95	(R)
For ¾ inch meter	$ 19.43	(R)
For 1 inch meter	$ 32.38	(I)
For 1-1/2 inch meter	$ 64.77	(I)
For 2 inch meter	$ 103.62	(I)
For 3 inch meter	$ 194.30	(I)
For 4 inch meter	$ 323.83	(I)
For 6 inch meter	$ 647.65	(I)
For 8 inch meter	$ 1,036.24	(I)
For 10 inch meter	$ 1,285.65	(N)

The service charge is a readiness-to-servecharge which is applicable to all metered service and to which is to be added the monthly charge computed at the quantity rates.

Special Conditions

1. All bills are subject to the reimbursement fee set forth in Schedule No. UF.

APPENDIX B
Page 6

California-American Water Company
Schedule No. LW-4
Larkfield Tariff Area
PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished for privately owned fire protection systems.

TERRITORY

Larkfield Estates and vicinity located approximately three miles north of the City of Santa Rosa, Sonoma County.

RATES		Per Service Per Month
Size of Service:		
For	1 ½-inch connection	$ 5.27
For	4-inch connection	$10.54
For	6-inch connection	$15.87
For	8-inch connection	$21.20
For	10-inch connection	$26.47

SPECIAL CONDITIONS

1. The fire protection service will be installed by the utility at the cost of the applicant. Such cost shall not be subject to refund.

2. If the distribution main of adequate size to serve a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a service main from the nearest existing main of adequate capacity will be installed by the utility at the cost of the applicant. Such cost shall not be subject to refund.

3. Service hereunder is for private fire protection system to which no connections for other than fire protection purposes are allowed and which are regularly inspected by the underwriters having jurisdiction, are installed according to specifications of the utility, and are maintained to the satisfaction of the utility. The utility may install the standard detector type meter approved by the Board of Fire Underwriters for protection against theft, leakage or waste of water.

4. For water delivered for other than fire protection purposes, charges will be made therefore under Schedule No.1, General Metered Service.

5. The utility will supply only such water at such pressure as may be available from time to time as a result of its normal operation of the system.

6. All bills are subject to the reimbursement fee set forth in Schedule No. UF

APPENDIX B
Page 7

California-American Water Company
Schedule No. SAC-1
Sacramento Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The unincorporated communities, subdivisions, and adjacent areas generally known as Cordova, Rosemont, Parkway Estates, Lindah, Foothill Farms, Arlington Heights, Linwood, Loretto Heights, Arden Highlands, Arden Estates and Sunrise Security Park. A part of the City of Citrus Heights and the communities of Antelope and Sabre City in Sacramento and Placer counties. The city of Isleton and vicinity and the unincorporated community of Walnut Grove in Sacramento County. The lower southwestern portion of Placer County including the areas Known as Morgan Creek, Doyle Ranch, Sun Valley Oaks and Riolo Greens.

RATES	Per Meter Per Month	
Quantity Rates:		
For all water delivered per 100 cu. ft.	$ .9412	(I)
Service Charge:		
For 5/8 x ¾-inch meter	$ 7.14	(R)
For ¾-inch meter	10.71	(I)
For 1-inch meter	17.85	(I)
For 1 1/2-inch meter	35.70	(I)
For 2-inch meter	57.13	(I)
For 3-inch meter	107.11	(I)
For 4-inch meter	178.52	(I)
For 6-inch meter	357.04	(I)
For 8-inch meter	571.26	(I)
For 10-inch meter	714.07	(I)
For 12-inch meter	821.19	

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the monthly charge computed at the Quantity Rates.

(Continued)

APPENDIX B
Page 8

California-American Water Company
Schedule No. SAC-1
Sacramento Tariff Area

General Metered Service (continued)

SPECIAL CONDITIONS

1. 1. All bills are subject to the reimbursement fee forth in Schedule No. UF.

2. 2. A surcharge is included on each bill to recover undercollected pumping power costs of $328,066. The pumping power surcharge is $ .483 per customer on a monthly basis. This surcharge will be collected over twelve-month period from the effective date of Advice Letter 578.

APPENDIX B
Page 9

California-AmericanWater Company
Schedule No. SAC4
Sacramento Tariff Area
PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service rendered for private fire protection purposes.

TERRITORY

The unincorporated communities, subdivisions, and adjacent areas generally known as Cordova, Rosemont, Parkway Estates, Lindale, Foothill Farms, Arlington Heights, Linwood, Loretto Heights, Arden Highlands, Arden Estates, and Sunrise Security Park. A part of the City of Citrus Heights and the communities of Antelope and Sabre City in Sacramento and Placer Counties. The City of Isleton and vicinity and the unincorporated community of Walnut Grove in Sacramento County. The lower Southwestern portion of Placer County including the areas known as Morgan Creek, Doyle Ranch, Sun Valley Oaks and Riolo Greens.

RATES

	Per Meter Per Month
For each Pinch connection, or smaller,	$26.91 (I)
For each 6-inch connection.....	44.82 (I)
For each 8-inch connection.....	63.11 (I)
For each 10-inch connection.....	78.37 (I)
For each 12-inch connection.....	112.36 (I)

SPECIAL CONDITIONS

1. The customer will pay without refund the entire cost of installing the service connection.

2. The maximum diameter of the service connection will not be more than the diameter of the main to which the service is connected.

3. The customer's installation must be such as to effectively separate the fire sprinkler system from that of the customer's regular water service. As a part of the sprinkler service installation there shall be a detector check with by-pass meter or other similar device acceptable to the company which will indicate the use of water. The utility may require a bi-annual test of the detector check installation at customer cost as a condition of furnishing service. Any unauthorized use will be charged for at the regular established rate for general metered service, and/or may be grounds for the company's discontinuing the fire sprinkler service without liability to the company.

(Continued)

APPENDIX B
Page 10

California-American Water Company
Schedule No. SAC-4 (Continued)
Sacramento Tariff Area
PRIVATE FIRE PROTECTION SERVICE

4. The company will supply only such water at such pressure as may be available from time to time as the result of its normal operation of the system.

5. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

6. A surcharge is included on each bill to recover undercollected pumping power costs of $328,066. The pumping power surcharge is $ .483 per customer on a monthly basis. This surcharge will be collected over a twelve-month period from the effective date of Advice Letter 578.

