Decision 09-06-036 June 18, 2009

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for Authority to Increase the Annual Charge for Water Supplied to California Water Service Company from the Miocene Canal, (U39M)	Application 07-04-022 (Filed April 27, 2007)

DECISION GRANTING JOINT MOTION TO APPROVE SECOND AMENDMENT TO CONTRACT AND SUPPLEMENTAL AGREEMENT FOR WATER SUPPLIED FROM THE MIOCENE CANAL

In this decision, we approve an agreement recently entered into between Pacific Gas and Electric Company (PG&E) and the California Water Service Company (CWS). The agreement would amend a long-standing contractual arrangement under which PG&E delivers water from its Miocene Canal in Butte County to the Powers Canal owned by CWS, which in turn uses the water to provide service to CWS's water customers in the City of Oroville. By approving the amendment – which is attached to this decision as Appendix A, and which is the second formal amendment to a water delivery agreement that dates back to 1927 – we bring to a close a dispute between PG&E and CWS that has lasted for more than a decade.

1. Background

As we explained in Decision (D.) 08-09-004, which approved the First Amendment to the water delivery agreement between PG&E and CWS,

PG&E has been supplying CWS with water from the Miocene Canal since the parties entered into their first contract in 1927. However, the price for that water had not changed from 1954 (when the Commission approved a 1953 Supplemental Agreement negotiated by the two companies)[1] until 2008, when the First Amendment to the 1927 contract and 1953 Supplemental Agreement was approved in D.08-09-004. Under the First Amendment, PG&E and CWS agreed that for a period of one year, the annual price for the water supplied by PG&E would increase from $32,400 – the price established in 1953 – to $152,400. PG&E and CWS also agreed that during the one-year period, PG&E would finance an engineering study to determine whether sales of surplus water from the Powers Canal, the CWS facility into which PG&E's water is delivered, would be sufficient to finance repairs to the Coal Canyon penstock.

The Coal Canyon penstock is owned by PG&E, and in addition to generating hydroelectric power, it had once been the point at which PG&E delivered the Miocene Canal water to CWS. However, the penstock has been out of service since a rupture in 2002. PG&E and CWS hoped that in addition to demonstrating the feasibility of paying for the penstock repairs through sales of surplus water, the engineering study would indicate whether sales of surplus water could also help defray the costs of maintaining the Miocene Canal.

2. Terms of the Proposed Second Amendment

The first phase of the engineering study contemplated by the First Amendment has now been completed. Although the results of this study were not as definitive as PG&E and CWS had hoped, they give reason to believe

[1] The 1953 Supplemental Agreement was approved in D.50839, 53 CPUC 666 (1954).

that significant revenues can be raised from sales of surplus water that is now being wasted. Based on the possibility that revenues can be raised from sales or transfers of this surplus water – which the Second Amendment refers to as Conservation Water – PG&E has agreed to bear the expense of repairing and restoring to operation the Coal Canyon penstock. For its part, CWS has agreed to pay the costs of repairing the Powers Canal (which is nine miles long), and to take reasonable steps to ensure that the amount of Conservation Water along the entire length of the Powers Canal can be determined. All of the repairs are to be completed by December 31, 2010, subject to a mutually agreed-upon extension of time.

PG&E and CWS have also agreed upon a formula for splitting the proceeds from any sales or transfers of Conservation Water. Under the formula set forth in the Second Amendment, PG&E would receive 70% of the first $100,000 obtained each year from sales or transfers of such water, and CWS would receive 30%. To the extent Conservation Water revenues in a particular year exceeded $100,000, PG&E and CWS would split the revenues over $100,000 evenly.

The parties have also agreed that the new base price for the water PG&E delivers to CWS should be the same price provided for in the First Amendment approved in 2008; *viz.*, $152,400 per year. In order to avoid the necessity of returning to the Commission for further price adjustments, the parties have also agreed that the $152,400 price – which the Second Amendment refers to as the First Amendment Price – shall be adjusted on March 31 of each year using the All Items Consumer Price Index for All Urban Consumers U.S. Macro – 30 Year Baseline, which is commonly known as the CPI-U index. The CPI-U index is published regularly by the United States Bureau of Labor Statistics.

