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**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Apple Valley)
Ranchos Water Company (U 346 W) for Authority)
to Increase Rates Charged for Water Service by) APPLICATION NO. 14-01-002
\$3,127,463 or 14.88% in 2015, \$2,056,455 or)
8.48% in 2016, and \$2,160,731 or 8.19% in 2017.)
_____)

**REPLY COMMENTS OF APPLE VALLEY RANCHOS WATER COMPANY
IN SUPPORT OF AMENDED SETTLEMENT AGREEMENT**

Edward N. Jackson
Representative
Director of Revenue Requirements
Park Water Company
9750 Washburn Road
P. O. Box 7002
Downey, CA 90241
Telephone: (562) 923-0711
Facsimile: (562) 861-5902
E-mail: ed.jackson@parkwater.com

Joseph H. Park
Attorney for Apple Valley Ranchos
Water Company
LKP Global Law, L.L.P.
1901 Avenue of the Stars, Suite 480
Los Angeles, CA 90067
Tel: (424) 239-1890
Fax: (424) 239-1882
E-mail: jpark@lkpgl.com

July 2, 2015

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I. INTRODUCTION

Pursuant to Rule 12.2 of the Commission’s Rules of Practice and Procedure (“Rules”), Apple Valley Ranchos Water Company (“AVR” or “Company”) hereby respectfully submits its Reply Comments in support of the Amended Settlement Agreement (“Amended Settlement Agreement”), Exhibit A-30. Specifically, AVR responds to the Comments of the Town of Apple Valley (the “Town”) regarding the Amended Settlement Agreement (“Town’s Comments”).

In its Comments, the Town makes three arguments – that the Amended Settlement Agreement is unreasonable and not in the public interest because: (1) the settled estimate for the main replacement program exceeds AVR’s historical levels; (2) AVR has over-invested in main replacements; and (3) ratepayers will likely pay significant surcharges due to Resolution W-5041. These arguments – and the Town’s assertions in support of these arguments – are unfounded, unsupportable, and wrong. In objecting to the Amended Settlement, the Town completely ignores the detailed factual support provided in the Amended Settlement, the record in this proceeding, as well as in testimony offered at the reasonableness hearing held in this proceeding. The Town’s objections should be rejected and the Amended Settlement approved.

First, the Town’s proposal to base authorized main replacement expenditures on historical levels of expenditures – a five-year average – does not address the unrefuted evidence

of the current and future needs of AVR's water system. As the evidence is clear that the main replacement level proposed in the Amended Settlement is significantly less than the level recommended by AVR's independent Asset Management Study, the Commission should reject the Town's recommendation that the main replacement expenditures be based on a five-year average.

Second, the Town's assertion that AVR has over-invested in its water mains is wholly without merit. The Town's "non-transparency" assertions in support of this argument reflect a fundamental misunderstanding of, or disagreement with, the General Rate Case ("GRC") process under the Commission's Rate Case Plan. In any case, the record demonstrates that AVR remains *under*-invested in its main replacement program, warranting further increases, not reductions, in its main replacements.

Third, the Town's argument that Resolution W-5041 will lead to additional, substantial surcharges is nothing more than speculation. As the record only indicates that any surcharges that might result from the implementation of Resolution W-5041 would only apply to heavy users to incentivize reduced usage, any such surcharges cannot be a basis for not approving the Amended Settlement. Moreover, assuming that the Commission adopts AVR's revised sales forecast (to account for the Governor's mandated reduction in water consumption and the Commission's Resolution W-5041), the Amended Settlement results in only a limited increase in the typical residential bi-monthly bill – an increase of 2.66%.¹ There is simply no merit to the Town's assertion that the Amended Settlement is unreasonable and not in the public interest.

Notwithstanding the Town's unfounded arguments to the contrary, the record amply supports the conclusion that the settlement reflected in the Amended Settlement Agreement is "reasonable, consistent with the law, and in the public interest."² The Amended Settlement will allow AVR to continue much needed infrastructure investments while having limited anticipated impact on the typical bi-monthly residential bill. Accordingly, AVR respectfully requests that the Commission reject the Town's unsupportable assertions in its Comments and approve the Amended Settlement Agreement without modification.

¹/ See "Amended Supplemental Testimony of Apple Valley Ranchos Water Company (U 346 W)", served on June 30, 2015 ("AVR Supp. Testimony"), at 21.

²/ Rule 12.1(d).