APPENDIX B
Page 11

California-American Water Company
Schedule No. SAC - 2R
Sacramento Tariff Area
RESIDENTIAL PLAT RATE SERVICE

APPLICABILITY

Applicable to all residential water service on a flat rate basis

TERRITORY

The unincorporated communities, subdivisions, and adjacent areas generally known as Cordova, Rosemont, Parkway Estates, Lindale, Foothill Farms, Arlington Heights, Linwood, Loretto Heights, Arden Highlands and Arden Estates. A part of the city of Citrus Heights and the communities of Antelope and Sabre City in Sacramento and Placer Counties. The unincorporated communities of Walnut Grove in Sacramento County.

RATES	Per Meter Per Month	
For a single-family residence including premises, having the following areas:		
4,500 sq. ft. or less	$ 16.33	(I)
4,501 to 8,000 sq. ft	22.09	(I)
For each additional residence on the same premises and served Prom the same service connection	14.66	(I)
For each 1,000 sq. ft. or part of the area in excess of 8,000 sq. ft	0.63	**(I)**

SPECIAL CONDITIONS:

1. The above residential flat rate charges apply to service connections not larger than ¾ inch in diameter.

(Continued)

APPENDIX B
Page 12

California-American Water Company
Schedule No. SAC-2R
Sacramento Tariff Area
RESIDENTIAL FLAT RATE SERVICE

(Continued)

SPECIAL CONDITIONS:

2. All service not covered by the above classification will be furnished only on a metered basis.

3. A meter may be installed at option of utility or customer for above classifications in which event service thereafter will be furnished only on the basis of Schedule No. SAC-1, General Metered Service. After a meter is installed, metered service must be continued for at least 12 months before service will again be furnished **at** flat rates.

4. All bills are subject to the reimbursement fee forth in Schedule No. UF.

5. A surcharge is included on each bill to recover undercollected pumping power costs of $328,066. The pumping power surcharge is $ .483 per customer on a monthly basis. This surcharge will be collected over twelve-month period from the effective date of Advice Letter **578.**

California-American Water Company

Rule No.11

DISCONTINUANCE AND RESTORATION OF SERVICE

(continued)

B. 2. For Noncompliance with Rules

The utility *may* discontinue service to any customer for violation of these rules after it has given the customer at least five days written notice of such intention. Where safety of water supply is endangered, service may be discontinued immediately without notice.

3. For Waste of Water

a. Where negligent or wasteful use of water exists on a customer's premises, the utility may discontinue the service if such practices are not remedied within five days after it has given the customer written notice to such effect.

b. In order to protect itself against serious and unnecessary waste or misuse of water, the utility may meter any flat rate service and apply the regularly established meter rates where the customer continues to misuse or waste water beyond five days after the utility has given the customer written notice to remedy such practices.

4. For Unsafe Apparatus or Where Service is Detrimental or Damaging to the Utility or its Customers.

If an unsafe or hazardous condition is found to exist on the customer's premises, or if the use of water thereon by apparatus, appliances, equipment or otherwise is found to be detrimental or damaging to the utility or its customers, the service may be shut off without notice. The utility will notify the customer immediately of the reasons for the discontinuance and the corrective action to be take by the customer before service can be restored.

5. For Fraudulent Use of Service

When the utility has discovered that a customer has obtained service by fraudulent means, or has diverted the water service for unauthorized use, the service to that customer may be discontinued without notice. The utility will not restore service to such customer until that customer has complied with all filed rules and reasonable requirements of the utility and the utility has been reimbursed for the full amount of the service rendered and the actual cost to the utility incurred by reason of the fraudulent use.

C. Restoration of Service

1. Reconnection Charge

Where service has been discontinued for violation of these rules or for nonpayment of bills, the utility may charge $10.00 for reconnection of service during regular working hours, or $15.00 ($50.00 for Felton, Larkfield, and Sacramento districts) for reconnection of service at other than regular working hours when the customer has requested that the reconnection be made at other than regular working hours, **(N)**

(continued)

(END OF APPENDIX B)

APPENDIX C
Page 1
CALIFORNIB-AMERICAN WATER COMPANY
Felton District
Test Year 2004 Increases

Each of the following increases in rates may be put into effect consistent with Ordering Paragraph No. 6.

		2004
Quantity Rates:		
For all water delivered, per 100 cu. Ft.		$ 0.114
Service Charge:		
For	5 / 8 x 3 / 4-inch meter	$ 3.30
	3 / 4-inch meter	$ 4.95
	I-inch meter	$ 8.24
	1-1 / 2-inch meter	$ 16.49
	2-inch meter	$ 26.38
	3-inch meter	$ 49.47
	4-inch meter	$ 82.44
Private Fire Protection		
	4-inch and smaller	$ 2.74
	6-inch	$ 4.12
	$-inch	$ 5.49
	10-inch	$ 11.00
	12-inch	$ 15.49

APPENDIX C
Page 2
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Test Year 2004 Increases

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rate which would otherwise be in effect on that date.

		2004
General Metered Service		
Quantity Rates:		
For all water delivered, per 100 cu. Ft.		$ 0.029
Service Charge:		
For	5/8 x 3/ Cinch metes	$ 1.03
	3/4-inch meter	$ 1.54
	1-inch meter	$ 2.57
	1-1/2-inch meter	$ 5.14
	2-inch meter	$ 8.23
	3-inch meter	$ 15.43
	Cinch meter	$ 25.72
	6-inch meter	$ 51.45
	8-inch meter	$ 82.31
	10-inch meter	$102.89
Private Fire Service		
	4 1/2-inch and less	$ .20
	Cinch	$ .39
	6-inch	$ .59
	8-inch	$ .79
	10-inch	$ .99

APPENDIX C
Page 3
CALIFORNIA-AMERICAN WATER COMPANY
Sacraments District
Test Year 2004 increases

Each sf the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rate which would otherwise be in effect on that date.

