

**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.)
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**AMENDMENT TO SETTLEMENT AGREEMENT
BETWEEN APPLE VALLEY RANCHOS WATER COMPANY
AND THE OFFICE OF RATEPAYER ADVOCATES**

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May 11, 2015

**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 \$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.

A.14-01-002
(Filed January 2, 2011)

**AMENDMENT TO SETTLEMENT AGREEMENT
BETWEEN APPLE VALLEY RANCHOS WATER COMPANY
AND THE OFFICE OF RATEPAYER ADVOCATES**

This Amendment to Settlement Agreement (“Amendment”) is entered into by and between Apple Valley Ranchos Water Company (“AVR”) and the Office of Ratepayer Advocates (“ORA”) of the California Public Utilities Commission (“Commission”). AVR and ORA are referred to jointly herein as the “Parties” or singularly as a “Party.” This Amendment amends Section 9.6 of the Settlement Agreement dated August 8, 2014 entered into by AVR and ORA (“Settlement Agreement”) and is premised on the background facts and procedural history noted below.¹

I. BACKGROUND FACTS AND PROCEDURAL HISTORY

A. AVR, a California corporation, is a Class A Public Utility Water Company regulated by the Commission providing regulated water service in and near the Town of Apple Valley in San Bernardino County, California. AVR is a wholly-owned subsidiary of Park Water Company (“Park”), a California Corporation. AVR’s office is located in Apple Valley, California. AVR has two “systems” – the Irrigation system and the Domestic system. The Irrigation System consists of a small gravity irrigation system that serves non-potable (untreated) water from an irrigation well with return flow to the Mojave River and has a single customer. All other customers are part of the Domestic system, which is a pressurized potable water system.

B. On January 2, 2014, AVR filed a General Rate Case (“GRC”) Application

^{1/} A copy of the original Settlement Agreement is attached hereto as Attachment A and is incorporated herein.

(“Application”) requesting authority to increase its rates by \$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. Concurrent with the filing of the Application, AVR supported its Application with prepared testimony and exhibits, its Revenue Requirements Report for Test Year 2015, its General Office Report for Test Year 2015, its Urban Water Management Report, and Minimum Data Requirements (“MDR”), all of which were served on January 2, 2014. ORA filed a timely protest to the application on February 10, 2014, and AVR filed a timely response.

C. On February 19, 2014, the Town of Apple Valley (the “Town”) filed a motion for party status, which was granted on February 20, 2014. A prehearing conference was held on April 1, 2014, by Administrative Law Judge (“ALJ”) S. Pat Tsen. In response to ALJ Tsen’s April 4, 2014 Ruling for Comments on the Division of Water and Audits Preliminary Report on AVR’s Water Quality, ORA served its comments on April 11, 2014. On April 17, 2014, the Commission issued the Scoping Memo and Ruling in this proceeding. Public Participation Hearings were held on April 30, 2014, at the Town of Apple Valley Conference Center in Apple Valley, California. On May 9, 2014, ORA served its Report on the Results of Operations, and on May 19, 2014, ORA served its Amended Report on the Results of Operations (“ORA Amended Report”).

D. The Parties engaged in informal settlement negotiations beginning on June 4, 2014. As a result of those negotiations, which continued through June 17, 2014, ORA and AVR reached a settlement on most of the issues raised in ORA’s Amended Report. While the Town participated in the settlement discussions, it is not a party to the settlement.

E. Evidentiary hearings on the unresolved issues were held on June 16 and 17, 2014. At the hearings, AVR’s, ORA’s, and the Town’s testimony and reports were marked as exhibits and entered into the record along with additional exhibits introduced at the hearings. Additionally, after the conclusion of the hearings, per the direction of ALJ Tsen, AVR submitted several late filed exhibits and both AVR and ORA filed motions to seal confidential versions of exhibits containing confidential information, which were granted by ALJ Tsen.

F. On July 21, 2014 and August 4, 2014, ORA, AVR, and the Town filed their Opening Briefs and Reply Briefs, respectively.

