

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

Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

A.12-04-019

(Filed April 23, 2012)

**REVISED TESTIMONY OF RON WEITZMAN
ON BEHALF OF WATER PLUS**

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I. Witness Information.

5 Q. Please tell me your name and provide some biographical information relevant to this proceeding, if you will?

A. Yes, I would be glad to do that. My name is Ron Weitzman. I am married and the father of two daughters, one deceased. I was born and began school in Chicago and completed my pre-college education in Los Angeles. I have a B.A. and an M.A. degree from Stanford University and a Ph.D. from Princeton
10 University in mathematical psychology. I have been on the faculties of a number of universities throughout the United States and elsewhere in the world, including the Middle East, the site of numerous desalination plants. I have taught many dozens of courses in psychology and statistics and published many dozens of articles and technical reports on mental test theory and survey analysis, a good
15 portion of them involving mathematical modeling. You can say that asking questions has been my field of specialization, and so I feel comfortable with the Q & A format of this prepared testimony. Throughout my work life and since retirement, I have been involved as a volunteer and an activist in numerous charitable and civic activities involving social services, performing arts, historic
20 preservation, environmental protection, and consumer interests. That now includes Water Plus, a non-profit public-benefit corporation that meets weekly and that I have served as president since founding it in September of 2010.

II. Purpose of Testimony.

25 Q. What is the purpose of this testimony?

A. I am presenting this testimony as a representative of Water Plus, a party to this proceeding, pursuant to Rules 1.7(b) and 13.8 of the Rules of Practice and Procedure of the California Public Utilities Commission (“CPUC”). Water Plus seeks to represent the ratepayers served by California-American Water’s
30 Monterey County District (“Cal Am”) in this proceeding. Our concern is ratepayers will foot the bill for yet another failed Cal-Am water-supply project.

III. The Current Cal Am Water Supply Project is Doomed to Failure.

35 Q. You say that the currently proposed Cal Am water-supply project is doomed to failure. Why?

A. The state Agency Act prohibits the exportation of groundwater from the Salinas Valley Groundwater Basin,¹ which is precisely what the Cal Am project proposes to do.²

40 Q. Supporters of the Cal Am project claim that the exportation prohibition applies only to the fresh-water component of the groundwater and that the project includes plans to return that component to the basin. How would you respond to that claim?

45 A. The Agency Act makes no distinction between fresh water and salt or brackish water. The only distinction it makes is between surface water and groundwater, and the Act's prohibition applies exclusively to groundwater, of whatever mix.

Q. That being the case, then why did the Salinas Valley farming community not invoke the Agency Act to prevent the now-dead Regional Desalination Project from exporting groundwater from the basin?

50 A. The farming community did not then invoke and has not even now invoked the Agency Act because it is a measure of last resort that can serve as a useful bargaining tool for farmers to share in the revenue obtained from any water-supply project that involves the exportation of groundwater from the Salinas Valley Groundwater Basin.

Q. What foundation, if any, do you have for that statement?

55 A. The issue concerning the farmers is that they have spent and are continuing to spend a great deal of money on stemming the intrusion of saltwater into the

¹ Monterey County Water Resources Agency Act ("Agency Act"), Stats. 1990, c. 1159, Section 21.

² .12-04-019: *Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates*, April 23, 2012 ("A.12-04-019").

Salinas Valley Groundwater Basin. So money is the basic issue. Any water-supply project that could satisfy the farmers would have to provide them with at least enough money to remediate whatever increase in saltwater intrusion the project might produce. Because the farmers have rights to the basin water, they can also add an extra charge for the use of their rights that may be sufficient to cover the costs they have incurred to date in addressing saltwater intrusion.

Q. Has this sort of negotiation ever occurred in other aspects of the Regional Desalination Project or in the current project, as far as you know?

A. Yes, in at least three. First, when Cal Am pulled out of the regional project, the county owed several million dollars to Cal Am, as well as to itself in money borrowed from internal programs unrelated to the project. To recover this money, the county made an agreement with Cal Am to exempt the company from a county ordinance that would have forbidden it from owning a desalination plant in the county.³ Very likely, Cal Am will use ratepayer revenue to cover the county's debt.⁴ Second, in the current project, a deal is pending between Cal Am and the Monterey Peninsula Regional Water Authority involving a trade-off between the establishment of a local project governance committee and a prohibition of support for public ownership. I am going to talk about this deal later in the testimony. Third, in the regional project, the Ag Land Trust drafted a rental agreement to allow the project to draw its groundwater from land owned by the trust. (I have a hard copy of a draft of this agreement.) This agreement never came to fruition because the Marina Coast Water District board believed it was neither a necessary nor an appropriate expenditure for the project to go forward. As a result, the Ag Land Trust sued and prevailed in Superior Court.⁵ An impediment to the regional project, the suit is now under appeal.