II. THE AMENDED SETTLEMENT MEETS THE CRITERIA FOR APPROVAL AND SHOULD BE APPROVED; THE TOWN'S ASSERTIONS LACK MERIT.

As demonstrated in the Amended Settlement Agreement itself, the Amended Settlement meets all standards for approval by the Commission, which are set forth in Rule 12.1(d):

The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest.³

As discussed in detail below, the Town's arguments against approval of the Amended Settlement are unsupported, illogical, and simply wrong. As the record amply supports the conclusion that the Amended Settlement meets the criteria for approval, AVR respectfully requests that the Commission reject the Town's arguments and approve the Amended Settlement.

A. THE TOWN'S COMMENTS ARE PREMISED, IN PART, ON MISSTATEMENTS AND UNSUPPORTED AND INACCURATE ASSERTIONS.

As an initial matter, AVR notes that the Town's Comments contain a number of misstatements as well as assertions that are inaccurate and/or unsupported.

First, as it did in its Opening Brief filed earlier in this proceeding,⁴ the Town begins its Comments with a false statement – without any citation to the record, the Town states that AVR's rates have increased by 96% from 2003 to 2013 and that the "average customer's water bill has nearly doubled in that time."⁵ This statement is simply wrong. The Town overlooks the fact that much of the increase to rates during that period resulted from reduced consumption and a rate design that recovers half or more of the fixed costs of operation through commodity rates, necessitating rate increases just to recover the amount of revenues that the Commission had determined were necessary to recover fixed costs. Because consumption was reduced, and the rate increases applied to less consumption, increases in customer's average bills were substantially less than the increases in rates.

In 2003, the average residential customer's bi-monthly consumption was 50 Ccf and the average residential bi-monthly bill at the rates adopted for 2003 was \$103.12.⁶ For 2015, AVR's

³/ Rule 12.1(d).

⁴/ Town Opening Brief (filed July 21, 2014), at 1.

⁵/ Town Comments, at 1.

⁶/ D.03-08-069, Appendix F.

original estimate of the average residential consumption was 33.18 Ccf and the average residential bi-monthly bill at the rates originally requested by AVR was \$148.10.⁷ Thus, for the twelve year period from 2003 to 2015, even including AVR's original Application request, this amounted to a 43.6% increase in the average residential customer's bi-monthly bill. The Town's assertion that bills nearly doubled from 2003 to 2013 is clearly wrong. Based on its incorrect (and unsupported) statement regarding the increases in water bills, the Town asserts that the level of increase is "unsustainable."⁸ This 43.6% increase from 2003 to 2015, however, is a compounded annual increase of only 3.06% per year.

Second, without any citation to the record, the Town makes the bald assertion that some of its "residents believe the aggressive investment in main replacement projects, starting in 2011, are due to a concerted and systematic effort to increase the rate base upon which AVR and its affiliated companies can recover a rate of return."⁹ Not only is this assertion unsupported by the record, it is nothing more than speculation lacking any foundation and therefore should not be considered by the Commission.

Third, the Town's statement that the Water Revenue Adjustment Mechanism ("WRAM") ensures that "AVR receives its authorized revenue requirement" is inaccurate and wrong. The WRAM and Modified Cost Balancing Account ("MCBA") only allows AVR to receive its authorized commodity rate revenue, net of the associated production costs, not the "authorized revenue requirement."¹⁰ AVR also notes that, under the WRAM/MCBA, AVR recovers any under-collection in the WRAM/MCBA over time pursuant to the annual advice letter procedure for amortization of the WRAM/MCBA balance.¹¹

B. LIMITING AVR TO A HISTORICAL FIVE-YEAR AVERAGE FOR ITS MAIN REPLACEMENT EXPENDITURES IS NOT REASONABLE AND IS AGAINST THE PUBLIC INTEREST.

The Town first argues against approval of the Amended Settlement Agreement on the grounds that the Amended Settlement's estimate for main replacements "far exceed" AVR's

⁷/ A.14-01-002, Appendix B.

⁸/ Town Comments, at 1.

⁹/ Town Comments, at 3.

¹⁰/ Exhibit A-1, at 133.

¹¹/ D.12-04-048 (Finding of Fact 11), at 40 (for annual filing requirements) and Appendix A (for amortization schedule).

historical main replacement expenditures.¹² In urging the Commission to limit AVR's authorized main replacement expenditures to a five-year historical average of approximately \$1.6 million per year,¹³ the Town provides no recognition or discussion of the need for increased main replacements or the consequences of reducing or deferring needed main replacements. The Town likewise fails to provide any justification for its assertion that the use of a five-year average is reasonable or otherwise meets the current or long-term needs of AVR's water system.