As far as rate treatment is concerned, the March 20, 2009 joint motion for approval of the Second Amendment requests a Commission determination that "amounts paid under the Second Amendment are appropriately passed to [CWS's] Oroville customers through the Oroville Purchased Water Balancing Account, and appropriately reflected in PG&E's customer rates, net of amounts assumed in PG&E's 2007 General Rate Case ('GRC'), through its Utility Generating Balancing Account ('UGBA')." (Joint Motion, pp. 1-2; footnote omitted.)

As explained below, we conclude that the settlement terms in the Second Amendment – which is Attachment A to the parties' March 20, 2009 joint motion – satisfy the requirements for settlements set forth in Rule 12.1(d) of our Rules of Practice and Procedure (Rules). Accordingly, we will approve the Second Amendment.

3. Procedural Background

As explained in D.08-09-004, PG&E's application in this matter was originally filed in early 2007. In the application, PG&E argued that its customers were suffering serious inequities as a result of the fixed price being paid by CWS for water supplied from the Miocene Canal. PG&E noted that while the $32,400 annual charge for water that had been approved in 1954 "has not changed in over fifty years, PG&E's costs of owning and operating the Miocene Canal System have increased significantly over this period." (Application, p. 2.) As a result, PG&E sought the following relief:

- An increase in the annual commodity charge for the water delivered by PG&E from $24,000 to $212,000, allegedly to reflect not only increases in the cost of water, but also in Administrative and General (A&G) and Operations and Maintenance (O&M) expense;

- An increase in the percentage of Miocene Canal capital costs borne by CWS from the 10% approved in 1954 to 50% for 2007 (for a total of $458,000);

- An order directing CWS to pay an advance in aid of construction of $914,000, 50% of the estimated costs of repairing the Coal Canyon penstock; and

- Commission approval of a formula for updating the water charge annually, without the need for subsequent applications.

On May 31, 2007, CWS filed a protest to the application. In its protest, CWS made the following arguments:

- If the Commission adopted PG&E's proposals, they would result in an unjustified shift of costs from PG&E's five million ratepayers to the ratepayers in CWS's Oroville district, who number only about 3,600;

- It would be unreasonable to require the Oroville district ratepayers to pay 50% of the A&G, O&M, and tax and depreciation expense for the Miocene Canal system, since these ratepayers benefit only from a portion of the O&M costs incurred to operate the Miocene system;

- The requested relief should be denied because PG&E was in breach of its contractual obligation to deliver water at the Coal Canyon penstock, and had refused to negotiate in good faith on this issue; and

- CWS should not be required to pay half of the capital costs of repairing the penstock, because this facility "is uniquely required to produce power, not to deliver water."

A prehearing conference (PHC) was held on October 5, 2007. At the PHC, the assigned Administrative Law Judge (ALJ) noted that CWS had suggested

that the parties might benefit from mediation of their dispute, and he urged PG&E to consider mediation as an alternative to litigation. On October 9, 2007, PG&E informed the ALJ and CWS that it was willing to engage in a mediation if the process could begin promptly. ALJ John Thorson was promptly assigned to the proceeding as a mediator.

ALJ Thorson held mediated discussions with the parties on December 5, 2007 and January 16 and February 20, 2008. As a result of these sessions, PG&E and CWS agreed upon the terms of the First Amendment, which was filed along with a joint motion seeking its approval on April 23, 2008. In D.08-09-004, the Commission approved the First Amendment without condition, and set October 23, 2009, as the resolution date for this proceeding.

During the Fall of 2008, the engineering study that the parties had agreed upon was undertaken. In a series of e-mails, PG&E and CWS informed the ALJ that the initial results of the study conducted by MBK Engineers had been presented to them in early November. Both parties had questions based on these initial results, which necessitated clarification and further research by the engineers. In mid-December 2008, the parties reported the following to the ALJ:

> "The MBK report indicates that a substantial amount of water is lost from the system during transit into and within the Powers Canal . . . The losses are due to a combination of factors, including leakage. Losses in excess of delivery commitments along the Powers canal are in the neighborhood of 7000 acre-feet per year.
>
> "The parties understand that if the losses can be remedied, then the water so saved should be a resource marketable locally or through the State Water Project system.
>
> "The next steps in the process are to estimate the cost of improvements to the Powers canal that would be needed to

> limit the transportation losses and determine whether a buyer can be found to take the available water. [CWS] will undertake during the month of January to prepare an estimate of repair costs to minimize leakage from the [Powers] canal."