Q. Why would Cal Am make such an agreement with Monterey County when the CPUC has voted to exempt the company from the county ordinance permitting only a public agency to own and operate a desalination plant in the county?

³ Monterey County Ordinance 10.72.030(B).

⁴ Monterey County Herald, December 5, 2012, front page.

⁵ Ruling by Monterey County Superior Court Judge Lydia Villarreal, February 2, 2012.

85 A. A number of parties to the proceeding have requested a rehearing on the
preemption decision by the CPUC. The agreement between the county and Cal
Am is Cal Am's insurance against a possible reversal of the CPUC decision.

Q. If the state Agency Act is determinative, then why did an advisory letter from
the State Water Resources Control Board to the CPUC⁶ fail to consider it and
90 instead indicated that the only hurdle involving water rights that Cal Am had to
overcome was to show that its project would do no harm to the farmers or others
who had the rights?

A. The advisory letter was solicited by the CPUC as an effort to obtain cover for
Cal Am's project in the event that it should fail on the water-rights issue. The
95 solicitation letter from the CPUC loaded its argument in favor of Cal Am's project
by interpreting groundwater as meaning fresh water, and the study summarized
in the advisory letter adopted that interpretation, contrary to the Agency Act.
The 30-page study report in fact referred only once in a footnote on p. 17 to the
Agency Act, and that reference incorrectly used the word "water" instead of
100 "groundwater", presumably in an attempt to obscure the intent of the act. In
short, rather than resolving the determinative water-rights issue, the advisory
letter succeeded only in circumventing it.

Q. Do you have any further observations to make about this advisory letter?

A. Yes. In a decision to preempt the Monterey County desalination ordinance so
105 that Cal Am could go forward with the approval process for its project, the CPUC
claimed that seawater is just another form of source water comparable to water
drawn from riparian wells so that, in drawing seawater from wells for
desalination, Cal Am would just be doing business as usual.⁷ The advisory letter
interestingly made the opposite claim. Rather than simply filtering water,
110 desalination is a process that produces it. That being the case, the exportation of
desalinated water from the Salinas Valley would not be the exportation of existing
groundwater but the exportation of something entirely new. Whichever

⁶ Letter from Michael Buckman to Paul Clanon, December 21, 2012.

⁷ D.12-10-030, October 31, 2012, pp.15-16.

interpretation is correct, if either, they cannot both be correct. Support for the Cal Am project lies on an anything-but-solid foundation.

115 **IV. The CPUC has Subverted its Mission by Discouraging Competition among Water Supply Projects.**

Q. You claim that the CPUC has subverted its mission by discouraging competition among water-supply projects? What do you mean by that?

120 A. A principal reason the CPUC exists is to protect the public from possible abuses by privately-owned public utilities that would otherwise be unregulated monopolies. The mission statement of the CPUC restricts its authority to apply solely to monopolies by requiring it to encourage competition wherever possible.⁸
125 In addition to the Cal Am project, private interests have proposed two other projects designed to meet local water needs. The Monterey Peninsula Regional Water Authority has in fact commissioned a study to compare these two projects with Cal Am's, but the CPUC has encouraged neither of their proponents to apply alongside Cal Am for a CPUC certification of public convenience and necessity.

Q. The intent of both these alternative projects is to be owned and operated by a public agency in compliance with the county desalination ordinance, but the CPUC has jurisdiction only over private companies. Why then would you expect the CPUC to act otherwise?

135 A. Neither of these other two projects has as yet acquired a public partner, and so currently each of their proponents is a private entity seeking to provide water for conveyance to members of the public. As such, they are currently subject to CPUC authority. Knowing of their existence, the CPUC should not only invite them, it should require them, to apply for a certification of public convenience and necessity alongside Cal Am. Cal Am has no more local history in the water-supply business than the proponents of these other two projects do.

⁸ According to its mission statement, the CPUC is to "regulate utility services, stimulate innovation, and promote competitive markets, where possible, in the communications, energy, transportation, and water industries."

140 Q. The administrative law judge assigned to this proceeding has indicated that time is too short for it to include other projects. The state cease-and-desist-order deadline is less than four years away. What do you have to say about that?

A. At the initial preconference hearing for this proceeding last June, I, as a representative of Water Plus, requested that in the interest of time the CPUC
145 consider all currently proposed projects simultaneously in a “horse race” rather than sequentially.⁹ If time were the true issue, that is the course that the proceeding should have taken from the beginning. Now, if Cal Am’s project fails, as I am confident that it will, we are going to have to start all over, just as we have done following the failure of the Regional Desalination Project. As long as the
150 CPUC has not certified any single project, it is not too late to include other projects in the proceeding.

Q. Cal Am is an experienced water purveyor with an existing investment in the community. What investment does either of these other two proponents have?