Instead, without any support, the Town accuses AVR and its corporate grandparent of engaging in a systematic effort to increase main replacement expenditures simply to increase profits.¹⁴ In doing so, the Town notes but ignores the testimony of AVR's witness Rick Dalton regarding the reasons for the unusually low main replacement expenditures recorded for 2009 and 2010.¹⁵ As Mr. Dalton testified, the low main replacement expenditures recorded for 2009 and 2010 resulted from "cash flow shortages during the economic downturn that caused a reduction in fund available for capital expenditures,"¹⁶ and that 2009 and 2010 "are very abnormal years."¹⁷ The substantially reduced levels of investments in main replacements during these years further justify increased expenditures to make up for the low expenditure years so that AVR can keep up with the water system's long term needs.¹⁸

At bottom, the Town's position is that – regardless of the need for main replacements or the consequences of not undertaking necessary main replacements – because the proposed main

¹²/ Town Comments, at 2.

¹³/ Town Comments, at 4.

¹⁴/ Town Comments, at 3. AVR notes that improved access to capital – to fund necessary capital improvements that had to be deferred under prior ownership – was one of the anticipated benefits noted by the Commission in its approval of the transfer of ownership of AVR's parent company (Park Water) to a Carlyle subsidiary. The Commission noted "Applicant's response is persuasive that an orderly transfer from Henry Wheeler to Carlyle... will provide... access to the capital markets, so that Park and Ranchos should remain financially healthy and provide reliable service." D.11-12-007, at 8, citing "Supplement 1," which was "Applicants' Submission of Supplementary Information", filed in A.11-01-019 on March 11, 2011. In the Supplement, the Applicants explained, at page 4, that: "the transaction will maintain or improve the financial condition of Park Water"; after the orderly succession in the management and ownership, Park Water will "have access to additional and more diverse financial resources than have been available in the past"; "[t]he Transaction will eliminate financial and ownership uncertainties that Park Water otherwise would face"; and "Applicants expect that the transaction will enhance Park's ability to raise capital."

¹⁵/ Town Comments, at 3.

¹⁶/ Ex. 18, at 11; Tr. Vol. IV, at 366:17-367:1.

¹⁷/ Tr. Vol. IV, at 371:10-13.

¹⁸/ Ex. 18, at 11.

replacement expenditures will increase rates, the Amended Settlement is unreasonable and not in the public interest. While rate impact is one factor to be considered in determining whether a settlement meets the requirements of Rule 12.1(d), the determination of whether a settlement is reasonable and in the public interest must be made on the basis of the whole record.¹⁹ Here, the record fully supports the conclusion that the proposed main replacement program meets the requirements of Rule 12.1(d) and is otherwise just and reasonable under Section 451 of the Public Utilities Code.

As the Commission is well aware, water mains form the backbone of a water system's infrastructure and are critical to the fulfillment of a water utility's primary mandate – delivering “clean, safe, and reliable water to their customers at reasonable rates.”²⁰ Recognizing the importance of a properly maintained infrastructure to water utilities' ability to meet this mandate, the Commission has highlighted investment in infrastructure as among its policy objectives in its Water Action Plan: “Water infrastructure in California continues to need significant improvement. The CPUC will encourage financial incentives and direction for investment in infrastructure needed to improve water quality.”²¹ The main replacement program proposed in the Amended Settlement Agreement is consistent with this Commission policy and is fully supported by two independent studies (the Asset Management Report and the ID Modeling Transmission Study) and unrefuted testimony that highlight the need for increased investments in main replacement to prevent leaks from aging and failing water mains and the attendant safety and economic consequences of main failures.²²

Among the numerous facts establishing the need for, and the reasonableness of, the proposed main replacement program that the Town ignores in its Comments include the following unrefuted facts that, taken as a whole, demonstrate that the Amended Settlement is just, reasonable, and in the public interest:²³

^{19/} As discussed below, if the Commission adopts AVR's revised consumption estimate that accounts for the mandated reduction in consumption, production, and revenue requirement, the Amended Settlement will result in only a limited increase in a typical bi-monthly residential bill (2.66%).

^{20/} <http://www.cpuc.ca.gov/puc/water/>

^{21/} 2010 Water Action Plan dated October 2010 (page 3) – Objective #2 – “Promote water infrastructure investment”.

^{22/} Ex. A-1, at 64-67; Ex. A-21 (Asset Management Report); Ex. A-23 (ID Modeling Transmission Study).

^{23/} See also, generally, AVR's Comments to PD (filed April 21, 2015), at 5-12, for additional discussion of the record regarding the need for the main replacement program.