In the same e-mail message, the parties proposed a schedule under which January 30, 2009 was set as the date for CWS's completion of its repair estimates, February 20 was established as the date for completing negotiations with prospective third-party water purchasers to the point where "PG&E and CWS feel they have sufficient information to attempt finally to resolve their pricing dispute," and March 13, 2009 was set as the date for presenting a new rate and/or revenue allocation scheme to the Commission. The ALJ accepted this schedule.

On February 23, 2008, counsel for CWS sent the ALJ an e-mail in which he stated that "our clients have reached an agreement in principle for a settlement of this application. The settlement in principle includes an annual adjustment that we hope will avoid any need to bring this issue to the Commission again." Counsel also proposed to file a motion for approval of the settlement on March 20, 2009. After a further exchange of e-mails, it was agreed that any necessary hearing on the proposed settlement would be held on April 8, 2009.

A joint motion for approval of the Second Amendment was filed by PG&E and CWS on March 20, 2009. On March 27, 2009, the ALJ sent the parties an e-mail setting forth questions he wanted them to address at the April 8 hearing. These questions concerned what the costs of repairing the Powers Canal would be, how CWS and PG&E proposed to account for the capital costs of repairing their respective canals, the basis of the formula for splitting the proceeds from sales of Conservation Water, and how much volatility in the water prices for Oroville customers could be expected from use of the CPI-U index.

4. The April 8, 2009 Hearing

Much of the testimony at the April 8, 2009 hearing concerned the ratemaking treatment for both CWS and PG&E that would flow from implementation of the Second Amendment, which is itself silent on ratemaking issues. The parties' March 20 joint motion for approval of the Second Amendment also did not shed much light on these issues, saying little more than that CWS and PG&E sought a determination from the Commission that "amounts paid under the Second Amendment are appropriately passed to [CWS's] Oroville customers through the Oroville Purchased Water Balancing Account, and appropriately reflected in PG&E's customer rates, net of amounts assumed in PG&E's 2007 General Rate Case" through its UGBA. (Joint Motion, pp. 1-2; footnote omitted.)[2]

The first of the ALJ's questions addressed at the hearing concerned the repair costs for the Powers Canal. In his e-mail, the ALJ had noted that while the application contained an estimate of repair costs for the Miocene Canal ($1.827 million), the record was silent about the repair costs for the Powers Canal. In response, CWS's witness, Thomas Smegal, presented a repair estimate for the Powers Canal of $1,060,050. (Ex. 1.) He noted that this was a "rough engineering estimate" of repair costs and represented the opinion of CWS's

---

[2] The only other reference to ratemaking in the March 20, 2009 joint motion for approval is the following statement on page 8:

> "In general, increases or decreases in the cost of water bought by [CWS] under the Second Amendment will be passed through to its Oroville District customers through the Oroville Purchased Water Balancing Account, and revenues received from [CWS] and possibly others for purchased water under the Second Amendment will be reflected in reduced rates to PG&E's customers through the UGBA."

licensed engineer, but it had not been reviewed by anyone else. (Tr. at 9, 18-19.) Smegal also pointed out that $850,000 of the estimate represented the cost of repairing two flumes,[3] that these flumes "are a part of the structure of the canal system," and that their eventual repair would be necessary even in the absence of a settlement with PG&E "in order to continue to operate the system." (*Id.* at 9-10.) Smegal also noted that repair costs for one of the flumes had been in CWS's capital budgets since 2003. (*Id*. at 19-20.)[4] However, it was not until recently that CWS decided that continuing to take water from PG&E pursuant to the proposed settlement represented the least costly water supply option for the Oroville District, and thus that the repairs should now be undertaken. (*Id.* at 21.)[5]

---

[3] Webster's Third International Dictionary (1961) defines a flume as "an inclined channel for conveying water usu[ally] from a distance for various uses (as power production, transportation, or irrigation)." Wikipedia's more recent definition reads as follows:

> "A flume is an open artificial water channel, in the form of a gravity chute, that leads water from a diversion dam or weir completely aside a natural flow. Often, the flume is an elevated box structure (typically wood) that follows the natural contours of the land."