A. I cannot speak for both of them, but I can speak for one, who has to date
155 invested some \$34 million in his project. By contrast, Cal Am investors have risked not an iota of capital on their project. The CPUC has no excuse but to include the other two projects in the proceeding.

Q. How can you say that? Where do you think the money that Cal Am has spent on its project to date has come from?

160 A. That money is an internal company loan recorded in a memorandum account for recovery from ratepayers when the proceeding is over, regardless of whether the project goes forward.

Q. That is not automatically the case. The CPUC can decide not to approve the recovery. So Cal Am investors are also risking capital, is that not so?

165 A. Either on its own or via its two erstwhile public partners, Cal Am has spent about \$40 million on the Regional Desalination Project, and, despite that project’s

⁹ Transcript of Preconference Hearing for A.12-04-019 on June 6, 2012, p. 45, l. 25 – p. 46, l. 15; p. 61, l. 1 – l. 14; p. 67, l. 12 – p. 68, l. 15.

failure, the CPUC has already approved the recovery of at least \$32 million from ratepayers, while its approval of the remainder is pending.¹⁰ So Cal Am has every reason to expect the CPUC to approve the recovery from ratepayers of all its expenses on the current project. Ratepayers, Water Plus included, have no reason to expect otherwise. If the CPUC does not include these other two projects in the current proceeding, all the capital their investors have risked will be lost. That does not constitute a level playing field. That does provide Cal Am an unfair monopolistic advantage in contravention of the CPUC mission to encourage competition.

Q. So what action are you proposing?

A. I am proposing that the CPUC invite the proponents of the other two projects to apply to it alongside Cal Am for a certification of public convenience and necessity. If either of these two decline, then the CPUC need not consider that project further. Otherwise, it should consider the projects of all applicants equally.

Q. How can a private party other than Cal Am apply to the CPUC to build, own, and operate a desalination plant in Monterey County when the county will enforce its ordinance preventing it from doing so while permitting Cal Am to circumvent the ordinance?

A. Rather than exempting Cal Am from the ordinance based on the merits of its project, the CPUC based its exemption of Cal Am solely on it as a private applicant.¹¹ Simply stated, the CPUC exempted the applicant, not the project. That being the case, the CPUC exemption should apply equally to other applicants, as well, regardless of the merits of their projects. Because the CPUC exemption takes precedence over the county ordinance, that ordinance cannot stand in the way of applications submitted to the CPUC by any private party, not solely Cal Am.

¹⁰ Monterey County Herald, July 19, 2012, front page.

¹¹ D.12-10-030 does not refer to any specifics of the Cal Am proposal in A.12-04-019, and so it does not authorize the project; it merely authorizes the applicant as a private company to go forward with processing its project application in prospective contravention of Monterey County Ordinance 10.72.030(B).

195 Q. Different from the proponents of the other two projects, Cal Am does not intend to sell its project to a public agency. Doesn't that make a difference?

A. No. As long as the other two projects are privately owned, they are no different in that regard from Cal Am's. Intentions can change. The CPUC should require all private proponents of water-supply projects to submit applications to it and ignore only the ones that fail to do so. Speaking for Water Plus, that is my
200 strong recommendation.

V. Any New Water Supply Project for the Monterey Peninsula Cannot Rely on the Use of Treated Sewer Water.

205 Q. The mayors' Monterey Peninsula Regional Water Authority, the Monterey Peninsula Water Management District, and Citizens for Public Water, among others, support the so-called three-legged stool, which includes processing sewer water for drinking along with aquifer storage and recovery and desalination. Why does Water Plus not support the sewer-water leg of this stool?

210 A. Treating sewer water to make it potable sounds like a good idea when first considered because it can contribute to the conservation of natural resources. On occasion, it may well be a good idea, but not everywhere and particularly not here on the Monterey Peninsula, for two reasons: cost and reliability.

Q. How can that be so? Elsewhere, reliability has not been a problem, and cost has been used as a reason to support the process.

215 A. Let me deal with reliability first. Locally, the pollution control agency would submit sewer water already treated for agricultural use to further treatment to make it potable. Farmers in the Salinas Valley and the Marina Coast Water District own the rights to the initially-treated water because they paid, and are continuing to pay, for the treatment facilities. Agriculture in the valley needs this
220 water throughout the year except possibly for the winter months. Only then could water be available for further treatment and then only in wet years. The frequency of such years is likely to decrease with the progression of global

warming. In a dry winter, when farmers will need their treated water, they will not be able to give permission to the agency to treat it further for use elsewhere.
225 So dependence on treated sewer water as part of the overall Monterey Peninsula water supply would make that supply extremely unreliable.