- Issues Raised in ORA’s Report Regarding the Asset Management Study (“AM Study”) Were Addressed: The various issues raised in ORA’s Report (Ex. O-1) relating to the AM Study – which formed the basis for ORA’s original recommendation that AVR’s authorized main replacement expenditures be based on five-year historical average – were addressed in AVR’s Rebuttal Testimony. ORA has acknowledged that the PD relied on an erroneous statement regarding the service lives used in the AM Study for plastic and steel pipes.²⁴
- The Proposed Main Replacement Program Replaces Substantially Less Pipe Than Recommended. The AM Study recommends replacements of approximately 10 miles per year until 2018, 8 miles per year through 2025, and then a decline to 6 miles per year by 2043.²⁵ This recommendation is based on balancing cost considerations against the goal of reducing the leak rate to an industry standard leak rate goal (0.15 leaks per mile). The recommendation does not achieve that leak rate goal, but brings the system leak rate to about twice the goal leak rate by 2043.

The AM Study’s “Raw Needs” scenario recommends 8.5 miles of replacement per year in 2014, gradually decreasing to around 6 miles per year over 30 years. The AM Study notes that this schedule also will not result in sufficient reduction in leaks. To moderate rate impact, in its Application, AVR originally proposed replacements of between 5.17 and 6.6 miles per year and agreed to a further reduction in the original Settlement Agreement, which was reduced even further to between 3.45 and 4.17 miles per year in the Amended Settlement Agreement.²⁶

The more gradual increase in pipeline replacement rate addresses the Commission’s desire to moderate the rate impact, while still providing an increase in main replacements to address the high level of leaks and other replacement needs in AVR’s system.²⁷

- The Use Of A Two-Year Or Five-Year Average Results In A Decrease In Expenditures In Real Dollars. Setting the capital expenditures for main replacements over the test period at the average of the 2012-2013 level (\$3,057,846 for TY 2014)

²⁴/ Ex. A-30, at 7.

²⁵/ Ex. A-30, at 8; Ex. A-21, at 7.

²⁶/ Ex. A-30, at 9; Ex. A-21, at 5.

²⁷/ Ex. A-30, at 7.

or a five-year average (\$1,689,314 for TY 2014) would result in a decrease in expenditures (in real dollars).²⁸

- AVR Plans To Replace Steel Pipes, Which Account For The Most Leaks. With the exception of projects required by the Town for street repair, all of the main replacement projects proposed by AVR in this Proceeding are to replace steel pipe, which account for the most leaks and which are approaching the end of their useful lives.²⁹ AVR has over 460 miles of pipe in its system. Assuming a 100 year useful life, the replacement rate should be 1.0% – or 4.6 miles per year. ORA notes that the national average rate is 0.5%, which effectively assumes a life of 200 years; as result of this national average replacement rate, in 2013, the American Society of Civil Engineers gave water infrastructure a grade of D, down from B- in 1988.³⁰
- AVR Will Be Required To Replace Pipes For Street Repair. In 2015, AVR is required to replace pipe due to Town construction projects. These projects, required by the Town, are not replacing old leaky pipe and the money spent on these projects will not accomplish the furtherance of AVR’s main replacement program. The Yucca Loma Road – Storm Drain Conflicts project is estimated at \$263,167 and the Highway 18/Apple Valley Road project is estimated at \$318,269, because the Town is improving the intersection at Highway 18 and Apple Valley Road by changing the street finish surface grade and adding storm drain facilities.³¹
- Main Replacement Will Improve Transmission Capacity. Over the years, due to over-drafting of the basin that led to the adjudication, water quality and quantity away from the Mojave River has declined. This caused AVR to abandon wells in those areas of the system away from the river and to drill new wells fairly close to the river.

^{28/} Ex. A-30, at 6.

^{29/} Ex. A-30, at 7-8; Ex. A-1, at 64, 68-79; Tr. Vol. IV, at 343:24-344:16.

^{30/} Ex. A-30, at 9. *See also* Ciaccia, Jr., Julius, “Considering the Context of Affordability”, AWWA Journal (May 2015) Letter to the Editor, at 12, copy attached as Attachment A (The CEO of the Northeast Ohio Regional Sewer District notes: “There is only one reason that our industry is consistently rated a D+ from the American Society of Civil Engineers, and that is because in the United States, we are dominated by publicly owned utilities that are dependent on local elected officials to agree to raise rates consistently.... We will forever remain a D+ or lower unless substantial investment happens over this century, and that will not happen if we are forever raising the white flag of affordability..... We cannot be expected to set rates on the lowest common denominator of affordability and also be expected to continue to provide essential water services to both the rich and poor without investing in our assets.”)

^{31/} Ex. A-30, at 9-10.