G. On August 8, 2014, the Parties filed their Joint Motion to Approve Settlement (“Joint Motion”) along with the Settlement Agreement and Joint Comparison Exhibit. On September 8, 2014, the Town filed its Comments to the Joint Motion. On September 22, 2014,

the Parties filed their Joint Reply Comments of Apple Valley Ranchos Company and the Office of the Ratepayer Advocates in Support of Joint Motion to Approve Settlement.

H. The Settlement Agreement included the following provisions, at Section 9.6, pages 52-53, relating to the resolution of the Main Replacement issue:

9.6 Main Replacement Program

AVR REQUEST:

AVR requests \$4,985,153 for main replacements in 2014, \$5,791,591 in 2015, and \$6,007,083 in 2016. AVR also requests \$200,000 per year in 2014, 2015, and 2016 for emergency main replacements. AVR's requested replacement of existing aged and undersize mains are based on the needs for transmission and maintaining a reliable water distribution system discussed in the Asset Management Study for Water Mains Report (KANEW analysis), AVR Exhibit A-21 and the Water Transmission Main Study, AVR Exhibit A-23. AVR's main replacement program also takes into consideration the need for improved fire flow capacity, improved fire hydrant spacing, improved water quality and work by others such as road construction.

ORA POSITION:

ORA disagrees with AVR's estimates of main replacements because the data provided by AVR does not substantiate such an aggressive main replacement program. ORA recommends \$1,689,314 in 2014, \$1,729,013 in 2015, and \$1,769,645 in 2016. ORA's estimates are based on a five-year average of recorded expenditures (2009 – 2013) escalated to the test year.

RESOLUTION:

As a result of further discussions, settlement negotiations, and review of AVR's rebuttal testimony, ORA and AVR agree to main replacement program in this GRC of \$4,985,153 in 2014, \$5,291,591 in 2015, and \$5,507,083 in 2016. This budget will allow AVR to replace the problematic steel mains which have a higher rate of leak than mains of other materials with the benefits of minimizing liability, property damage, customer complaints, and unaccounted for water; and will allow AVR to improve transmission capacity to minimize pumping costs, meet peak demands and provide adequate fire flow capacity.

Year 2014

	AVR Original	ORA Original	Difference	Settlement
Main Replacements	\$4,985,153	\$1,689,314	\$3,295,839	\$4,985,153

Test Year 2015

	AVR Original	ORA Original	Difference	Settlement
Main Replacements	\$5,791,591	\$1,729,013	\$4,062,578	\$5,291,591

Test Year 2016

	AVR Original	ORA Original	Difference	Settlement
Main Replacements	\$6,007,083	\$1,769,645	\$4,237,438	\$5,507,083

REFERENCES: AVR Exh. A-1, pp. 63-80, Exh. A-18, pp. 11-15, AVR Exh. A-21, AVR Exh. A-23; ORA Exh.O-1, pp. 8-30 – 8-40.

I. On January 8, 2015, ALJ Tsen issued an email ruling requiring AVR to submit additional information relating to AVR's main replacement projects. On January 15, 2015, AVR filed its Response to Administrative Law Judge's Ruling.

J. On April 1, 2015, ALJ issued her Proposed Decision ("PD"), in which ALJ Tsen decided the disputed/litigated issues and partially approved the Settlement Agreement. Specifically, the PD proposed to approve the Settlement Agreement with the exception of the Parties' resolution of the Mains Replacement Program, for which the PD proposed the following modified amounts: \$3,057,846 in 2014, \$3,129,705 in 2015, and \$3,203,253 in 2016.

K. On April 21, 2015 and April 27, 2015, the Parties filed their Comments to the PD and Reply Comments, respectively. On April 24, 2015, ALJ Tsen issued the Presiding Officer's Ruling Setting Evidentiary Hearings and Scheduling the Remainder of the Proceeding ("April 24 Ruling"). The April 24 Ruling provided, *inter alia*:

1. By May 1, 2015, the parties were to notify the Commission as to whether the parties would accept the PD's modification to the Settlement Agreement;
2. If the parties declined to accept the PD's modification to the Settlement

Agreement, by May 4, 2015, the parties were to file a Joint Case Management Statement updating the Commission on the settled and disputed issues in this proceeding and providing a list of witnesses;

3. Evidentiary hearings were scheduled for May 11-15, 2015; and
4. Opening Briefs and Reply Briefs were to be filed and served on May 29, 2015 and June 12, 2015, respectively.

