

Decision **PROPOSED DECISION OF ALJ WEATHERFORD**
(Mailed 10/30/2012)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Application of California-American Water Company (U210W) for a Certificate of Public Convenience and Necessity to Construct and Operate its Coastal Water Project to Resolve the Long-Term Water Supply Deficit in its Monterey District and to Recover All Present and Future-Costs in Connection Therewith in Rates.

Application 04-09-019
(Filed September 20, 2004)

DECISION GRANTING IN PART AND DENYING IN PART A PETITION FOR MODIFICATION OF DECISION 12-07-008, AND ORDERING THE CLOSING OF THE PROCEEDING

1. Summary

By this decision, we grant a portion and deny a portion of California-American Water Company’s Petition for Modification of Decision 12-07-008 and close the proceeding for a second time.

2. Background

On September 7, 2012, the California-American Water Company filed and served a Petition for Modification of Decision (D.) 12-07-008, requesting clarification and modification of that decision with regard to the recovery of costs incurred by California-American Water Company (Cal-Am) in its participation in the Regional Desalination Project (RDP) for which a Certificate of Public

Convenience and Necessity was granted in D.10-12-016 (December 3, 2010) of Application (A.) 04-09-019.

In D.12-07-008, we resolved then-pending motions and closed the proceeding in Cal-Am A.04-09-019. In that decision the Commission treated the RDP as no longer being viable and the Monterey Peninsula Water Supply Project applied for by Cal-Am in A.12-04-019 as being its proposed replacement. Concerning the issue of disputed costs arising out of the RDP, we stated in D.12-07-008 at 19-20 (footnotes omitted) that:

The assigned ALJ directed Cal-Am to provide an accounting of costs expended thus far on the Regional Desalination Project. Thus far, \$26,568,651 has been approved for recovery in pre-construction costs related to the Coastal Water Project. In A.11-06-030, Cal-Am is requesting approval of an additional \$5,354,229 in pre-construction costs accrued in 2010. Cal-Am is also tracking post 2010 costs which totaled \$687,167 as of January 31, 2012. These are not trivial amounts. Cal-Am has recovered \$14,426,284 from its customers through its approved Special Request I surcharge. Cal-Am is required to file separate applications to seek recovery of these costs.

The amounts described above do not include amounts lent to MCWD and MCWRA under the Water Purchase Agreement or under the Reimbursement Agreement approved in D.10-08-008. According to Cal-Am, MCWD and MCWRA owe Cal-Am \$6,244,852 and \$1,946,219, respectively. MCWD and MCWRA may dispute these amounts and do dispute the interpretation of the requirements in the Water Purchase Agreement and the Reimbursement Agreement. The parties have stated that they are meeting to discuss these issues and to determine whether they can be settled or must be litigated. We encourage the parties in their settlement discussions and can assign a neutral ALJ to assist in the mediations. To the extent that the disputed costs and associated cost recovery must be addressed by this Commission, Cal-Am should file a new application.

The relevant Ordering Paragraph 2 in the decision at 25, provided:

2. California-American Water Company shall file a new application to the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. California-American Water Company should not claim any costs incurred for the California-American Water Company-only facilities after January 17, 2012, the date California-American Water Company announced its withdrawal from the Regional Desalination Project, in connection with the authorization in D.10-12-016. The recoverability of costs that have been incurred in Application (A.) 04-09-019 related to the Regional Desalination Project will be examined in other proceedings. Nothing herein is intended to prevent California-American Water Company from incurring reasonable costs related to its current application A.12-04-019, nor does it limit any more general authorization California-American Water Company received prior to the selection of the Regional Desalination Project.

3. The Modification Sought by Cal-Am and the Responses of DRA and the Public Trust Alliance

In its Appendix A to the Petition for Modification, Cal-Am seeks the following revisions (set out in *italic font*) in Ordering Paragraph 2:

2. California-American Water Company shall file a new application to the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. California-American Water Company should not claim any costs incurred for the

California-American Water Company-only facilities after January 17, 2012, the date California-American Water Company announced its withdrawal from the Regional Desalination Project, in connection with the authorization in D.10-12-016. *California American Water may claim costs related to the California-American Water only facilities paid after January 17, 2012, as long as it incurred the costs on or before that date.* The recoverability of costs that have been incurred in Application (A.) 04-09-019 related to the Regional Desalination Project will be examined in other proceedings. *Post-2010 preconstruction costs and ongoing legal costs related to the Regional Desalination Project should be tracked and recovered according to the process established in D.03-09-002 and D.06-12-040.* Nothing herein is intended to prevent California- American Water Company from incurring reasonable costs related to its current application A.12-04-019, nor does it limit any more general authorization California-American Water Company received prior to the selection of the Regional Desalination Project.

Cal-Am's bases for these proposed revisions are an alleged need to clarify (1) how it should track and recover post-2010 pre-construction costs related to the RDP,¹ (2) how it should track and recover legal costs incurred after January 17, 2012 in connection with RDP-related mediation and litigation,² and (3) that the statement in D.12-07-008 that California American Water "should not claim any costs incurred for the California-American Water Company-only facilities after January 17, 2012" means "that costs incurred before January 17, 2012, but paid out after that date are recoverable."³

¹ Cal-Am's Petition for Modification.