[4] Funds for one of the two flumes at issue, Flume F, had also been included in CWS's 2006 rate case for the Oroville District. CWS's dispute with the Division of Ratepayer Advocates over these funds was part of the settlement approved in D.07-12-055 and is discussed at page 18 of that decision.

[5] Smegal also pointed out that if CWS had chosen to pursue another source of water for the Oroville District besides PG&E, the estimated cost of abandoning the Powers Canal would have been about $2.3 million, without taking into consideration the cost of dismantling the flumes. (*Id.* at 10; note to Ex. 2.)

Smegal's testimony also made clear that CWS was proposing to account only for water acquisition and sale costs through the Oroville Purchased Water Balancing Account (now known as the Modified Cost Balancing Account, or MCBA),[6] and that the costs of repairing the Powers Canal would be handled in the usual manner through capital accounts as additions to ratebase:

> "What I would say is that these [Powers Canal] capital costs would follow the normal course of the rate proceedings that we have with the Commission.

---

[6] Although balancing accounts for the Oroville District for purchased water, purchased power, and pump taxes had been phased out in the late 1990s pursuant to a settlement approved in D.98-07-090 (81 CPUC2d 200, 326-328), such balancing accounts were reauthorized in 2004 pursuant to the discussion at pp. 23-24 and Ordering Paragraph 9 of D.04-04-041. (*See also* Attachment A, ¶ 5.2 of D.04-04-041.)

The MCBA, which is the current version of this balancing account, was established pursuant to CWS Advice Letter (AL) 1863-A, which was filed on August 12, 2008 pursuant to D.08-02-036. (Tr. at 11-14.) A complete copy of AL 1863-A was admitted into the record as Exhibit 2 at the April 8 hearing.

D.08-02-036 approved a settlement between the Division of Ratepayer Advocates (DRA), The Utility Reform Network, and CWS establishing the MCBA in conjunction with the Water Revenue Adjustment Mechanism (WRAM) that has been in place for CWS since 1996. D.08-02-036 states (at pages 25-26) that the purpose of the WRAM and MCBA "are to sever the relationship between sales and revenue and to remove the disincentive to implement conservation rates and conservation programs, to ensure cost savings are passed on to ratepayers, and to reduce overall water consumption." The decision also notes that the MCBA "will replace existing cost balancing accounts for purchased water, purchased power, and pump tax." (*Id.* at 26.)

In his testimony at the April 8 hearing, Smegal emphasized that any revenues received by CWS from sales or transfers of Conservation Water will be treated as an offset to purchased water costs under the MCBA. (Tr. at 11.)

> "[CWS] has a general rate case filing where all its districts will be made on July 1st of this year, and it will include the Oroville district and include these costs as capital items to be included in rate base along with other capital costs that we are planning to construct facilities. And the Division of Ratepayer Advocates is an active participant in [CWS's] rate proceedings, and certainly they will review these costs both for reasonableness of the cost estimate and the necessity of doing improvement as part of the normal cost-based rate making that we have." (*Id.* at 19.)

Smegal also pointed out that it is an open question how much revenue CWS and PG&E can expect from sales or transfers of Conservation Water. This is because the current situation on the Powers Canal makes it difficult to determine the amount of water that is available for sale or transfer:

> "One of the major conclusions of the first MBK report was that it was extremely difficult to determine the amount of water leaving the system . . . at various points along the [Powers Canal] because two of the measuring devices that [CWS] was using were not . . . necessarily accurate and . . . and it was over a nine-mile stretch. We essentially had only three data points, and two of them – one was suspicious and one didn't register, so it was very difficult to determine where the problem was.
>
> "The second part of [the problem], which I think PG&E recognizes, is that the first stretch of the Powers Canal is not in water. It's dewatered right now due to the penstock outage. And the difficulty there is it's obviously very difficult to determine what water might leave the canal system in what way when there's no water in the canal.
>
> "And so . . . there is a joint effort involved in PG&E reintroducing water to the top of the canal and [CWS] measuring that water at various points to determine where

> and in what amounts that water is leaving the canal."
> (*Id.* at 23.)