	2004
General Metered Service	
Quantity Rates:	
FOP all water delivered. per 100 cu. Ft.....	$ 0.00
Service Charge:	
For 5 / 8 x 3 / 4-inch meter	$ .48
3 / 4-inch meter	$ .73
1-inch meter	$ 1.21
1-1 / 2-inch meter	$ 2.42
2-inch meter	$ 3.87
3-inch meter	$ 7.25
4-inch meter	$ 12.09
6-inch meter	$ 24.17
8-inch meter	$ 38.67
10-inch metes	$ 48.34
12-inch meter	$ 55.59
Private Fire Service	
4-inch and less	$ 2.93
6-inch	$ 4.89
8-inch	$ 6.88
10-inch	$ 8.54
12-inch	$ 12.25
Unmetered	
4500 Sq ft or less	$ .79
4501 to 8000 Sq. ft.	$ 1.06
Each 1000 Sq. ft. or part thereof above 8000 Sq. ft.	$ .03
Additional House on Lot	$ .71

(END OF APPENDIX *C*)

APPENDIX D
Page 1
CALIFORNIA-AMERICAN WATER COMPANY
Felton District

Adopted Quantities

	2003	2004
PURCHASED POWER:		
PGE		
Water Production (kCcf)	198.414	198.639
Total Kwh	355671	356073
Kwh/Ccf	1.792570081	1.792563394
Unit Cost ($/Kwh)	0.180576994	0.18057814
Total Purchased Power Cost	$64,226	$64,299
CHEMICAL COSTS:		
Water Production (kCcf)	198.414	198.639
Unit Cost ($ /kCcf)	19.65587106	19.65877798
Total Chemical Cost	$3,900	$3,905

APPENDIX D
Page 2
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Taxes Based on Income

	($000) Test Year 2003	Test Year 2004
Operating Revenues	990.8	1,063.0
Deductions:		
O & M expenses	953.8	158.4
A & G Expenses	54.7	57.3
G. O. Prorated Expenses	91.3	93.5
Payroll	228.5	235.3
Acquisition Premium	51.0	54.6
Taxes not on Inc.	67.1	77.4
Interest	71.6	84.4
Book Depreciation	123.2	133.7
Income before taxes	149.6	168.4
California Corp. Franchise Tax		
State Tax Depreciation	-	-
Taxable Income for CCFT	149.6	168.4
CCFT Rate	7.56%	7.56%
CCFT	11.3	12.7
Less Deferred Taxes	3.8	3.8
Total State Income Taxes	7.5	8.9
Federal Income Tax		
Federal Tax Deductions	(14.1)	(7.5)
Taxable income for FIT	163.7	160.9
FIT Rate	35.00%	35.00%
FIT	57.3	56.3
Less:		
Investment Tax Credit	-	-
Amortization of Reg. Assets	-	-
Deferred Taxes - U.P.A.A.	-	-
Amort of Excess Deferred Taxes	-	-
Total Federal Income Tax	57.3	56.3
Total FIT and CCFT	**64.8**	**65.2**

APPENDIX D
Page **3**
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Weighted Average Depreciated Rate Base

	($000) Test Year 2003	Test Year 2004
WTD AVG PLANT IN SERVICE	3,479.3	4,087.9
MATERIALS & SUPPLIES	10.3	10.5
WORKING CASH, OPERATIONAL	0.0	48.8
WORKING CASH, LEAD-LAG	71.3	74.7
WTD AVG DEPR RESERVE	(937.6)	(1,044.9)
ADVANCES	0.0	0.0
UNAMORTIZED ADVANCES (20 YR AMORTIZATION)	(1.4)	(1.4)
CONTRIBUTIONS	(9.7)	(28.9)
UNAMORTIZED CONTRIBUTIONS (20 YR AMORTIZATION)	(162.5)	(153.7)
ACCUM. DEFERRED FIT	(96.0)	(170.0)
ACCUM. DEFERRED SIT	(22.0)	(40.0)
GENERAL OFFICE ALLOC.		
ACRS & MACRS DEPRECIATION		
UNAMORTIZED ITC		
TAXES O N - ADVANCES		
TAXES O N - CIAC		
AVERAGE RATE BASE	**2,331.7**	**2,783.0**

APPENDIX D
Page 4
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Water Sales Per Average Customer

	(ccf) Test Year 2003	Test Year 2004
Residential	101.1	101.1
Commercial	298.6	298.6
Public Authority	2,205.4	2,205.4
Industrial	-	-
Irrigation	528.0	528.0
Private Fire Service	0	0

APPENDIX D
Page 5
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Average Number of Customers

	Test Year 2003	Test Year 2004
Metered Connections		
Residential	1,134	1,136
Commercial	168	168
Public Authority	6	6
Industrial	0	0
Irrigation	1	1
Total metered connections	1,309	1,311
Fire Protection connections		
Private Fire Service	9	9
Total Active connections	1,318	1320
Include Fire Protection	1,318	1,320
Exclude Fire Protection	1,309	1,311

APPENDIX D
Page 6
CALIFORNIA-AMEMCAN WATER COMPANY
Felton District
Total Sales and Supply (KCCF)

	Test Year 2003	Test Year 2004
METERED SALES		
Residential	114.6	114.8
Commercial	50.2	50.2
Public Authority	13.2	13.2
Industrial	-	-
'Irrigation	0.5	0.5
TOTAL METERED SALES	178.6	178.8
PRIVATE FIRE SERVICE	0.0	0.0
FLAT RATE SALES		
Unaccounted For Water (10%)	19.8	19.9
TOTAL DELIVERED	198.4	198.7
PRODUCTION		
Creeks and Springs	198.4	198.7
Total Production	198.4	198.7

APPENDIX D
Page 7
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Plant In Service

	($000) Test Year 2003	Test Year 2004
Plant in Service - BOY	3,271.4	3,579.3
Additions		
Gross Additions	322.0	627.0
Retirements of Plant	(14.1)	(27.9)
Net Additions	307.9	599.1
CWIP - BOY	-	25.0
CWIP - EOY	25.0	200.0
Net Change - CWIP	25.0	175.0
Plant in Service - EOY	3,579.3	4,178.4
WEIGHTING FACTOR	62.44%	62.44%
WTD. AVG. PLANT IN SERVICE	3,479.3	4,087.6

APPENDIX D
Page 8
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Depreciation Reserve & Expense

	($000) Test Year 2003	Test Year 2004
DEPRECIATION RESERVE - B.O.Y.	881.1	989.8
ACCRUALS		
Salvage and Cost of Removal	(0.9)	(1.7)
Contributions	0.5	1.5
Depreciation Expense	123.2	133.7
TOTAL ACCRUALS	122.8	133.5
RETIREMENTS	(14.1)	(27.9)
DEPRECIATION RESERVE - E.O.Y.	989.8	1,095.4
WEIGHTING FACTOR	51.98%	51.98%
WTD. AVG. DEPRECIATION RESERVE	937.6	1,044.7

APPENDIX D
Page 9
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Number of Customers by Metes Size