² *Id.* at 3-4.

³ *Id.* at 5.

Division of Ratepayers Advocate (DRA) opposes the revisions proposed by Cal-Am.⁴ DRA argues that Cal-Am remains authorized⁵ to track pre-construction costs, including post-2010 ones, in a memorandum account and recover those costs through annual applications. As a result, according to DRA, no separate or new authorization is needed. Concerning legal costs incurred after January 17, 2012 in connection with mediation and litigation related to the RDP, DRA contends that those costs should not be part of annual pre-construction cost review applications; rather they should be tracked separately and recovery sought in a new application along with other contested RDP costs.⁶ As to costs for Cal-Am-only facilities incurred on or before January 17, 2012, but paid after this date, DRA states that no clarification or modification is needed because it is the practice of the Commission's Division of Water and Audit to base pre-construction costs on the date incurred, not the date paid.⁷

The Public Trust Alliance's response opposes Cal-Am's petition and airs more general grievances about Cal-Am's conduct and the Commission's actions. It alleges that the modifications sought by Cal-Am would lead to cumulative "excessive public costs," magnifying the depletion of "public resources on the Carmel River."⁸ It calls for the Commission "to place reasonable limits on possibly damaging business behaviors," asserting that the Commission "should

⁴ Response of DRA at 2-6.

⁵ *Id.* at 2.

⁶ *Id.* at 2-4.

⁷ *Id.* at 5.

⁸ Public Trust Alliance's Response at 2.

appear less like an effort to establish a perpetually approved bar tab that obligates ratepayers to pay for whatever drinks utility managers happen to be serving.”⁹ It further notes that compensation for intervenor participation in this reopened proceeding is precluded by the prior denial of Notices of Intent (NOI).¹⁰

The Settlement in A.04-09-019 without the participation of intervenors is also objected to by the Public Trust Alliance.

In a reply to those responses¹¹ by DRA and the Public Trust Alliance, Cal-Am reiterated its position that a modification is necessary concerning the memorandum account tracking of RDP-related post-2010 pre-construction costs:

California American Water believes that the requested clarifications are necessary because future intervenors and parties, other than DRA, may interpret D.12-07-008 differently. Any lack of clarity invites unnecessary relitigation of resolved issues. DRA concedes that California American Water’s proposed modifications do not expand California American Water’s existing authority. As such, the Petition for Modification should be granted in order to promote clarity and consistency.

Cal-Am sees DRA’s opposition to a modification concerning the RDP-related litigation costs as erroneously resting on a contention that such costs are “disputed costs” linked to the reimbursement and water purchase agreements and thus fall within D.12-07-008’s instruction that such costs can be recovered under a separate application. Cal-Am counters¹² that:

⁹ *Ibid.*

¹⁰ *Ibid.* D.12-07-008 denied the NOI of Water Plus and LandWatch Monterey’s request for leave to file a NOI.

¹¹ Cal-Am’s Reply (October 8, 2012), at 2 (footnote omitted).

¹² *Id.* at 2-3 (footnotes omitted).

“Disputed costs,” within the context of D.12-07-008, refer solely to California American Water’s loans to Monterey County Water District (MCWD) and Monterey County Water Resources Agency (MCWRA). As such, D.12-07-008 finding of fact #9 and conclusion of law #7, which DRA relies upon, do not apply to California American Water’s own litigation costs. Moreover, the Commission has already recognized that California American Water will undoubtedly have to incur litigation costs to defend itself against the contractual disputes arising from the now defunct RDP.

...DRA’s substantive concern, which is that litigation costs be tracked separately from other costs and recovered via application, is not in conflict with California American Water’s proposed modifications. The memorandum account treatment established by the Commission in no way prevents California American Water from tracking litigation costs separately from other water supply project costs. In addition, the existing process requires that California American Water file applications to review the reasonableness of costs tracked in the memorandum account before they are recovered. Accordingly, the Commission and DRA will have an opportunity to review all litigation costs for reasonableness. DRA fails to explain what purpose would be served by establishing an entirely separate process for the recovery of RDP related litigation costs. To the contrary, establishing a new process to track costs that can be adequately tracked and recovered through an existing mechanism is inefficient, duplicative and will result in unnecessary delay.

4. Discussion

4.1. No Additional Authorization through a Modification of D.12-07-008 is Needed to Track Post-2010 Pre-construction Costs for Potential Recovery

We agree with DRA¹³ that no modification of D.12-07-008 is needed concerning the tracking of post-2010 RDP pre-construction costs for potential recovery. Ironically, the following portion¹⁴ of Cal-Am's Petition for Modification is persuasive on the point:

In D.03-09-022, the Commission authorized California American Water to establish a memorandum account to track ongoing preconstruction costs related to a water supply project for the Monterey Peninsula. Since 2006, the Commission has allowed California American Water to file annual applications for recovery of preconstruction costs via the Special Request 1 surcharge. The tracking and recovery process that the Commission established in D.03-09-022 and D.06-12-040, and continued in subsequent decisions, provide an opportunity for review and recovery at regular intervals. The Commission, California American Water, the Division of Ratepayer Advocates, and other interested parties are familiar with the process, which has been used successfully for several years. There is no reason to try to develop an alternate process at this point, especially given the long-standing process already in place for the Commission to address the costs.