Q. What about cost?

A. The cost of treating sewer water to make it drinkable is especially high here in Monterey County. One reason is that, if available at all, the water for treatment
230 would be available only during the four winter months. That means that the capacity of the treatment facility would have to be three times greater than normal for the yield of a specific amount of drinkable water each year. Whatever the reasons, however, the cost of treating sewer water is much greater than desalinating seawater locally. In fact, a study commissioned by the Monterey
235 Peninsula Regional Water Authority showed that for Cal Am's project a combination of desalinated and treated sewer water costs \$1,000 per acre-foot more here than the cost of desalinated water alone.¹²

Q. So, is Water Plus against any use of treated sewer water on the Monterey Peninsula?

240 A. No. Water Plus is not against the use of treated sewer water as a supplementary or emergency water supply. We are just against its use as part of a water supply that our community would depend on.

Q. Does that mean that Water Plus could support its use on the Monterey Peninsula?

245 A. No. Although we would not be against its use as a supplement, we could not support it either.

¹² Separation Processes, Inc. & Kris Helm Consulting: Evaluation of Seawater Desalination Projects: Final Report Update, January 2013, Table ES 1-2, p. ES-6. This table shows desalinated water would cost \$1,000 less per acre-foot when obtained from Cal Am's large desalination plant versus its small one, which would require supplementation by treated sewer water to provide the total amount of potable water needed. The supplementary treated sewer water, according to pollution control agency head Keith Israel in the March 15, 2012, Monterey County Weekly, would cost about \$1,000 more per acre-foot than desalinated water obtained from the large desalination plant proposed by either of the other two projects described in the SPI table.

Q. Why?

250 A. Many people have phobias, such as the fear of heights or public speaking. Similarly, many people have a fear of drinking treated sewer water. They find the very idea to be repulsive. Mixing treated sewer water in the only water supply available to them would be inhumane, regardless of how other people, including Water Plus, may feel about it.

Q. Do you have any other reason why Water Plus does not support the local use of treated sewer water?

255 A. Yes. Our local economy depends on tourism. Using treated sewer water could hardly contribute to our community's attractiveness as a tourist destination.

Q. In view of all these arguments against the use of treated sewer water, do you know of any reason other than conservation that some people may have to support its use locally?

260 A. Yes. People who oppose further growth on the Monterey Peninsula support the three-legged stool because it could provide a cap on desalination, which they fear, if unfettered, could open the floodgates to development.¹³ Water is essential to life. Water Plus believes that its supply is an end in itself and should not be used as a means to achieve other ends.

265 **VI. A Large Desalination Plant Is Preferable to a Small One for the Monterey Peninsula.**

Q. You seem to be saying that Water Plus favors a large desalination plant over a small one. Is that true?

270 A. Yes, at least with respect to cost. A large desalination plant may cost more than a small one to build, but the opposite is true for the water they produce. Each unit of water costs less, often much less, when produced by a large

¹³ An example is the local chapter of the League of Woman Voters. Its president had a letter in The Carmel Pine Cone on February 8, 2013, taking just this position.

desalination plant than by a small one.¹⁴ So, except for providing a bulwark
against development, building a small desalination plant in a community in short
275 supply of water like ours does not make sense. Why pay more for less?

Q. Are you aware of other reasons favoring a large over a small desalination plant
locally?

A. Yes. Our community has thousands of lots of records that lack water, and a
number of our cities need additional water to meet the requirements of their
280 development plans, particularly for their downtowns. This need exists especially
in Monterey, Seaside, and Pacific Grove, whose downtowns are dying. People
who want to add a bathroom to their homes are not able to do so, and the
scarcity of water is constantly increasing its cost on the Monterey Peninsula,
where we are paying several thousand dollars per acre-foot for it when the
285 national average is less than \$900.¹⁵ This is especially unfortunate because many
local residents are retirees who live on a limited income and because our hotels,
vital to our tourist industry, must be competitive in price with hotels elsewhere.
This challenge to competitiveness extends to our local military institutions, which,
like tourism, are a mainstay of our economy. The ever-escalating cost of water
290 escalates the cost of everything eventually to the point where a budget-
constrained Pentagon may have to move our local military institutions to
communities where the cost of living is lower. For all these reasons, both the
local hospitality industry and the Monterey Peninsula Chamber of Commerce
have publicly supported a large over a small desalination plant.¹⁶ Water Plus joins
295 them in that support.

¹⁴ This relationship between size and cost is due at least in part to economies of scale. The Division of Ratepayer Advocates presented a graph showing this relationship to support its request that the Regional Desalination Project cap the cost per acre-foot of product water to \$2,200, shown on the graph as a high-end value for a 10,000 acre-foot desalination plant. The graph was based on empirical data.

¹⁵ Cal Am's Monterey Peninsula water-supply revenue is now about \$50 million annually. For 11,000 acre-feet of current annual usage, that amounts to more than \$4,500 per acre-foot. In the nearby, publicly-owned Marina Coast Water District, it is about half that amount, according to its Comprehensive Annual Financial Report dated June 30, 2012. The current national average, as reported in Wikipedia, is \$886 per acre-foot.