Thus, the 7000 acre feet of water per year referred to in the e-mail from CWS's counsel referred not to the amount of water that is now being wasted, but to the difference between PG&E's measured deliveries at the top of the Powers Canal and what CWS's "Oroville Treatment Plant metered at the end of the Powers Canal." (*Id.* at 24.) A second engineering study that determines not only how much water is leaving the system, but also at what points, will be necessary before the amount of Conservation Water available for sale or transfer can be determined. (*Id.* at 29.)[7]

As to the 70-30 split the parties agreed upon for dividing the first $100,000 in revenue from sales or transfers of Conservation Water, it was based partly on capital costs and partly on PG&E's operating costs. PG&E's witness, Joseph O'Flanagan, explained the matter as follows:

---

[7] When asked about the possible causes of water loss along the Powers Canal, and why a second engineering study was needed to determine them, Smegal explained:

> "[T]here are customers on that canal who are using water for irrigation or for stock watering and that sort of thing, and it may be in part going to them. And it may be seeping to the ground. It may be going into rivers and streams along the course. We . . . just didn't know where the water is leaving the system. And it is important to know where it's leaving the system because that will help determine what the benefit is as far as water that could be used in another place.
>
> "[Further,] if the water's leaving the system and going directly back into the Sacramento River, it is essentially of no value from a legal standpoint because the State Water Project which controls the Sacramento River . . . they are getting it already. Why would they let us sell it again [?]"
> (*Id.* at 25.)

> "Our original intent in asking for that split, we had asked for a hundred percent up to the first . . . hundred thousand dollars . . . was to get up to 50 percent of our estimated cost of maintaining the Live Saddle Coal Canyon water conveyances that we had estimated at $250,000.
>
> "So given the revenues we had under the [F]irst [A]mendment [i.e., $152,400] plus the hundred thousand dollars, that would be equal to 50 percent of our cost of basically delivering water to the [P]owers [C]anal . . . And then we negotiated down from that." (*Id.* at 28-29.)

The final point discussed at the hearing was the CPI-U index. In his March 27, 2009 e-mail message, the ALJ had asked how much this index had increased for each of the last 10 years. PG&E provided this data in Exhibit 3, which shows that annual increases in the CPI-U index between 1999 to 2008 ranged from 1.6% in 2002 to 3.8% in 2008. O'Flanagan noted, however, that these increases were less than those for the hydro O&M index that PG&E had originally proposed. (*Id.* at 31.)

5. Discussion

We have decided to approve the settlement set forth in the Second Amendment because we believe that (1) it satisfies our criteria for approving settlements, (2) it equitably balances the interests of PG&E's customers against those of CWS ratepayers in the Oroville District, and (3) it appears to be a permanent solution to the pricing issues over which PG&E and CWS have been fighting for more than a decade.

In their March 20, 2009 joint motion, PG&E and CWS argue that the Second Amendment is reasonable and should be approved because, among other reasons, it conforms to our rules concerning settlements. The

Commission's fundamental standard for evaluating settlements is set forth in Rule 12.1(d), which provides in full:

> "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."

We have no difficulty in concluding that the Second Amendment satisfies the first part of this test; *i.e.,* is reasonable in light of the whole record. As the discussion above demonstrates, CWS has now concluded that the most cost-effective option for obtaining the water needed to serve its Oroville customers is to continue to accept water deliveries from PG&E's Miocene Canal system. In light of this decision, each party has agreed to make a substantial investment to upgrade its system, PG&E by repairing the Coal Canyon penstock, and CWS by repairing and minimizing water losses along the Powers Canal. Although the precise amount of surplus water the parties will have for sale or transfer remains uncertain, CWS and PG&E have agreed to split the first $100,000 of revenue they receive each year from sales or transfers of Conservation Water by dividing these revenues roughly in proportion to the capital investments necessary to repair their respective systems.[8] CWS will also continue to pay PG&E the so-called First Amendment price for water; *i.e.,* the $152,400 price that is approximately equal to the price that would result from

[8] Further, as noted in the text, the revenues from sales or transfers of Conservation Water will be flowed through to the two companies' ratepayers. In CWS's case, that will occur through the MCBA, and in PG&E's case, through UGBA.

updating the factors used in the parties' 1953 Supplemental Agreement.[9] Finally, to ensure that future relief will not be needed from the Commission, the parties have agreed to an annual update of the First Amendment price using the CPI-U index.