		Test Year *2003*	Test Year 2004
Average Customers by Meter Size			
	5/8 x 3/4"	1,263	1,265
	3/4"	2	2
	1"	22	22
	1 1/2"	8	8
	2"	13	13
	3"	-	-
	4"	1	1
	6"	-	-
	8"		-
TOTAL		1,309	1,311
Private Fire Protection			
	4" and smaller	3	3
	6"	6	6
	8"		
	10"		
	12"		
TOTAL		9	9

APPENDIX D
Page 10
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Adopted Quantities

	2003	2004	
PURCHASED POWER			
PGE			
Water Production (kCcf)	567.8	573.1	
Total Kwh	755,227	762,162	
Kwh/Ccf	1.33	1.33	
Unit Cost ($/Kwh)	$ 0.1441	$ 0.1441	
Total Purchased Power Cost	**$ 108,834**	**$ 109,833**	
PURCHASED WATER:			
Sonoma County Water Agency			
Service Charge	$ 2,226	$ 2,358	
Acre Feet Purchased	306.0	306.0	
Unit Cost ($ / A.F.)	$ 496.67	$ 496.67	Effective 7/1/2003
Total Quantity Cost	$ 151,981	$ 151,981	
Total Purchased Water Cost	**$ 154,207**	**$ 154,339**	
CHEMICAL COSTS:			
Water Production (kCcf)	567.8	573.1	
Unit Cost ($ /kCcf)	$ 11.80	$ 12.39	
Total Chemical Cost	**$ 6,700**	**$ 7,100**	

APPENDIX D
Page 11
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Taxes Based on Income

	($000) Test Year 2003	Test Year 2004
Operating Revenues	1,879.0	1,953.0
Deductions:		
O & M expenses	404.3	393.1
A & G Expenses	72.2	62.5
G. O. Prorated Expenses	163.6	167.4
Payroll	188.9	195.0
Acquisition Premium	91.5	98.8
Taxes not on Inc.	63.3	67.5
Interest	172.9	194.2
Book Depreciation	368.5	398.5
Income before taxes	353.8	376.0
California Corp. Franchise Tax		
State Tax Depreciation		
Taxable Income for CCFT	353.8	376.0
CCFT Rate	7.56%	7.56%
CCFT	26.8	28.4
Less Deferred Taxes		
Total State Income Taxes	26.8	28.4
Federal Income Tax		
Federal Tax Deductions	(6.9)	(26.8)
Taxable income for FIT	360.7	349.2
FIT Rate	35.00%	35.00%
FIT	126.3	122.2
Less:		
Investment Tax Credit		
Amortization of Reg. Assets		
Deferred Taxes - U.P.A.A.		
Amort of Excess Deferred Taxes		
Total Federal Income Tax	126.3	122.2
Total FIT and CCFT	**153.0**	**150.6**

APPENDIX D
Page 12
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Weighted Average Depreciated Rate Base

	($000) Test Year 2003	Test Year 2004
WTD AVG PLANT IN SERVICE	10,864.5	11,650.6
MATERIALS & SUPPLIES	7.0	7.0
WORKING CASH, OPERATIONAL	21.7	15.2
WORKING CASH, LEAD-LAG	107.7	112.6
WTD AVG DEPR RESERVE	(2,400.3)	(2,595.2)
ADVANCES	0.0	0.0
UNAMORTIZED ADVANCES (20 YR AMORTIZATION)	(2,677.2)	(2,532.5)
CONTRIBUTIONS	(9.7)	(28.9)
UNAMORTIZED CONTRIBUTIONS (20 YR AMORTIZATION)	(279.9)	(264.7)
ACCUM. DEFERRED FIT	(56.0)	(126.0)
ACCUM. DEFERREDSIT	(6.0)	(9.0)
GENERAL OFFICE ALLOC.	0.0	0.0
ACRS & MACRS DEPRECIATION	0.0	0.0
UNAMORTIZED ITC	0.0	0.0
TAXES O N - ADVANCES	0.0	0.0
TAXES O N - CIAC	0.0	0.0
AVERAGE RATE BASE	**5,571.8**	**6,229.1**

APPENDIX D
Page 13
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Water Sales Pea Average Customer (CCF)

	Test Year 2003	Test Year 2004
Residential	179.00	179.00
Commercial	466.90	466.90
Public Authority	1858.00	1858.00
Industrial	0.00	0.00
Irrigation	647.20	647.20
Private Fire Service	0.00	0.00
Unmetered	0.00	0.00

APPENDIX D
Page 14
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Average Number of Customers

	Test Year *2003*	Test Year 2004
Metered Connections		
Residential	2,064	2,085
Commercial	238	240
Public Authority	7	7
Industrial	1	1
Irrigation	27	27
Total metered connections	2,337	2,360
Private Fire Service	36	36
Unmetered	0	0
Total Active connections		
Including Fire Protection	2,373	2,396
Excluding Fire Protection	2,337	2,360

APPENDIX D
Page 15
CALIFORNIA-AMERICANWATER COMPANY
Larkfield District
Total Sales and Supply (KCCF)

	Test Year 2003	Test Year 2004
METERED SALES		
Residential	369.5	373.2
Commercial	111.1	112.1
Public Authority	13.0	13.0
Industrial	-	-
Irrigation	17.5	17.5
TOTAL METERED SALES	511.1	515.8
PRIVATE FIRE SERVICE		-
FLAT RATE SALES		-
Unaccounted For Water (9.5%)	56.8	57.3
TOTAL DELIVERED	567.9	573.1
PRODUCTION		
Wells	434.5	439.8
Purchased water	133.3	133.3
Total Production	567.8	573.1

APPENDIX D
Page 16
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Plant In Service

	($000) Test Year 2003	Test Year 2004
Plant in Service - BOY	9,478.2	10,666.7
Additions		
Gross Additions	1,407.0	1,324.5
Retirements of Plant	(218.5)	(205.7)
Net Additions	1,188.5	1,118.8
CWIP - BOY	452.1	759.7
CWIP - EOY	759.7	0.0
Net Change - CWIP	307.6	759.7
Plant in Service - EOY	10,666.7	11,785.5
WEIGHTING FACTOR	62.44%	62.44%
WTD. AVG. PLANT IN SERVICE	10,864.5	11,650.6

APPENDIX D
Page 17
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Depreciation Reserve & Expense