The need for additional transmission capacity to transmit water from the wells concentrated along the river to other parts of the system is due to the fact that the mains installed in past years near the river were sized to meet localized needs for transmission capacity but do not meet current needs to transmit water from a concentration of wells in one area to the rest of the system. Transmission capacity is still necessary, despite reduced customer demand, to fill tanks in a timely manner after peak demands and to address the need for improved fire flow capacity.³²

- AVR Balances A Variety Of Factors To Prioritize Main Replacements. AVR needs to incorporate and balance numerous considerations into its plans for main replacements. AVR cannot focus entirely and exclusively on replacement of the mains that are leaking the most. Severity of leaks, consequences of failure, damage to others, safety, and criticality of service interruption must also be taken into account, as well as opportunities to address both leaks and the need for improved transmission capacity and fire flow capacity in a cost-effective manner.³³
- Increasing Main Replacements Will Help Reduce Unaccounted For Water, Which Will Help AVR Comply With Resolution W-5041. Replacing aging and leaking mains is critical to reducing leak rates, which in turn reduces unaccounted for water. Reducing unaccounted for water will help AVR comply with Resolution W-5041 by reducing the amount of water production needed to meet demand. Every gallon of water not lost as unaccounted for water through main replacements is one less gallon of consumption reduction required to comply with Resolution W-5041 and thereby benefits the public. Conversely, every additional gallon of water lost to leaks and unaccounted for water is an additional gallon of conservation by customers needed to meet Resolution W-5041.³⁴

Consideration of these undisputed facts supports the conclusion that the main replacement expenditures proposed in the Amended Settlement Agreement are just, reasonable, and in the public interest. Accordingly, the Town's first argument should be rejected and the Amended Settlement Agreement should be approved.

³²/ Ex. A-30, at 10; Ex. A-18, at 15; Tr. Vol. IV, at 359:3-360:22.

³³/ Ex. A-30, at 10-11; Ex. A-18, at 15.

³⁴/ Ex. A-1, at 63-65; Tr. Vol. IV, at 403:18-404:10.

C. AVR HAS *NOT* OVER-INVESTED IN MAIN REPLACEMENTS.

The Town next argues that the Amended Settlement Agreement should not be approved because “AVR has already over-invested in main replacements.”³⁵ The Town’s basic argument is that the Amended Settlement is somehow unreasonable and not in the public interest because AVR’s main replacement expenditures in 2011-2013 exceeded the main replacement estimates authorized in the last GRC and did so in a “non-transparent” manner. As discussed below, the Town’s argument is premised on a fundamental misunderstanding of the GRC process and is illogical.

1. The Town’s Position Reflects A Fundamental Misunderstanding Of The GRC Process.

The Town’s contentions regarding AVR’s purported “over-investment” in main replacements are premised on a “non-transparency” argument – that, somehow, AVR did something improper in a surreptitious manner by exceeding the authorized main replacement expenditures for the last rate case cycle.³⁶ This argument is not only misleading, it reflects the Town’s fundamental misunderstanding of, and/or or objection to, the GRC process itself.

As with any GRC application, AVR’s application for the prior GRC was based on budgets set for anticipated capital projects for the periods covered by the rate case cycle. This entails anticipating projects one, two, and three years down the road. In recognition of the fact that GRC applications are based on projections and forecasts, the Commission affords water utilities the flexibility and discretion to allocate authorized capital expenditures to address changed conditions and circumstances:

A GRC is used to set rates based on reasonable estimates of the costs the utility will incur in providing service. It is not generally intended to set a specific budget. Actual costs for the test year, including plant additions, may vary.If the Commission were to adopt DRA’s recommendation [to remove a number of capital projects from the GRC and authorize AVR to file advice letters for projects, after completion], AVR would be limited to these projects without the ability to make changes in response to changed conditions or opportunities.... In addition, AVR should have some flexibility in making final decisions on plant additions.³⁷

^{35/} Town Comments, at 3.

^{36/} Town Comments, at 3-4.

^{37/} D. 08-09-026 (AVR GRC), at 7. *See also* Tr. Vol. IV, at 391:13-22 (“The authorized amounts, whether they are based on settlement or not according to Commission’s prior decisions, are not intended

AVR has exercised this flexibility to shift resources and change priorities to address changed conditions and opportunities by undertaking capital projects that were different than those that were anticipated at the time that a GRC application was prepared – one or even three years earlier. Often, increased expenditures on main replacements were offset by decreased expenditures in other areas such that the overall capital expenditures for the periods in question were relatively close to the authorized amounts. As explained by AVR in its Comments to ALJ Tsen’s original PD in this proceeding and at the reasonableness hearing held in connection with the Amended Settlement, not only is there nothing improper for AVR’s 2011-2013 main replacement expenditures to exceed the authorized amounts, there are also good reasons for the difference.³⁸