These provisions clearly represent a careful balancing of the interests of the ratepayers of both PG&E and CWS, and when taken as a whole, we find them to be reasonable and amply supported by the record.

We also believe that the second prong of Rule 12.1(d)'s test for approving settlements is met here. As the March 20 joint motion for approval states, "[t]he parties are aware of no statutory provision or prior Commission decision that would be contravened or compromised by the Second Amendment. The issues resolved in the Second Amendment are within the scope of the proceeding." (Joint Motion, p. 7.) We agree with these assertions.

Finally, we agree with PG&E and CWS that the terms of the Second Amendment will serve the public interest, the third factor in Rule 12.1(d). In addition to noting that approval of the settlement will save the Commission and

---

[9] As we pointed out on page 6 of D.08-09-004, CWS's May 31, 2007 protest had stated that an update of the pricing factors used in the 1953 Supplemental Agreement would result in a price for Miocene Canal water of approximately $150,000:

> "While no capital cost charge is justified, if the Commission were to apply the formula used in 1953, and accepting arguendo the numbers supplied by PG&E in it application at Table 3-4, the 'demand charge' would be limited to 10% of the 'depreciation expense' in Table 3-4, or $26,300 annually. No taxes, franchise fees, or return were included in the 1953 calculation. The annual commodity charge would be 50% of the actual O&M for the project, excluding A&G expense. That would be $125,000. So the total annual fee would be no more than $150,000 under the 1953 formula." (Protest, p. 5.)

the parties the time, expense, and uncertainty of litigation, the joint motion argues that the public interest will be served in the following ways:

> "[B]oth active parties with an interest in the settled issues, PG&E and [CWS], formulated the Second Amendment after extensive negotiations, including disclosures made through a voluntary mediation process, discovery and investigations into the conditions of the Miocene Canal. The negotiations were accomplished at arm's length over the course of several months. Together these parties fairly represent the affected interests.[10]
>
> "The interests at stake in the proceeding are primarily those of the customers of the respective companies. In general, increases or decreases in the cost of water bought by [CWS] under the Second Amendment will be passed through to its Oroville District customers through the Oroville Purchased Water Balancing Account, and revenues received from [CWS] and possibly others for purchased water under the Second Amendment will be reflected in reduced rates to PG&E's customers through the UGBA.
>
> "There is also a broader public interest in the renewable energy produced by the Coal Canyon power house. The Second Amendment advances this public interest because, with the repair of the Coal Canyon penstock, it will make it possible to restart an otherwise uneconomic hydroelectric plant that is an important renewable energy resource." (*Id.* at 7-8.)

We agree that approving the settlement before us will serve the public interest. It seems clear from the course of this proceeding that CWS and PG&E

[10] The joint motion also notes that the DRA elected not to intervene in this proceeding, presumably because "it concluded that [CWS] and PG&E were effectively representing the interests of their respective customers." (*Id.* at 8.)

have effectively represented the interests of their customers, who will benefit directly from implementation of the Second Amendment and from any revenues from Conservation Water that the two companies receive as a result of the settlement. It is also apparent that this has been a vigorous negotiation, with both sides engaging in give-and-take in order to reach the settlement before us. Accordingly, we conclude that the Second Amendment satisfies the tests for approving settlements set forth in Rules 12.1(d), and we will approve it.[11]

6. Waiver of Comments

Because the parties are treating the Second Amendment as a final settlement of this proceeding and we are approving it without condition, we will

---

[11] In addition to arguing that the Second Amendment meets the standards for settlements set forth in Rule 12.1(d), CWS and PG&E argue that it also meets the tests for approving an all-party settlement. These tests, which were originally set forth in D.92-12-019 (46 CPUC2d 538, 550-551), are as follows:

1. The settlement agreement commands the unanimous sponsorship of all active parties to the proceeding;

2. The sponsoring parties are fairly reflective of the affected interests;

3. No term of the settlement contravenes statutory provisions or prior Commission decisions; and

4. The settlement conveys to the Commission sufficient information to permit it to discharge its future regulatory obligations with respect to the parties and their interests.