	($000) Test Year 2003	Test Year 2004
DEPRECIATION RESERVE - B.O.Y.	2,314.4	2,479.7
ACCRUALS		
Salvage and Cost of Removal	(9.2)	(8.7)
Contributions	0.2	0.0
Depreciation Expense	368.5	398.5
Adjust-Backflow Prevention	24.3	38.0
TOTAL ACCRUALS	383.8	427.8
RETIREMENTS	(218.5)	(205.7)
DEPRECIATION RESERVE - E.O.Y.	2,479.7	2,701.8
WEIGHTING FACTOR	51.98%	51.98%
WTD. AVG. DEPRECIATION RESERVE	2,400.3	2,595.2

APPENDIX D
Page 18
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Number of Customers by Meter Size

		Test Year 2003	Test Year 2004
Average Customers by Meter Size			
	5/8 x 3/4	1512	1535
	3/4	595	595
	1	144	144
	1 1/2	50	50
	2	28	28
	3	1	1
	4	6	6
	6	1	1
	8	0	0
	10	0	0
TOTAL		2,339	2,360

APPENDIX D
Page 19
CALIFORNIA-AMERICAN WATER COMPANY
Sacraments District
Adopted Quantities

	2003	2004	
PURCHASED POWER:			
PGE			
Wafer Production (kCcf)	137.6	138.4	
Total Kwh	129,344.0	130,096.0	
Kwh/Ccf	0.94	0.94	
Unit Cost ($/Kwh)	0.18830413	0.18830413	
Power Cost	$24,356	$24,498	
SMUD			
Water Production (kCcf)	20,210.0	20,332.5	
Total Kwh	25,055,088.7	25,206,956.5	
Kwh/Ccf	1.24	1.24	
Unit Cost ($/Kwh)	0.09408733	0.09408733	
Power Cost	$2,357,366.4	$2,371,655.2	
Total Purchased Power Cost	**$2,381,722.4**	**$2,396,152.9**	
PURCHASED WATER:			
CITY OF SACRAMENTO:			
Annual Fixed Connection Fee	146,799.0	146,799.0	
Service Charge	420.0	420.0	
KCcf Purchased	943.9	970.4	
Unit Cost ($ /Ccf)	0.2	0.2	Effective 7/1/03
Total Quantity Cost	199,158.3	204,760.5	
Total Cost City of Sacramento	$346,377.3	$351,979.5	
CITRUS HEIGHTS			
Acre Feet Purchased	169.6	180.9	
Unit Cost ($ / A.F.)	110.0	110.0	Effective 1/1/03
Total Quantity Cost	$18,656.0	$19,899.0	
PLACER COUNTY WATER AGENCY:			
Service Charge	29,322.0	29,322.0	
KCcf Purchased	13.0	82.9	
Unit Cost ($ / Ccf)	0.6	0.6	Effective 1/1/03
Total Quantity Cost	8,083.6	51,367.6	
Total Cost Placer County	37,405.6	80,689.6	
Water Management Programs	$107,784.0	$110,707.0	
Total Purchased Water Cost	**$510,222.8**	**$563,275.1**	
CHEMICAL COSTS:			
Water Production (kCcf)	20,347.6	20,470.9	
Unit Cost ($ /kCcf)	4.5	4.6	
Total Chemical Cost	**$91,700.0**	**$94,900.0**	

APPENDIX D
Page 20
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Taxes Based on Income
($000)

	Test Year 2003	Test Year 2004
Operating Revenues	21,680.0	22,700.0
Deductions:		
O & M expenses	4,298.5	4,420.1
A & G Expenses	762.8	795.0
G. O. Prorated Expenses	3,883.5	3,973.7
Payroll	1,600.7	1,651.1
Acquisition Premium	2,174.0	2,341.9
Taxes not on Inc.	609.0	656.7
Interest	1,419.3	1,589.1
Book Depreciation	3,941.5	4,203.8
Income before taxes	2,990.6	3,068.6
California Corp. Franchise Tax		
State Tax Depreciation	-	
Taxable Income for CCFT	2,990.6	3,068.6
CCFT Rate	7.56%	7.56%
CCFT	226.1	232.0
Less Deferred Taxes	-	
Total State Income Taxes	226.1	232.0
Federal Income Tax		
Federal Tax Deductions	(224.0)	226.1
Taxable income for FIT	3,214.6	2,842.5
FIT Rate	35.00%	35.00%
FIT	1,125.1	994.9
Less:		
Investment Tax Credit		
Amortization of Reg. Assets		
Deferred Taxes - U.P.A.A.		
Amort of Excess Deferred Taxes	-	
Total Federal Income Tax	1,125.1	994.9
Total FIT and CCFT	**1,351.2**	**1,226.9**

APPENDIX D
Page 21
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Weighted Average Depreciated Rate Base

	($000) Test Year 2003	Test Year 2004
WTD AVG PLANT IN SERVICE	118,632.8	128,284.2
MATERIALS & SUPPLIES	18.8	19.3
WORKING CASH, OPERATIONAL	772.7	774.0
WORKING CASH, LEAD-LAG	188.7	233.7
WTD AVG DEPR RESERVE	(39,380.2)	(41,778.1)
ADVANCES	(4,699.0)	(7,038.2)
UNAMORTIZED ADVANCES (20 YR AMORTIZATION)	(20,656.7)	(19,540.1)
CONTRIBUTIONS	(356.4)	(532.5)
UNAMORTIZED CONTRIBUTIONS (20 YR AMORTIZATION)	(7,574.4)	(7,165.0)
ACCUM. DEFERRED FIT	(1,082.6)	(1,913.1)
ACCUM. DEFERRED SIT	(255.6)	(447.2)
GENERAL OFFICE ALLOC.	0.0	0.0
ACRS & MACRS DEPRECIATION	0.0	0.0
UNAMORTIZED ITC	0.0	0.0
TAXES ON - ADVANCES	0.0	0.0
TAXES ON - CIAC	0.0	0.0
AVERAGE RATE BASE	**45,608.1**	**50,896.9**

APPENDIX D
Page 22
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Water Sales Per Average Customer

	Test Year 2003	Test Year 2004
Residential	239.0	239.0
Commercial	981.4	981.4
Public Authority	5,531.0	5,531.0
Industrial	1,358.0	1,358.0
Irrigation	1,897.0	1,897.0
Private Fire Service	0	0
Unmetered	252.9	252.9

APPENDIX D
Page 23
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Average Number sf Customers

	Test Year 2003	Test Year 2004
Metered Connections		
Residential	4,540	5,328
Commercial	4,317	4,351
Public Authority	86	86
Industrial	12	12
Irrigation	527	527
Total metered connections	9,482	10,304
Fire Protection connections	0	0
Private Fire Service	644	674
Unmetered	46,118	45,698
Total Active connections	56,244	56,676
Include Fire Protection	56,244	56,676
Exclude Fire Protection	55,600	56,002