L. On April 30, 2015, in response to a joint request by all parties, ALJ Tsen held a conference call to address the parties' questions regarding the April 24 Ruling. On May 1, 2015, ORA and AVR informed ALJ Tsen that they respectfully declined the modification of the Settlement Agreement proposed in the PD. On May 4, 2015, ORA, AVR, and the Town filed their Joint Case Management Statement informing the Commission that, *inter alia*:

1. ORA and AVR agreed to maintain the terms of the Settlement Agreement as to all issues other than the Mains Replacement Program;
2. ORA and AVR had reached agreement on a revised resolution on the Main Replacement Program;
3. The Town contested the revised resolution of the Mains Replacement Program; and
4. All parties waived evidentiary hearings and agreed to brief the Mains Replacement Program issue based on the existing record.

M. On May 5, 2015, ALJ Tsen issued the Presiding Officer's Ruling Setting a Reasonableness Hearing on the Proposed Amended Settlement Agreement Between Apple Valley Ranchos Water Company and the Office of Ratepayer Advocates.

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II. AMENDMENT TO SETTLEMENT AGREEMENT

A. Amendment. Based on the foregoing recital of the background facts and procedural history, the Parties: (1) affirm the continuing validity and applicability of all provisions of the Settlement Agreement, except Section 9.6 of the Settlement Agreement; and (2) agree to amend Section 9.6 of the Settlement Agreement (at pages 52-53) – Main Replacement Program – by adding the following provisions to the end of Section 9.6 in the Settlement Agreement (at page 53):

REVISED SETTLEMENT ON MAIN REPLACEMENTS

ORA and AVR (the “Parties”), while continuing to believe their original settlement to be reasonable, propose this alternate revised settlement on the issue of AVR’s Main Replacements to address the concerns in the Proposed Decision (“PD”) regarding rate impact and the balancing of competing interests.

The Parties do not believe that setting the capital expenditures for main replacements over the test period at the average of the 2012-2013 level – resulting in a decrease in expenditures (in real dollars) – is the appropriate balance between rate impact and the need to replace aging and undersized mains. The Parties believe that maintenance of infrastructure reliability requires some increase from actual expenditures in 2013 for AVR to make progress in reducing the leaks in its system in a timely manner. The Parties therefore propose that the Commission adopt capital expenditures for main replacements for this test period in the amounts of \$3,637,248 for 2014, \$4,095,036 for 2015, and \$4,610,396 for 2016.² The Parties estimate that this will allow for the replacement of approximately 3.45 miles, 3.79 miles, and 4.17 miles of pipelines in 2014-2016 respectively.³

Year	AVR Original	ORA Original	Original Settlement	Proposed Decision	Rev. Settlement	Rev. Settlement Approx. Miles
2014	\$4,985,153	\$1,689,314	\$4,985,153	\$3,057,846	\$3,637,248	3.45 miles
2015	\$5,791,591	\$1,729,013	\$5,291,591	\$3,129,705	\$4,095,036	3.79 miles
2016	\$6,007,083	\$1,769,645	\$5,507,083	\$3,203,253	\$4,610,396	4.17 miles

^{2/} Specific expenditures are not adopted for 2017 under the Rate Case Plan since the rate base for 2017 is determined by the attrition-year procedure.

^{3/} These estimates are derived by dividing the proposed expenditures for each of the estimated years by a cost per mile based on the normalized 5-year average (2009-2013) of historic main replacement cost per mile, normalized to that estimated year, using the Engineering News Record Construction Cost Index.

The Parties believe that this 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.