As the discussion in the text makes clear, the first three of the all-party settlement tests are met in this case. As to the fourth, we agree with the joint motion that it is also satisfied "because the inclusion of a price adjustment clause will minimize the potential for disputes between the parties regarding pricing under the contract." (*Id.* at 7.)

treat this case as an uncontested matter that grants the relief requested. Accordingly, we are waiving the otherwise-applicable comment period for this proposed decision pursuant to Rule 14.6(c)(2).

7. Assignment of Proceeding

Timothy Alan Simon is the assigned Commissioner for this proceeding, and A. Kirk McKenzie is the assigned ALJ.

Findings of Fact

1. Under the contract that PG&E entered into with CWS in 1927, PG&E agreed to deliver water without charge to CWS via the Miocene Canal for 25 years, in consideration of CWS's assumption of PG&E's obligation to serve the residents and other water customers in the City of Oroville.

2. Under Paragraph 7 of the 1927 contract between PG&E and CWS, the deliveries of water by PG&E to CWS after May 1952 were to be made at such price "as may from time to time be established therefor" by the Commission.

3. Under the Supplemental Agreement that PG&E and CWS entered into in 1953, which agreement was approved by the Commission in 1954 in D.50839, the price for the water delivered by PG&E to CWS via the Miocene Canal was set at $32,400 per year, with no provision for escalation.

4. PG&E contends in its application that the costs of delivering water to CWS via the Miocene Canal have increased so much since 1954 that an annual price for the water of $670,000 is now justified.

5. In its protest, CWS contends that the new water price sought by PG&E would inequitably shift costs from PG&E's approximately five million ratepayers to the customers in CWS's Oroville District, who number approximately 3,600.

6. On April 23, 2008, following a mediation process the parties had agreed to at the October 2007 PHC, PG&E and CWS submitted for Commission approval a

proposed First Amendment to their 1927 contract and 1953 Supplemental Agreement.

7. Under the terms of the First Amendment, CWS agreed to pay PG&E, for the period from April 1, 2008 to March 31, 2009, an annual charge of $152,400 for deliveries of water from the Miocene Canal.

8. The First Amendment also provided that once its terms went into effect, PG&E would pay for an engineering study of water flows through CWS's Powers Canal, the object of the study being to determine whether sales of surplus water could help finance repair of the Coal Canyon penstock and contribute to the maintenance costs associated with the Miocene Canal.

9. The First Amendment also provided that after receipt and evaluation of the engineering study, either PG&E or CWS could choose to terminate the First Amendment and cease further negotiations, in which case the price for the water delivered by PG&E to CWS would revert to the $32,400 annual price set forth in the 1953 Supplemental Agreement.

10. The Commission approved the First Amendment in D.08-09-004.

11. The engineering study called for by the First Amendment was performed in the Fall of 2008.

12. Based on the engineering study, it appears that the difference between the amount of water delivered by PG&E to CWS and the amount of water metered at the Oroville Treatment Plant at the end of the Powers Canal is approximately 7000 acre feet per year.

13. Although further engineering studies will be necessary to determine the exact amount, it appears that some portion of the 7000 acre feet of water per year that leaves the system along the Powers Canal will be available for sale or

transfer to third parties. Such water available for sale or transfer is referred to in the Second Amendment as Conservation Water.

14. On March 20, 2009, PG&E and CWS submitted a joint motion for approval of the Second Amendment.

15. If approved, the Second Amendment would represent a complete settlement of the issues raised by the instant application.

16. Among other things, the Second Amendment provides that PG&E will assume the costs of repairing the Coal Canyon penstock, and that CWS will assume the costs of repairing the Powers Canal.

17. In addition to repairing the Powers Canal, CWS agrees under the Second Amendment to take reasonable steps to ensure that the amount of Conservation Water available along the entire length of the Powers Canal can be determined.

18. Under the Second Amendment, the repairs of the Coal Canyon penstock and the Powers Canal are to be completed by December 31, 2010, unless CWS and PG&E mutually agree upon an extension of time.

19. The Second Amendment provides that revenues from sales or transfers of Conservation Water up to $100,000 per year will be split in the ratio of 70% to PG&E and 30% to CWS, and that revenues from such sales or transfers in excess of $100,000 per year will be split equally between the two companies.