APPENDIX D
Page 24
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Total Sales and Supply (KCCF)

	Test Year 2003	Test Year 2004
METERED SALES		
Residential	1,085.1	1,273.4
Commercial	4,236.7	4,270.1
Public Authority	475.7	475.7
Industrial	16.3	16.3
Irrigation	999.7	999.7
TOTAL METERED SALES	6,813.4	7,035.1
PRIVATE FIRE SERVICE	0.0	0.0
FLAT R A E SALES	11,663.2	11,557.0
Unaccounted For Water (9.5%)	1,939.5	1,951.6
TOTAL DELIVERED	20,416.2	20,543.8
PRODUCTION	0.0	0.0
Wells	19,385.4	19,411.7
Purchased water	1,030.8	1,132.1
Total Production	20,416.2	20,543.8

APPENDIX D
Page 25
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Plant In Service

	($000) Test Year 2003	Test Year 2004
Plant in Service - BOY	111,893.5	119,093.3
Additions		
Gross Additions	8,217.7	14,336.8
Retirements of Plant	(1,017.9)	(1,775.9)
Net Additions	7,199.8	12,560.9
CWIP - BOY	3,462.2	1,510.7
CWIP - EOY	1,510.7	1,250.0
Net Change - CWIP	(1,951.5)	(260.7)
Plant in Service - EOY	119,093.3	131,654.2
WEIGHTING FACTOR	62.44%	62.44%
WTD. AVG. PLANT IN SERVICE	118,632.8	128,284.2

APPENDIX D
Page *26*
CALIFORNIA-AMERICAN WATER COMPANY
Sacraments District
Depreciation Reserve & Expense

	($000) Test Year 2003	Test Year 2004
DEPRECIATION RESERVE - B.O.Y.	37,960.5	40,691.7
ACCRUALS		
Salvage **and** Cost of Removal	(200.8)	(350.2)
Contributions	8.4	12.3
Depreciation Expense	3,941.5	4,203.8
TOTAL ACCRUALS	3,749.1	3,865.9
RETIREMENTS	(1,017.9)	(1,775.9)
DEPRECIATION RESERVE - E.O.Y.	40,691.7	42,781.7
WEIGHTING FACTOR	0.5	0.5
WTD. AVG. DEPRECIATION RESERVE	39,380.2	41,778.1

APPENDIX D
Page 27
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Number of Customers by Meter Size

		Test Year ***2003***	Test Year 2004
Average Customers by Meter Size			
	5/8 x 3/4	4,827	5,615
	3/4	-	-
	1	1,985	1,986
	1 1/2	622	624
	2	1,908	1,940
	3	21	21
	4	78	78
	6	21	21
	8	19	19
	10	1	1
Total		9,482	10,305

(END OF APPENDIX D)

APPENDIX E
Page 1
CALIFORNIA-AMERICAN WATER COMPANY
Felton District
Bill Comparison

Comparison of typical bills for residential metered customers of various usage levels and average level at present and authorized rates for the test year 2003, excluding the *SDWBA* surcharge

General Metered Service
(5/8-inch meters)

Monthly Usage (Ccf)		Present Rates	Authorized Rates	Percent Increase
0		$13.12	$19.89	51.6%
5		$24.82	$34.36	38.4%
8.425	(avg)	$34.89	$47.03	34.8%
12		$46.35	$61.44	32.6%
20		$74.90	$97.20	29.8%

APPENDIX E
Page 2
CALIFORNIA-AMERICAN WATER COMPANY
Larkfield District
Bill Comparison

Comparison of typical bills for residential metered customers of various usage levels and average level at present and authorized rates for the test year 2003

General Metered Service
(5/8-inch meters)

Monthly Usage		Present Rates	Authorized Rates	Percent Increase
(Ccf)				
0		$14.00	$12.95	-7.5%
5		$23.76	$25.99	9.4%
10		$33.51	$39.02	16.4%
14.9	(Avg.)	$43.07	$51.79	20.3%
20		$53.02	$65.09	22.8%
30		$72.53	$91.16	25.7%

APPENDIX E
Page **3**
CALIFORNIA-AMERICAN WATER COMPANY
Sacramento District
Bill Comparison

Comparison of typical bills for residential metered customers of various usage levels and average level at present and authorized rates for the test year 2003

General Metered Service
(5/8-inch meters)

Monthly Usage	Present Rates	Authorized Rates	Percent Increase
0	$7.75	$7.14	-7.9%
5	$11.27	$11.85	5.2%
10	$14.78	$16.55	12.0%
19.9 **(avg)**	$21.74	$25.87	19.0%
20	$21.81	$25.96	19.0%
30	$28.84	$35.38	22.7%

(END OF APPENDIX E)

(APPENDIX F)

In the Matter of the Application of California-American Water Company (U210W) for an Order Authorizing it to Increase Rates for Water Service for its Sacramento, Montara, Larkfield and Felton Districts.	Applications A.02-09-030 02-09-031 02-09-032 02-09-033

AMENDED SETTLEMENT

1.00 GENERAL

1.01 The Parties to this Amended Settlement before the California Public Utilities Commission (Commission) are California-American Water Company ("Cal-Am") and the Office of Ratepayer Advocates ("ORA") – collectively, "the Parties." The Parties, desiring to avoid the expense, inconvenience, and uncertainty attendant to litigation of the matters in dispute between them have agreed on this Amended Settlement which they now submit for approval.

1.02 In addition, since this Amended Settlement represents a compromise by them, the Parties have entered into each Stipulation on the basis that its approval by the Commission not be construed as an admission or concession by any Party regarding any fact or matter of law in dispute in this proceeding. Furthermore, the Parties intend that the approval of this Amended Settlement by the Commission not be construed as a precedent or statement of policy of *any* kind for or against my Party in any current or future proceeding.

1.03 The Parties agree that no signatory to this Amended Settlement or any member of ORA assumes any personal liability as a result of their agreement. The Parties agree that no legal action may be brought by any Party in *any* state or federal court, or ***any*** other forum, against any individual signatory representing the interests of O M , attorneys representing ORA, or the ORA itself related to this Amended Settlement. All rights and remedies of the Parties are limited to those available before the Commission.

1.04 No Party to this Amended Settlement should provide, either privately or publicly, before this Commission any rationale or strategy for support of any compromise reached herein beyond that stated herein unless otherwise agreed to by the Parties.