In 2011 and 2012, AVR spent more than the total authorized amounts for main replacements for those years, in part, to accomplish reinvestment of the tax benefits from bonus depreciation allowed under the 2010 Tax Act.³⁹ The Commission specifically provided for the use of additional funds available from these tax benefits to be used for investment in needed infrastructure in Resolution L-411A.⁴⁰ The expenditures over what had been authorized for these years did *not* create any increase in rate base and did *not* have any rate impact.⁴¹

In 2013, AVR expended \$512,536 for a new main to address transmission needs. Because new mains were not included in the settlement in the prior GRC, only main replacements, a proper apples-to-apples comparison should reduce the 2013 actual expenditures noted in Table 4-B of the PD by this amount. Additionally, unbudgeted main replacements are inevitable, including a 2013 expenditure of \$693,273 to replace pipe that was experiencing high leakage rates. This project was not anticipated during the budgeting process which preceded the filing of the last GRC Application.⁴²

to be a budget. They are not intended to be something that we absolutely adhere to. It is understood that [] they are estimates... And we may need to do something different.”)

³⁸/ See AVR Comments to PD (filed April 21, 2015), at 11-12.

³⁹/ Tr. Vol. IV, at 382:11-385:29.

⁴⁰/ Resolution L-411A, at 16, Finding & Conclusion No. 9.

⁴¹/ Tr. Vol. IV, at 385:4-8.

⁴²/ AVR Comments to PD, at 11. These two projects, totaling approximately \$1.2 million, account for more than 70% of the \$1.7 million difference between authorized and actual expenditures in 2013. (PD, at 16, Table IV-B).

Additionally, the Asset Management Study and the ID Modeling Transmission Study were completed in August of 2013.⁴³ Throughout the process leading up to the completion of these reports, AVR provided data to and participated in discussions with the consultants. As such, even before the reports were finalized, AVR had indications of what the final reports would reveal. In fact, AVR commissioned these studies because AVR was aware that the rate of decrease in leaks and progress toward industry standard leak rates had leveled off in the several preceding years and was also aware of growing transmission capacity issues with transmitting water to the eastern portion of its system.⁴⁴ It would not have been prudent for AVR to blindly adhere to the estimated level of main replacement expenditures adopted during the prior GRC for 2013 (based on estimates made in 2010, since the TY 2012 GRC was filed in January, 2011) when AVR had good reason to believe that higher expenditure for main replacements were both reasonable and necessary.

The Town also notes that AVR's actual main replacement expenditures for 2014 exceeded the settlement amount reflected in the original Settlement Agreement – by \$142,461, or 2.85%.⁴⁵ As noted in AVR's submission in its Response to Administrative Law Judge's Ruling, filed January 15, 2015, however, AVR expended \$649,411 for an unplanned main replacement project: "This is an example of an unplanned main replacement project that was required to replace a leaking water main to mitigate safety, liability, and service reliability issues. This project involved replacing a water main in a very busy traffic area in front of the main entrance to Saint Mary Hospital and a number of doctor offices and clinics."⁴⁶ Absent this large, unanticipated main replacement expenditure, AVR's 2014 main replacement expenditures would have been less than the originally settled amounts for 2014.

Finally, although the Town implies that AVR's capital expenditures are not subject to review, that is simply not the case. As explained by AVR's witness Leigh Jordan:

All capital expenditures on utility plant are booked into the plant account, and they are all reviewed by ORA. ORA reviewed our historic plant balance for any

⁴³/ Exs. A-21 and A-23, cover pages.

⁴⁴/ Ex. A-1, at 63-64, 66.

⁴⁵/ The original Settlement Agreement would have authorized 2014 main replacement expenditures of \$4,985,153. (Original Settlement Agreement, § 9.6, at 53). AVR's actual 2014 expenditures were \$5,127,614, a difference of \$142,461, or 2.85%. (AVR Response to ALJ Ruling dated January 8, 2015, at 1.)