¹⁶ In a Monterey County Herald commentary on December 1, 2012, Dale Ellis and Bob McKenzie, representing the Coalition of Peninsula Businesses (including the local hospitality industry), recommended a desalination plant having a capacity of nearly a 20,000 acre-feet per year, and in a November 26, 2012, advertisement in the same

VII. Open-ocean Intake Is Superior to Intake from Slant Wells Almost Generally and Particularly in Monterey County.

300 Q. Cal Am has proposed to use slant wells terminating under the ocean floor as a source of water for desalination. Hydrologists for and against this proposal have recently submitted reports refuting each other's positions. Are you sure you want to chime in on this dispute among experts?

305 A. Yes, but not as a hydrologist, which I am not. Both sides agree that the proposed wells will draw groundwater rather than surface water and that the Salinas Valley Groundwater Basin extends under the ocean. Their only significant disagreement seems to be whether at the well site an aquitard may exist above the 180-foot aquifer that could prevent the seepage of ocean water through the ocean floor down to the aquifer.¹⁷ This is the aquifer from which Cal Am initially proposed that its slant wells would draw source water. Acknowledging a possible
310 problem here, Cal Am has now modified its proposal so that withdrawing water from this aquifer would be its fallback choice. Cal Am's currently preferred choice for its groundwater source is the so-called Sand Dunes aquifer, which lies above the disputed aquitard.¹⁸ In either case, Cal Am would be drawing source water from the Salinas Valley Groundwater Basin, an action specifically prohibited by
315 the state Agency Act.

Q. That might justify your claim that the use of slant wells is a bad idea in Monterey County, but you also claim that it is almost generally a bad idea. How would you defend that claim?

320 A. Different from open-ocean intake, which is the local alternative, slant wells have no history of anything other than experimental use. Aside from a possibly

newspaper the Monterey Peninsula Chamber of Commerce president recommended one having a capacity of 15,000 acre-feet per year.

¹⁷ GEOSCIENCE: Technical Memorandum, February 6, 2013, a response solicited by the CPUC to Timothy J. Durbin: California-American Water Company – Comments on Proposal to Pump Groundwater from the Salinas Valley Groundwater Basin.

¹⁸ Monterey County Weekly, November 15, 2012, "Cal Am Files Contingency Plans for Desal Roadblocks" by Kera Abraham.

less adverse impact on sea life than open-ocean intake, they have minimal justification. The very existence of a dispute among experts regarding their local viability indicates that geological conditions varying along the shoreline can compromise their usefulness. Not being an expert in this case, I would assign a
325 50% chance that each side is right. If I were a farmer, that is a chance that I would not like to take. As a ratepayer, that is certainly a chance that I would not like to take. Neither would Cal Am if its shareholder money were at risk. Certainly, investors facing a risk like that would be extremely reluctant to purchase bonds to support the project.

330 Q. The risk may be 50-50 or even worse, but if the CPUC certifies the project, investors may never know about that risk. What do you have to say about that?

A. That question goes to the difference between the world of law and the world of science, but, as you suggest, it is practical question, not just a philosophical one. Let me try to answer the philosophical question first. A joke among
335 philosophers aptly describes this situation: ““Well yes, it works in practice, but will it work in theory?” The dispute among hydrologists is about the validity of different models of local geology. Models are theories having limited and specific applications. So, in this sense, acting in a legal world, the CPUC is seeking to find in favor of one theory as opposed to another. All the CPUC needs is a finding to
340 move the project forward.

Q. And the practical question?

A. A finding is not a fact. The consequences of making an incorrect finding just to move the project forward can be devastating. Responsibility to both Cal Am customers and prospective project investors requires that the CPUC be risk-averse
345 in making its findings.

Q. Do you have anything further to say on this issue?

A. Yes. A recent white paper I read by experts not involved in the local dispute over slant wells identified a number of problems with them that may not be

merely site-specific.¹⁹ Examples: The accumulation of sedimentation that could
350 clog the intake pipes may make the operation of slant wells costlier and less
reliable than open-ocean intake. Further increasing cost and compromising
reliability, suction of source water through the ocean floor could deplete its
oxygen and intensify its particulate content to the point that aeration, filtration,
and other expensive pre-processing such as temperature elevation would be
355 necessary to prevent the destruction of the membranes involved in the reverse
osmosis to remove the salt. Based on these and other problems, the paper
concludes that, in general, open-ocean intake is superior to the use of slant wells
as a source of water for desalination. Now I have a question. Shouldn't the
recommendation of independent experts take precedence over a
360 recommendation made by experts hired to favor either party to a dispute?