BASIS FOR REVISED SETTLEMENT

In agreeing to the foregoing revised settlement, the Parties reviewed and considered the full evidentiary record in this Proceeding, including the following facts and considerations:

A. Asset Management Study on Mains ("AM Study")

1. The issues initially noted in ORA's Report regarding the AM Study were addressed in AVR's Rebuttal Testimony:

a. The PD (page 15) references an erroneous statement from ORA's Report. ORA's testimony stated that it appeared that the AM Study used service lives for Plastic and Steel pipelines taken from the average figures for the Southern part of the United States from the AWWA Buried No Longer ("BNL") Report.⁴ The AM Study, however, states: "We used those values in the study conducted for AVRWC when data was not sufficient or non-conclusive (for DIP and PLASTIC). Otherwise EULs [Effective Useful Lives] were calculated using the history of leaks (leaks), replacement, and characteristics of the inventory."⁵ The service lives for Steel pipe used in the AM Study were based entirely on actual AVR data and the AWWA values were used only for Plastic and Ductile Iron pipe ("DIP").

b. The AM Study's use of the AWWA service life for the Southern area for Plastic and DIP was based on actual AVR data and actual AVR data best fit the AWWA values for the Southern area.⁶

c. As all of the DIP is of relatively recent vintage (average age of 8 years), the AM Study did not find a need to replace the DIP at this time

^{4/} Ex. O-1, at 8-32.

^{5/} Ex. A-21, at 14.

^{6/} Ex. A-18, at 13-14.

and AVR is not planning to do so.⁷ With the exception of projects required by the Town for street repair (*see* Other Needs below), all of the projects proposed by AVR in this Proceeding are to replace steel pipe.⁸ Therefore, any uncertainty that may be caused by use of the AWWA service life value for Plastic and DIP is essentially moot for the purpose of this Proceeding.

d. ORA's concern that the AM Study inflated leak rates by including leaks not associated with any pipelines⁹ was addressed in AVR's Rebuttal. The AM Study included only pipeline and leak data that had absolutely no anomalies and had a positive correlation between the leak and the pipe. The AM Study included data for leaks that were not positively connected to a specific pipe and the AM Study assigned these leaks to a pipe category based on the actual distribution of leaks that were positively connected to a pipe. The expert consultant assured AVR this was the appropriate methodology.¹⁰

2. 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 2043.¹¹ This recommendation is based on balancing cost considerations against the goal of reducing the leak rate to an industry standard leak rate goal. The recommendation does not achieve that leak rate goal, but brings the system leak rate to about twice the goal leak rate by 2043. 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.

3. The PD's modification to the settlement provides for main replacements at less than 3 miles per year, assuming a cost per mile based on a normalized 5-year average of historic main replacement cost (2009-2013), normalized to estimated

⁷/ Ex. A-21, at 6.

⁸/ Ex. A-1, at 64, 68-79.

⁹/ Ex. O-1, at 8-33.

¹⁰/ Ex. A-18, at 14.

¹¹/ Ex. A-21, at 7.

years using the Engineering News Record Construction Cost Index.

4. 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 will not result in sufficient reduction in leaks.¹²

5. The AM Study determines an effective useful life for the Steel6 category of pipe of 50 years, finds that it is at the end of its useful life, and recommends that it be replaced within the next five years. As AVR's system has approximately 20 miles of Steel6 pipe, the Steel6 pipe category alone would require almost 4 miles of replacement per year.¹³

6. AVR's system has 108 miles of Steel5 category pipe, with an average age of 47 years (as of the date of the AM Study) but with portions up to 70 years old. Segments of pipe in this category were found to demonstrably leak at age 45, with the worst leaking in the group installed prior to 1962. The AM Study determined an effective useful life of 80 years for this category of pipe.¹⁴ This 108 miles of Steel5 pipe should be replaced over the next 30-40 years and a significant backlog will build up if AVR does not start replacing the worst of this pipe category.

7. 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%, effectively assuming a life of 200 years.¹⁵ It is also noted that, 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 1988.¹⁶

B. Other Requirements

1. 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

^{12/} Ex. A-21, at 5.

^{13/} Ex. A-21, at 4, 7, 33.

^{14/} Ex. A-21, at 28.