⁴⁶/ AVR Response to ALJ Ruling dated January 8, 2015, at 2.

specific projects that [] were authorized in the last decision and were not done. Any projects that were done which were not authorized in the last decision or any projects for which the costs were significantly over what was estimated in the last decision are specifically pointed out to ORA in the minimum data requirements.⁴⁷

While information comparing actual to authorized capital expenditures for the full 2013 year was not available at the time AVR prepared its Application and related materials, ORA requested and reviewed information on all the actual projects constructed by AVR in 2013.⁴⁸ There is nothing in the record to indicate that ORA did not execute its mission to “to obtain the lowest possible rate for service consistent with reliable and safe service levels” by thoroughly reviewing AVR’s capital expenditures for the 2011-2013 rate case cycle.⁴⁹ That ORA determined AVR’s capital expenditures during the 2011-2013 rate case cycle to be reasonable is reflected in the fact that ORA identified no issues with AVR’s plant in service in ORA’s Report.⁵⁰

2. AVR Has Under-Invested, Not Over-Invested, In Main Replacements.

Based on its assertions regarding the differences between AVR’s authorized and recorded expenditures on main replacements during the 2011-2013 period, the Town makes the false assertion that AVR has over-invested in main replacements. As any determination of whether AVR has “over-invested” in main replacements necessarily requires review and analysis of the status of AVR’s mains and AVR’s main replacement needs – and given that the Town provides no discussion or analysis of AVR’s mains or its replacement needs – the Town’s assertion has no foundation whatsoever. What the unrefuted record does establish is that AVR has *under*-invested in main replacements – not over-invested – and that AVR must increase its main replacements.

Specifically, as discussed above, the independent study of AVR’s mains (the AM Study) recommended that AVR replace approximately 10 miles of mains per year until 2018, 8 miles per year through 2025, and then decline to 6 miles per year by 2043. Under the AM Study’s “Raw Needs” scenario, the study recommended 8.5 miles of replacement per year in 2014, gradually decreasing to around 6 miles per year over 30 years. Given that the Amended Settlement proposes main replacements of between 3.45 and 4.17 miles per year – significantly

⁴⁷/ Tr. Vol. IV, at 387:19-388:2.

⁴⁸/ Tr. Vol. IV, at 391:9-12.

⁴⁹/ <http://www.ora.ca.gov/default.aspx>

⁵⁰/ Ex. O-1, at 8-2.

less than either the 10 miles or 8.5 miles per year recommended in the AM Study – there is simply no basis for the Town’s assertion that AVR has over-invested in main replacements.⁵¹

3. The Memorandum Account Proposed By The Town Should Be Rejected.

The Town recommends that the Commission order AVR to establish a memorandum account to record expenses in excess of the authorized amounts for main replacements, with the ability to seek reimbursement for such expenditures established to be reasonable. As explained in detail in AVR’s Comments to the PD in this proceeding – which proposed the memorandum account noted in the Town’s Comments – the proposed memorandum account does not comport with the Commission’s Standard Practice U-27-W, is impractical, provides no benefit to AVR, and is unnecessary.⁵² Accordingly, the Town’s recommendation for a memorandum account should be rejected.

D. THE POTENTIAL FOR SURCHARGES DOES NOT JUSTIFY REJECTION OF THE AMENDED SETTLEMENT; THE COMMISSION SHOULD APPROVE THE AMENDED SETTLEMENT, WHICH WILL HAVE LIMITED BILL IMPACTS.

As its final argument, the Town argues that the Amended Settlement should be rejected based on the possibility that, to comply with the Commission’s Regulation W-5041, “AVR ratepayers will likely pay significant surcharges.”⁵³ This speculative argument, without any support in the record, provides no basis for the conclusion that the Amended Settlement is unreasonable or not in the public interest.

Under Rule 12.1(d), the reasonableness of a settlement must be based “in light of the whole record.” The only evidence in the record regarding potential surcharges is that AVR was expecting to revise its Schedule No.14.1 to include a drought surcharge at a certain stage to incentivize large users to reduce their water consumption.⁵⁴ Thus, under the Town’s argument, the possibility that surcharges may be imposed on heavy users, to incentivize reduced consumption pursuant to Resolution W-5041, would somehow render the Amended Settlement unreasonable and against the public interest. This assertion is illogical and unsupportable – the

^{51/} Ex. A-30, at 8-9, A-21, at 5, 7.

^{52/} AVR Comments to PD, at 15-16.

^{53/} Town Comments, at 5.

^{54/} Tr. Vol. IV, at 398:17-27

potential for surcharges imposed on heavy users during this period of heightened drought conditions should have no bearing whatsoever on the determination of whether the Amended Settlement is reasonable and should be approved.