20. The Second Amendment provides that beginning on April 1, 2009, CWS shall pay to PG&E the First Amendment price of $152,400 per year for the water that PG&E delivers to CWS from the Miocene Canal.

21. The Second Amendment provides that on March 31, 2010, and thereafter on March 31 of each year or the first business day of such year after March 31,

the First Amendment price, including any prior price adjustments, shall be adjusted upward or downward by the annual change in the CPI-U index.

22. In the joint motion for approval of the Second Amendment, the parties request that CWS be authorized to recover the costs of Miocene Canal water that CWS purchases from PG&E through the Oroville Purchased Water Balancing Account (now known as the MCBA), and that revenues received by CWS from sales or transfers of Conservation Water be treated as an offset to this balancing account.

23. In the joint motion for approval of the Second Amendment, the parties request that PG&E be authorized to book revenues received from CWS for Miocene Canal water, as well as revenues received from sales or transfers of Conservation Water, to UGBA.

24. CWS intends to include the repair costs for the Powers Canal as part of the proposed capital additions for the Oroville District in CWS's next GRC, which is scheduled to be filed on July 1, 2009.

25. PG&E intends to include the repair costs for the Coal Canyon penstock as part of the proposed capital additions to its system in PG&E's next GRC, which is scheduled to be filed in 2011.

Conclusions of Law

1. The proposed settlement set forth in the Second Amendment is reasonable in light of the whole record.

2. The proposed settlement set forth in the Second Amendment is consistent with law.

3. The proposed settlement set forth in the Second Amendment is consistent with the public interest.

4. The proposed settlement set forth in the Second Amendment satisfies the tests for an all-party settlement set forth in D.92-12-019.

5. The proposed settlement set forth in the Second Amendment, which is attached to this decision as Appendix A, should be approved.

6. The ratemaking treatment proposed by the parties for PG&E's sales of Miocene Canal water to CWS, and for the handling by CWS and PG&E of revenues received by them from sales or transfers of Conservation Water, as described in Findings of Fact (FOF) 22-23, is reasonable and should be approved.

7. CWS's plan to include the repair costs for the Powers Canal as part of the proposed plant additions for the Oroville District in CWS's next GRC, as described in FOF 24, is reasonable.

8. PG&E's plan to include the repair costs for the Coal Canyon penstock as part of the proposed plant additions to PG&E's system in the company's next GRC, as described in FOF 25, is reasonable.

9. This order should be made effective immediately.

O R D E R

IT IS ORDERED that:

1. The Second Amendment to Contract and Supplemental Agreement for Water Supplied from the Miocene Canal, which is set forth in Appendix A to this decision, is hereby approved.

2. California Water Service Company is authorized to book amounts it pays to Pacific Gas and Electric Company for water deliveries from the Miocene Canal, pursuant to the Second Amendment to Contract and Supplemental Agreement for Water Supplied from the Miocene Canal approved in this decision, to the Modified Cost Balancing Account established pursuant to California Water Service Company Advice Letter 1863-A, as authorized by Decision 08-02-036.

3. California Water Service Company is authorized to book amounts it receives from sales or transfers of Conservation Water, as defined in Paragraph 4 of the Second Amendment to Contract and Supplemental Agreement for Water Supplied from the Miocene Canal approved in this decision, as an offset to the Modified Cost Balancing Account established pursuant to California Water Service Company Advice Letter 1863-A.

4. Pacific Gas and Electric Company is authorized to book amounts it receives from California Water Service Company for deliveries of Miocene Canal water, pursuant to the Second Amendment to Contract and Supplemental Agreement for Water Supplied from the Miocene Canal approved in this decision, to the Utility Generation Balancing Account authorized by Decision 07-03-044.

5. Pacific Gas and Electric Company is authorized to book amounts it receives from sales or transfers of Conservation Water, as defined in Paragraph 4 of the Second Amendment to Contract and Supplemental Agreement for Water Supplied from the Miocene Canal approved in this decision, to the Utility Generation Balancing Account authorized by Decision 07-03-044.

6. Application 07-04-022 is closed.

This order is effective today.

Dated June 18, 2009, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners

McKenzie Appendix A