1.05 The following discussion addresses the items settled by the Parties. Attached as Appendix A to this Amended Settlement are tables which show ORA's and Cal-Am's stipulated estimates.

1.07 Differences between Cal-Am's and ORA's estimates are, for the most part (except as specifically noted), due to the findings in ORA's audit and, in some instances, due to later data available to ORA. Some stipulated expenses are the consequence

of additional discussion between ORA and Cal-Am, with results which are no greater than Cal-Am's estimates but greater than ORA's estimates.

1108 The items which remain in disagreement are reflected in the comparison exhibit filed in this case as Exhibit No. _____

2.00 Sacramento District

Cal-Am agrees to accept ORA's estimates, where an agreement was reached, except for the following where a Amended Settlement was reached:

2.01 **Average Consumption per Customer and Total Production**

Cal-Am and ORA agree to the estimates of average consumption for each class in the Sacramento District except for residential and commercial customers. For residential customers, Cal-Am and ORA agree to an average consumption based on the average of the last three recorded years which is more reflective of the current normal use for metered customers. For commercial customers, Cal-Am and ORA agree that both of their methods for estimating consumption are valid and that an average of the two parties estimates is reflective of current usage.

	Original Positions (CCFs)		Amended Settlement (CCFs)
	Cal-Am	ORA	
Residential	231.0	246.8	239.0
Commercial	975.0	987.8	981.4

The original and stipulated estimates are set forth in Tables B-1 and Tables B-2.

.10 **Operations and Maintenance Expenses**

2.11 **T&D Reset Meters**

ORA and Cal-Am agree that T&D Reset Meter expense should be based on including some of the 1999 costs previously excluded by ORA based on a showing by the Company as to the validity thereof

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 12.8	$ 7.6	$ 10.2
2004	$ 13.2	$ 7.8	$ 10.5

2.12 **T&D Meter Maintenance**

ORA and Cal-Am agree &at T&D Meter Maintenance Expense should be based on including some of the 1999 costs previously excluded by ORA based on a showing by the Company as to the validity thereof

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 15.5	$ 9.0	$ 12.3
2004	$ 16.0	$ 9.2	$ 12.6

2.20 **Administrative and General Exgenses**

2.21 **Labor Inflation Rate**

Cal-Am and O M agree that the labor inflation rate should be based on the current negotiated and signed union contract, for union Babor, and that the same rate should be used for non-union labor based on a showing by the Company as to historical inflation rates and the current allowance for 2003, which is already been effectuated. The labor inflation rates to be used are 3.3% for 2003 and 3.0% for 2004.

2.22 **Overtime and Capital Labor Pecentaees**

Cal-Am and ORA agree to the following overtime and capital labor percentage based on a determination that both parties used reasonable methods for estimation and that the average of the two estimates was reflective of current trends.

	Original Positions (%)		Amended Settlement (%)
	Cal-Am	ORA	
Overtime	8.47%	8.03%	8.25%
Capital	9.74%	9.25%	9.50%

2.23 **Group Insurance Inflation Factor**

Cal-Am and ORA agree that based on current market trends, group insuance inflation rates are generally in excess of 10%, and based on this information the parties agree to use an inflation rate of 7.5% for ratemaking.

2.24 **Miscellaneous General Expense**

Cal-Am and O M agree that the estimate for this account should be based on the showing by the Company as to the current level of expense for 2002 under Cal-Am ownership.

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 465.1	$ 192.7	$ 232.1
2004	$ 478.4	$ 197.6	$ 237.9

2.30 **Rate Base**

2.31 O M agrees with Cal-Am's position that if a capital expenditure is removed from rate base, then if *any* contributions for that project were received, they must likewise be removed from rate base. ORA recommends that the expenditures related to the Mather Booster should be placed in a deferred account, therefore they now recommend that the contribution of $650,000 received for this project be removed from the unamortized contributions. Gal-Am still does not agree that any projects should be removed from rate base due to third party liability for the contamination, but does agree that ORA's position is now consistent with their recommendation.

Original Positions (000s)			Amended Settlement (000s)
	CaI-Am	ORA	
2003	$ 465.1	$ 192.7	$ 232.1
2004	$ 478.4	$ 197.6	$ 237.9

3.00 **Montara District**

Cal-Am agrees to accept ORA's estimates, where an agreement was reched, except for the following where a Amended Settlement was reached:

.01 **Average Consumption per Customer and Total Production**

Cal-Am and O M agree to the estimates of average consumption for each class in the Montara District except for residential and commercial customers. For residential customers, Cal-Am and ORA agree to an average consumption based on the average of the last three recorded years which is more reflective of the current normal use for metered customers. For commercial customers, Cal-Am and ORA agree that both of their methods for estimating consumption are valid and that an average of the two parties estimates is reflective of current usage.

Original Positions (CCFs)			Amended Settlement (CCFs)
	Cal-Am	ORA	
Residential	92.5	98.11	93.9
Commercial	336.0	360.3	348.2

The original and stipulated estimates are set forth in Tables B-1 and Tables B-2.

3.10 **Operations and Maintenance Expenses**

3.11 **Water Treatment Expense**

ORA and Cal-Am agree that water treatment expense should be based on including some of the 1999 costs previously excluded by ORA based on a showing by the Company as to the validity thereof.

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 36.5	$ 31.7	$ 34.1
2004	$ 37.5	$ 32.5	$ 35.0

3.20 **Administrative and General Expenses**

3.21 **Labor Inflation Rate**

Cal-Am and ORA agree that the labor inflation rate should be based on the current negotiated and signed union contract, for union labor, and that the same rate should be used for non-union labor based on a showing by the Company as to historical inflation rates and the current allowance for 2003, which is already been effectuated. The labor inflation rates to be used are 3.3% for 2003 and 3.0% for 2004.

3.22 **Overtime and Capital Labor Pecentages**

Cal-Am and ORA agree to the following overtime and capital labor percentage based on a determination that both parties used reasonable methods for estimation and that the average of the two estimates was reflective of current trends.

	Original Positions (%)		Amended Settlement (%)
	Cal-Am	ORA	
Overtime	15.37%	17.01%	16.19%
Capital	7.57%	7.55%	7.56%

3.23 **Group Insurance Inflation Factor**

Cal-Am and ORA agree that based on current market trends, group insuance inflation rates are generally in excess of 10%, and based on this information the parties agree to use an inflation rate of 7.5% for ratemaking.