That the Amended Settlement is reasonable and is in the public interest is further supported by a review of the anticipated impact of the Amended Settlement on a typical residential bill. Pursuant to Commissioner Peterman's Ruling Amending Scope and Schedule dated June 19, 2015 ("Amended Scoping Memo"), on June 24, 2015, AVR submitted its "Supplemental Testimony," in which it provided its revised sales forecast to account for mandatory reductions in water consumption.⁵⁵ If the Commission adopts AVR's revised sales forecast, the Amended Settlement will result in only a 2.66% increase in a typical residential customer's bi-monthly bill. The limited anticipated increase in the typical bill further supports the conclusion that the Amended Settlement is reasonable and is in the public interest. Accordingly, notwithstanding the Town's speculative arguments regarding potential surcharges and its unfounded assertion that approving the Amended Settlement Agreement would "exacerbate adverse bill impacts," given the need for the main replacements and the limited anticipated bill impact of the Amended Settlement, the Commission should approve the Amended Settlement.⁵⁶

^{55/} AVR served its "Amended Supplemental Testimony" on June 30, 2015 to correct subsequently discovered errors in its original Supplemental Testimony.

^{56/} See Attachment A (Ciaccia, Jr., Julius, "Considering the Context of Affordability", AWWA Journal (May 2015) Letter to the Editor, at 12) ("We cannot be expected to set rates on the lowest common denominator of affordability and also be expected to continue to provide essential water services to both the rich and poor without investing in our assets.")

III. CONCLUSION

For the reasons set forth in the Amended Settlement Agreement and in these Reply Comments, AVR respectfully requests that the Commission approve the Amended Settlement Agreement without modification. Notwithstanding the Town's arguments to the contrary, the Amended Settlement Agreement is reasonable in light of the whole record, consistent with the law, and in the public interest.

Executed at Los Angeles, California,
July 2, 2015

Respectfully submitted,

/s/ Joseph H. Park
Joseph H. Park
Attorney for
Apple Valley Ranchos Water Company
LKP Global Law, L.L.P.
1901 Avenue of the Stars, Suite 480
Los Angeles, California 90067
Telephone: (424) 239-1890
Facsimile: (424) 239-1882
Email: jpark@lkpgl.com

Edward N. Jackson
Representative
Director of Revenue Requirements
Park Water Company
9750 Washburn Road
P. O. Box 7002
Downey, CA 90241
Telephone: (562) 923-0711
Facsimile: (562) 861-5902
E-mail: ed.jackson@parkwater.com

CONSIDERING THE CONTEXT OF "AFFORDABILITY"

In reading the Open Channel column by David LaFrance and Tom Curtis that was published in the February issue of *Journal AWWA*, I question the true context of the discussion about affordable water. This has become a very hot topic for me since I came over to the wastewater side after working for 31 years in drinking water. When I joined the Northeast Ohio Regional Sewer District (Cleveland) in 2007, I immediately had to pick up the ball on stalled combined sewer overflow consent order negotiations. We ultimately settled on a \$3 billion program to be completed over 25 years. During negotiations, I had the opportunity to engage the government for more than a year on the economics of our program and had to endure the lunacy of the current affordability guidance document criteria during that time. At the end of the day, the Cleveland region was determined to be high burdened. Now, what did that get us? The answer is *time*. The exercise had nothing to do with how truly affordable water is, or isn't, or how affordable regulations are, or aren't, except in the context of a condensed schedule. Basically it was an academic exercise, but it was a useful negotiating topic.

What I am concerned about is the varied context in which the word "affordability" is being thrown around. We cannot continue to defer investment in our utilities, nor can we shortchange our commitment to human health or the environment. My major concern is that this debate, if not carefully put into the right context, will give many local elected officials a flawed narrative to avoid raising rates. There is only one reason that our industry is consistently rated a D+ from the American Society of Civil Engineers, and that is because in the United States, we are dominated by publicly owned utilities that are dependent on local elected officials to agree to raise rates consistently. So I believe we water professionals, including our industry organizations, need to be very careful how we align on this issue and how we communicate it. We will forever remain a D+ or lower unless substantial investment happens over this century, and that will not happen if we are forever raising the white flag of affordability.

There is no question that as we raise rates to pay for basic infrastructure renewal and replacement, as well as respond to new mandates, that more people may find these critical services unaffordable. I am not at all insensitive to this fact. As such I believe we should advocate for programs at all levels of government for these individuals.

We cannot be expected to set rates based on the lowest common denominator of affordability and also be expected to continue to provide essential water services to both the rich and poor without investing in our assets. As I think about the other utilities (e.g., gas, electric) in our regions, I wonder why they are not mired in the 2.0 or 2.5 MHI debate since they are well above that marker. We need to ask ourselves, are their services more vital and valuable than ours?

So my bottom line to everything I am saying here is that we need to stop and think about just what are we saying when we throw the word "affordability" around. What is the true context of this narrative?

Julius Ciaccia Jr.

Chief Executive Officer

Northeast Ohio Regional Sewer District, Cleveland

<http://dx.doi.org/10.5942/jawwa.2015.107.0095>

MHI = median household income

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