^{15/} Ex. O-1, at 8-34.

^{16/} Ex. A-21, at 10.

furtherance of AVR's main replacement program.¹⁷

a. AVR must replace plastic pipe due to a Town storm drain and street reconstruction project (Yucca Loma Road – Storm Drain Conflicts) estimated at \$263,167; and

b. AVR must replace steel pipe that is not the oldest steel pipe (installed in 1969), 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.

2. Transmission Capacity. ORA's Report contended that the need for additional transmission capacity was due to growth and that reduced demand should mitigate the need for additional transmission capacity.¹⁸ As AVR explained in its Rebuttal, 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.

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.¹⁹

3. Balancing: As explained in its Rebuttal, AVR needs to incorporate and balance these other requirements 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

^{17/} Ex. A-1, at 74-75.

^{18/} Ex. O-1, at 8-36 to 8-38.

^{19/} Ex. A-18, at 15.

capacity and fire flow capacity in a cost-effective manner.²⁰

C. Further Terms And Conditions Of The Amendment

1. Rule 12.1(d). Rule 12.1(d) requires that a settlement be “reasonable in light of the whole record, consistent with the law, and in the public interest.” The Settlement between the Parties in this proceeding – as modified by this Amendment (“Amended Settlement”) – satisfies the criteria in Rule 12.1(d). The Commission should approve, and adopt this Amended Settlement, which is supported by ORA and AVR.

2. The Amended Settlement is Reasonable. The Amended Settlement, taken as a whole, provides a reasonable resolution of the issues settled in this Proceeding. The reasonableness of the Amended Settlement is supported by ORA’s reports and testimony, and by the testimony, reports, and rebuttal testimony of AVR. In addition, the Parties considered the affordability of the rates, letters to the Commission, the financial health of AVR and the Commission’s Water Action Plan. The Parties fully reached a reasonable compromise on the various issues that were in contention. The settlement negotiations were accomplished at arm’s length over the course of numerous weeks.

3. The Amended Settlement is Lawful. The Parties are aware of no statutory provisions or prior Commission decision that would be contravened or compromised by the Amended Settlement. The issues resolved in the Amended Settlement are clearly within the scope of the proceeding. Moreover, the Amended Settlement, if adopted, would result in just and reasonable rates to AVR’s customers.

4. The Amended Settlement Serves the Public Interest. The Amended Settlement is in the public interest. The Commission has explained that a settlement which “commands broad support among participants fairly reflective of the affected interest” and “does not contain terms which contravene statutory provisions or prior Commission decisions” well serves the public interest. *Re San Diego Gas & Elec.*, D.92-12-019, 46 CPUC 2d at 552. In this proceeding, the

^{20/} Ex. A-18, at 15.

Parties fairly represent the affected parties' interests. AVR provides water service to the customers in its service territory in San Bernardino County, and ORA is statutorily mandated with representing ratepayers in California, including those ratepayers not directly at issue in this proceeding.

The principal public interest affected in this proceeding is the delivery of safe, reliable water service at reasonable rates. The Amended Settlement advances these interests. In addition, Commission approval of the Amended Settlement will provide speedy resolution of contested issues, which will conserve Commission resources.

5. The Amended Settlement Conveys Sufficient Information. The Parties believe that the Amended Settlement conveys sufficient information for the Commission to discharge its future regulatory obligations. Thus, taken as a whole, the Amended Settlement will satisfy the Commission's standards for approving a settlement presented to it.

III. CONCLUSION

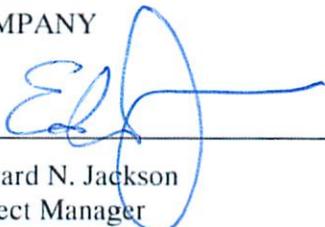
The Parties mutually believe that, based on the terms and conditions set forth above, the Amended Settlement is reasonable, consistent with the law, and in the public interest.

OFFICE OF RATEPAYER ADVOCATES

By:  For Joseph P. Como
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Dated: May 11, 2015

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Dated: May 11, 2015