4.00 **Larkfield District**

Cal-Am agrees to accept ORA's estimates, where an agreement was reached, except for the following where a Amended Settlement was reached:

4.01 **Average Consumption per Customer and Total Production**

Cal-Am and ORA agree to the estimates of average consumption for each class in the Larkfield District except for residential, commercial and irrigation customers. For all of these customers, Cal-Am and ORA agree that both of their methods for estimating consumption are valid and that an average of the two parties estimates is reflective of current usage.

Original Positions (CCFs)			Amended Settlement (CCFs)
	Cal-Am	ORA	
Residential	176.5	182.2	179.0
Commercial	465.0	468.9	466.9
Irrigation	637.3	657.0	447.2

The original and stipulated estimates are set forth in Tables B-1 and Tables B-2.

4.10 **Operations and Maintenance Expenses**

4.11 **Water Treatment Expense**

ORA and Cal-Am agree that water treatment expense should be based on including some of the 1999 costs previously excluded by ORA based on a showing by the Company as to the validity thereof.

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 23.9	$ 18.9	$ 20.6
2004	$ 24.6	$ 19.4	$ 20.9

4.12 **T&D Service Maintenance**

ORA and Cal-Am agree that T&D Service Maintenance Expense should be based on including some of the 1999 costs previously excluded by ORA based on a showing by the Company as to the validity thereof

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 20.1	$ 11.4	$ 15.8
2004	$ 20.4	$ 11.7	$ 16.2

4.20 **Administrative and General Expenses**

4.21 **Labor Inflation Rate**

Cal-Am and ORB agree that the labor inflation rate should be based on the current negotiated and signed union contract, for union labor, and that the same rate should be used for non-union labor based on a showing by the Company as to historical inflation rates and the current allowance for 2003, which is already been effectuated. The labor inflation rates to be used are 3.3% for 2003 and 3.0% for 2004.

4.22 **Overtime and Capital Labor Percentages**

Cal-Am and ORB agree to the following overtime and capital labor percentage based on a determination that both parties used reasonable methods for estimation and that the average of the two estimates was reflective of current trends.

	Original Positions 4%)		Amended Settlement 4%)
	Cal-Am	OWA	
Overtime	11.29%	10.55%	10.92%
Capital	7.59%	8.69%	8.14%

4.23 **Group Insurance Inflation Factor**
Cal-Am and O M agree &at based on current market trends, group insuance inflation rates are generally in excess of 10%, and based on this information the parties agree to use an inflation rate of 7.5% for ratemaking.

4.30 **Plant in Service**

4.31 **Wickiup Bridge M d n Project**
Based on a showing by the Company that extensive workpapers were supplied for this project, including theLarkfield Master Plan, and that the project was complete and in service, ORA agreed to Cal-Am's request that this project be induded in rate base at the actual cost of construction of $140,453.

4.32 **Construct New North Wickiup Tank No. 2**
Based on a showing by the Company that extensive workpapers were supplied for this project, including theLarkfield Master Plan, and the shortage of storage in the area, ORA agreed to Cal-Am's request that this project be included in rate base at the estimated cost of construction of $300,000.

5.00 **Felton District**
Cal-Am agrees to accept ORA's estimates, where an agreement was reached, except for the following where a Amended Settlement was reached:

5.01 **Average Consumption per Customer and Total Production**
Cal-Am and ORA agree to the estimates of average consumption for each class in the Felton District except for residential, commercial and public authority customers. For all of these customers, Cal-Am and ORA agree that both of their methods for estimating consumption are valid and that an average of the two parties estimates is reflective of current usage.

	Original Positions (CCFs)		Amended Settlement (CCFs)
	Cal-Am	ORA	
Residential	100.3	103.0	101.1
Commercial	293.3	303.9	298.6
Public Authority	2,056.0	2,354.7	2,205.4

The original and stipulated estimates are set forth in Tables B-1 and Tables B-2.

5.10 **Operations and Maintenance Expenses**

5.11 **Water Treatment Expense**

ORA and Cal-Am agree that the Company's estimate of water treatment expense is more reflective of current needs based on including some of the 1999 costs previously excluded by ORA (based on a showing by the Company as to the validity thereof), and based on the level of expense in 2002 due to changing treatment requirements.

	Original Positions (000s)		Amended Settlement (000s)
	Cal-Am	ORA	
2003	$ 25.2	$ 22.0	$ 25.2
2004	$ 25.9	$ 22.6	$ 25.9

5.20 **Administrative and General Expenses**

5.21 **Labor Inflation Rate**

Gal-Am and ORA agree that the labor inflation rate should be based on the current negotiated and signed union contract, for union labor, and that the same rate should be used for non-union labor based on a showing by the Company as to historical inflation rates and the current allowance for 2003, which is already been effectuated. The labor inflation rates to be used are 3.3% for 2003 and 3.0% for 2004.

5.22 **Overtime and Capital Labor Pecentages**

Cal-Am and ORA agree to the following overtime and capital labor percentage based on a determination that both parties used reasonable methods for estimation and that the average of the two estimates was reflective of current trends.

	Original Positions (%)		Amended Settlement (%)
	Cal-Am	ORA	
Overtime	11.29%	10.55%	10.92%
Capital	7.59%	8.69%	8.14%

5.23 **Group Insurance Inflation Factor**

Cal-Am and ORA agree that based on current market trends, group insuance inflation rates are generally in excess of 10%, and based on this information the parties agree to use an inflation rate of 7.5% for ratemaking.

OFFICE OF RATEPAYER ADVOCATES

By _____
Raymond A Charvez
Project Manager for Office of Ratepayer Advocates
State of California
Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102
(415) 703-1654

Dated: May 9,2003

CALIFORNIA-AMERICAN WATER COMPANY

By: _____
David P. Stephenson
Assistant Treasurer for California-American Water Company

California-American Water Company
303 H Street, Suite 250
Chula Vista, CA 911910
(619) 409-7712

Dated: May 9,2003

(END OF APPENDIX F)

CERTIFICATE OF SERVICE

I certify that I have by regular mail and e-mail this day served a true copy of the Alternate Proposed Decision of Commissioner Kennedy on A.02-09-030 regarding the Application of the California-American Water Company (U210W) Authority to Increase Its rates for Water Service in its Sacramento District etc, on all parties of record in this proceeding or their attorneys of record.

Dated April 22, 2004, at San Francisco, California.

Halina Marcinkowski

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

* *

The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074 or TDD# (415) 703-2032 five working days in advance of the event.