VIII. Financing Can Cost Ratepayers Hundreds of Millions of Dollars Less if the Project is Owned by a Public Agency rather than by Cal Am.

Q. Water Plus has been claiming for years that public ownership of a desalination
365 plant could be significantly less costly than ownership by Cal Am. How specifically
can you substantiate that claim?

A. All you have to do is Google a mortgage calculator to see that for yourself. Cal
Am has for years obtained from ratepayers a return of investment on capital-
improvement projects of between 8% and 9%. This return is determined by a
370 formula involving about 6.5% interest charged to ratepayers on debt and about
10% profit on equity. By contrast, a public agency can borrow money now for
less than 3.5% interest, with no profit add-on chargeable to ratepayers. These
percentages are not the only differences between Cal Am and a public agency
affecting the cost of capital to ratepayers. SPI, the mayors' consultant, estimated
375 the capital cost of each of the projects at close to \$200 million, but Cal Am's own
estimate for its project is about twice that amount, the difference accountable as
Cal Am shareholder equity (based on a \$200 million debt and a 50-50 debt-to-

¹⁹ WaterReuse Association: Overview of Desalination Plant Intake Alternatives: White Paper, June, 2011.

equity ratio).²⁰ Entering 8.25% with \$400 million for Cal Am and 3.5% with \$200 million for a public agency into the mortgage calculator for a 30-year loan yields
380 total costs of approximately \$1.08 billion for Cal Am and \$323 million for a public agency. That is a savings of public over Cal Am ownership of about \$757 million, well over a half-billion dollars. And that does not even include taxes and the cost of doing business with the CPUC, expenses that a public agency does not have.

385 Q. If that is the case, as it appears to be, then why have the local mayors and others supported the Cal Am project?

A. Obviously, money is not their sole or even their principal concern. Yet, the difference is so large that even they cannot ignore it. So both they and Cal Am have proffered a number of possible offsets that are, unfortunately, unlikely to work in practice.

390 Q. What are these possible offsets and why do you claim that they are unlikely to work in practice?

A. A February 12, 2013, commentary in the Monterey County Herald by two of the mayors listed these possible offsets: (a) a partial “contribution” (of about \$100 million) to the project by a public agency, (b) an interest-free \$99 million
395 surcharge proposed by Cal Am, (c) at least partial financing via the state revolving fund under the federal Clean Water Act, and (d) decreased electricity costs.²¹ These options are either likely to fail to materialize or if they did they would also be available to a public agency that could lower its costs by the same or even a greater amount.

²⁰ See Footnotes 2 and 12 for reference to this information. These estimates exclude Cal-Am only facilities such as the pipeline from the desalination site to Seaside. Since Cal Am filed its application on April 23, 2012, it has increased the capacity of its larger proposed desalination plant to be close to 10,000 acre-feet per year so that its estimated debt-plus-equity cost to ratepayers will now likely be well over \$400 million. The ratio currently proposed by Cal Am for its project is 47-53, and so 50-50 is a conservative prediction of what this ratio will actually turn out to be.

²¹ These four possible offsets represent an evolution of five originally proposed in an October 1, 2012, letter sent to Cal Am’s president, Robert MacLean, by Monterey mayor Charles Della Sala and Monterey County supervisor David Potter. This letter also contains suggestions for a local governance structure to provide oversight on Cal Am’s project. The word “contribution” is in quotes because it is not a true contribution, or grant, but a loan to be repaid with interest..

400 Q. Now why do you claim that the first offset might not work out?

A. In their commentary, the mayors did not specify any public agency they might have in mind, but since the water management district general manager was a principal author of their proposal the most likely candidate would be that district. This appears to be the behind-the-scenes deal worked out between the authority
405 and the district. The problem is that Cal Am has no incentive to go along with it. The company had a public partner in the Marina Coast Water District and pulled out of the partnership in favor of the current project precisely because this project would offer its shareholders a much greater profit.²² The mayors' hope apparently is that the CPUC will force Cal Am to accept their deal.

410 Q. Why wouldn't the CPUC do that?

A. The CPUC has no control over the water management district but is responsible for the safety and reliability of our local water supply. The district has no history of running a water-supply project on its own, and its possible involvement with Cal Am in a complex financial partnership would involve too
415 many uncertainties for the CPUC to take the risk. For the same reason, financing the project would also be at risk.

Q. What about the surcharge?

A. Local ratepayers are extremely upset about even the idea of a surcharge, which, according to the mayors' consultant's data, could amount to almost half
420 the capital cost of the project. Normally, in a capital-improvement project like desalination that requires a loan, the public would pay the interest on the loan and Cal Am would pay the principal out of the profits its shareholders make on the project. A surcharge is entirely different. The ratepayers would pay all the capital costs, and Cal Am shareholders would pay nothing and yet have complete
425 ownership.²³ In ordinary life, that would be called robbery. Aside from getting an

²² Reinforcing this claim is the CPUC filing by Cal Am on October 26, 2012, opposing public ownership of a desalination plant, reported in The Monterey County Herald, November 11, 2012, front page.

²³ Accountants may have a different view of this transaction if it takes the form of a so-called Mirror CWIP (Construction Work in Process): During construction, ratepayers pay costs treated as debt matched by equity earning shareholder profits used to pay ratepayers back in the form of relatively reduced bills following

early start on rate increases to avoid skyrocketing-rate shock later on, which
payback on a partial-project loan could also do, the only excuse for the surcharge
is that it would save ratepayers the cost of interest and some profits, a cost that
could be substantial. That is the excuse. The reason is something else: Cal Am is
430 unable to secure open-market financing on the beginning of a project that has
such an uncertain outcome. The surcharge may be the only money available for
the project to get going. Why else would Cal Am choose to forgo a large portion
of its possible profit on the project? At the same time, on the other side, why
should ratepayers take the risk? They already have lost between \$30 million and
435 \$40 million on Cal Am's failed regional project.²⁴ The CPUC must think long and
hard before it approves the surcharge.

Q. What about money from the state revolving fund?

A. That is a pie in the sky if ever there was one. Only public agencies or non-
profit organizations are eligible for legislatively-defined low-interest funding from
440 this source, and non-profits only when their projects are designed to eliminate at
least some non-point-source pollution.²⁵ The funding is also quite limited and
usually distributed in relatively small amounts. Since the desalination component
of Cal Am's project is not designed to eliminate non-point-source pollution, the
applicant for funding must be a public agency. Again, the mayors in their
445 commentary are unclear about the identity of this agency, and again a good bet is
the water management district, which has been working hand-and-glove with the
mayors. That being the case, what the mayors likely have in mind is funding for a
partial public "contribution" to the project, their first cost-reduction proposal. To
be effective, that might require public ownership, which the mayors have failed to
450 specify, Cal Am would resist, and the CPUC likely disapprove.²⁶

Q. And reduced electrical rates?

construction. Whatever the accounting treatment, however, ratepayers would bear all the risks and make all
actual payments while Cal Am owns the paid-for project components regardless of whether the entire project
reaches completion. This is of especial concern to Water Plus members, who believe the project is going to fail.

²⁴ See Footnote 10.

²⁵ This fund is administered by the state Water Resources Control Board under the federal Clean Water Act.

²⁶ Without public ownership, Cal Am may have to consider the loan to be *its* debt that, matched by equity, would
render the public "contribution" ineffectual in reducing ratepayer bills.

455 A. Like a partial public “contribution”, a surcharge, and revolving-fund financing, this is a cost-saving measure available at least as much to a public agency as to Cal Am.²⁷ This suggestion, like the previous one, amounts to no more than a public-relations ploy.

Q. Do you have anything else to say about the financing proposals of the mayors?

460 A. Yes. The mayors base their entire financing argument on the capital cost of Cal Am’s project estimated by SPI, the consulting firm they engaged to compare project costs. That estimate, around \$200 million, is about half of Cal Am’s own estimate, which includes shareholder equity as well as debt.²⁸ To determine the total cost to ratepayers of Cal Am’s project, SPI correctly used a percentage charged to ratepayers of between 8% and 9% but incorrectly applied it to its \$200 million rather than Cal Am’s \$400 million estimate (approximate figures).²⁹ The mayors fail to take this obvious discrepancy into account in their project
465 comparisons. This failure provides additional impetus to the suspicion that the principal concern of the mayors is something other than cost to ratepayers and that their cost-offset proposals amount to little, if anything, more than a smoke-screen obscuring their principal concern.

Q. What do you believe this principal concern might be?

470 A. The mayors are politicians. The concern that appears most strongly to motivate them is re-election. They have not even obtained the approval of their city councils for their cost-offset proposals, to say nothing of their endorsement of Cal Am’s project. The Monterey City Council recently voted unanimously in favor of public ownership,³⁰ and yet the mayor of Monterey voted on the
475 authority board to endorse Cal Am, a private owner. The Pacific Grove mayor did likewise though his city council has voted to work on the acquisition of one of the

²⁷ Both of the two alternative projects, in fact, involve the use of solar energy to help offset the cost of electricity.

²⁸ See Footnote 20.

²⁹ See Footnote 12 for reference to the SPI report.

³⁰ The Monterey City Council adopted that resolution at its January 2, 2013, meeting as a contingency in the event that Cal Am’s currently proposed project fails. The resolution did not give the mayor permission to vote for the Cal Am project on the Monterey Peninsula Regional Water Authority board.

two alternative projects as a public owner.³¹ The mayors' support of Cal Am hardly has any demonstrable support in the public other than among politically active no-growth groups like the League of Women Voters.³² As laudable as the goals of these groups might be, they do not include the best interests of ratepayers, particularly with respect to the size of their monthly water bills.

IX. The Pending Deal between Cal Am and the Monterey Peninsula Mayors Costing Ratepayers Hundreds of Millions of Dollars Stands on a Shaky Legal Foundation.

Q. Why would the Monterey Peninsula mayors make a deal with Cal Am that could cost local ratepayers hundreds of millions of dollars? Surely the mayors must realize that their making a deal like that could eventually have an adverse political effect on them.

A. The cease-and-desist-order deadline is just over the horizon, December 31, 2016,³³ and local political leaders are getting jittery about it. In contrast to the local proponents of the alternative projects, the mayors perceive Cal Am as part of a national megalith having the strong financial assets needed to go forward with its project. The mayors fear taking a risk on a local project. That fear dominates any concern they may have over costs.

Q. What does that fear have to do with a deal between the mayors and Cal Am?

A. That fear is compounded by another one that strengthens the cost-benefit mindset of the mayors favoring the Cal Am project despite its cost to ratepayers.

Q. What is this other fear?

A. Five of the six mayors comprising the Monterey Peninsula Regional Water Authority or their representatives also sit on the Monterey Regional Water Pollution Control Agency board. These five have voted on the agency board to

³¹ The Pacific Grove City Council took that action at its meeting on April 18, 2012.

³² See Footnote 13.

³³ California Water Resources Control Board Order WR 2009-0060, based on WR 95-10

505 spend sewer ratepayer money on plans for converting sewer to drinking water for
Cal Am water ratepayers, a possible misappropriation of funds in violation of
Proposition 218. In 2008, the agency's attorney admonished the agency to
terminate that expenditure of funds, then amounting to \$700,000.³⁴ Now,
despite that admonition, the expenditure has risen to over \$2 million.³⁵ The
mayors' support of the deal with Cal Am depends on the acceptance by Cal Am of
the governance structure proposed by the mayors that gives them the authority
510 to decide whether to include the conversion of sewer to drinking water in Cal
Am's project, an inclusion that would allow the agency to recover the
misappropriated funds.³⁶ In this exploitation of their authority in one agency to
favor another on whose board they also sit, the mayors may be in violation of a
Section 1099 conflict of interest. That is in addition to their possible Proposition
515 218 violation.

Q. What is Cal Am's position on this deal?

A. The deal that Cal Am made with Monterey County, which involves the
forgiveness of county debt to Cal Am in exchange for the exemption of Cal Am
from the county's desalination ordinance, also prohibits the county from
520 supporting public ownership in opposition to Cal Am.³⁷ The deal between Cal Am
and the Monterey Peninsula Regional Water Authority makes the same
prohibition.³⁸ These deals are good for Cal Am, Monterey County, and the
mayors' water authority, as well as no-growth special-interest groups.
Unfortunately, they are not good for Monterey Peninsula ratepayers who, as
525 indicated earlier, may lose hundreds of millions of dollars because of them.

Q. Is that the end of your testimony?

³⁴ Letter from attorney Rob Wellington to Keith Israel, general manager of the pollution control agency, dated January 22, 2008.

³⁵ This information comes from an agency table titled "Urban Reclamation Projects: Summary of Total Costs" and dated March 31, 2011.

³⁶ Two of the three voting members of the proposed governance committee that would have this explicit authority are members of the mayors' regional water authority. The third is a member of the water management district board, which also seeks the inclusion of treated sewer water in Cal Am's project.

³⁷ See Footnotes 3 and 4.

³⁸ These prohibitions need not be explicit because the deals would make no sense without them.

A. Yes, with just one additional observation. On February 11, 2013, the Monterey Regional Water Pollution Control Agency board voted to use up to \$750,000 more of sewer ratepayer funds to support a study of the conversion to drinking water of not only sewer water but also Salinas agricultural and urban run-off water for use by water ratepayers on the Monterey Peninsula.³⁹ Although the inclusion of run-off water enabled members of the board opposed to the use of sewer water to go along with the vote, the expenditure still may represent a violation of Proposition 218. Conflict of interest may sully the current Cal Am project at least as much as it did the previous one, toward the same ultimate fate.⁴⁰

February 22, 2013

Respectfully submitted,

Revision: March 21, 2012

WATER PLUS

By:

President, Water Plus

³⁹ The addition of run-off to sewer water literally poisons the well because the resulting brew will contain contaminants like DDT that cannot be removed to the extent required to make the treated water potable.

⁴⁰ David Potter is another example of conflict of interest involved in the current project. The mayors' proposed governance committee consists of a single voting representative from each of three public agencies. Mr. Potter sits on the boards of all three of these agencies and has been appointed to be the representative of one of them on the committee.