In short, authorization exists to track post-2010 RDP pre-construction costs for potential recovery. We find no reason to disturb or duplicate that existing authority, and accordingly deny that particular request of Cal-Am's Petition. A

¹³ Response of DRA at 2.

¹⁴ At 2 (footnotes omitted).

confirmation of that authority is hereby made to quell any doubts, however groundless, that might otherwise be raised in the future.

4.2. Legal Costs Incurred after January 17, 2012, concerning RDP-Related Mediation and Litigation can Continue to be Recorded in a Segregated Manner in the Existing Memorandum Account but Recovery shall be Sought in a Separate Application

We agree with Cal-Am that legal costs incurred after January 17, 2012 can continue to be recorded in a segregated manner in the existing memorandum account¹⁵ already established by D.03-09-022 but do not agree that those costs should be recoverable as a part of annual pre-construction cost review applications; rather, such recovery ought to be sought subsequently through a separate application, one that is distinct from the potential one identified in D.12-07-008 at 20 and 25. The time and expense that would be associated with a separate application proceeding to establish a new memorandum account at this juncture, when there are so many demands being placed on the parties and the Commission in A.04-09-019, A.12-04-019, and Cal-Am's recently filed

¹⁵ Cal-Am has been tracking RDP-related costs in the memorandum account established in D.03-09-022. By letter of July 6, 2012, the Division of Water and Audits indicated to Cal-Am that:

Legal and related expenses that Cal-Am may claim for the Regional Desalination Project (RDP) will be subject to a prudency review by the Commission. The Division of Water and Audits therefore directs Cal-Am to track separately all legal and legal-related expenses for the RDP. The expenses leading up to Cal-Am's decision to terminate the Water Purchase Agreement and related agreements on September 28, 2011 and beyond should be identified separately.

A.12-10-003 (dated October 2, 2012)¹⁶ is not justified. The legal costs are likely to be complex and controversial enough to warrant a distinct reasonableness review by the Commission, separate from other costs being recorded in the existing memorandum account. Accordingly, the following modifications in italic font will be made in D.12-07-008:

at 20, in substitution for the last sentence of first full paragraph,

To the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement of the RDP (other than legal costs mentioned next), and associated cost recovery must be addressed by this Commission, Cal-Am should file a new application. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. In regards to RDP-related legal costs (including mediation and litigation costs) incurred before and after January 17, 2012, those costs shall be tracked in a segregated manner in the memorandum account established by D.03-09-022¹⁷ and later be subject to reasonableness review for cost recovery through a

¹⁶ Application of Cal-Am for an Order Authorizing the Transfer of Costs Incurred in 2011 for a Long-Term Water Supply Project for the Monterey District to its Special Request 1 Surcharge Balancing Account.

¹⁷ Cal-Am has been tracking RDP-related costs in the memorandum account established in D.03-09-022. By letter of July 6, 2012, the Division of Water and Audits indicated to Cal-Am that:

Legal and related expenses that Cal-Am may claim for the Regional Desalination Project (RDP) will be subject to a prudency review by the Commission. The Division of Water and Audits therefore directs Cal-Am to track separately all legal and legal-related expenses for the RDP. The expenses leading up to Cal-Am's decision to terminate the Water Purchase Agreement and related agreements on September 28, 2011 and beyond should be identified separately.

distinct application, separate from the aforementioned application for recovery of disputed costs.

and at 25, Ordering Paragraph 2, in substitution for the first two sentences,

To the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement of the Regional Desalination Project (other than legal costs mentioned next), and associated cost recovery must be addressed by this Commission, Cal-Am should file a new application. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. In regards to Regional Desalination Project related legal costs (including mediation and litigation costs) incurred before and after January 17, 2012, those costs shall be tracked in a segregated manner in the memorandum account established by D.03-09-022¹⁸ and later be subject to reasonableness review for cost recovery through a distinct application, separate from the aforementioned application for recovery of disputed costs.

¹⁸ Cal-Am has been tracking RDP-related costs in the memorandum account established in D.03-09-022. By letter of July 6, 2012, the Division of Water and Audits indicated to Cal-Am that:

Legal and related expenses that Cal-Am may claim for the Regional Desalination Project (RDP) will be subject to a prudency review by the Commission. The Division of Water and Audits therefore directs Cal-Am to track separately all legal and legal-related expenses for the RDP. The expenses leading up to Cal-Am's decision to terminate the Water Purchase Agreement and related agreements on September 28, 2011 and beyond should be identified separately.

4.3 No Modification of D. 12-07-008 is Needed Concerning Costs for Cal-Am-Only Facilities Incurred on or before January 17, 2012, because of the Established Practice of the Commission's Division of Water and Audit to Base Pre-construction Costs on the Date Incurred, Not the Date Paid

Cal-Am should be permitted to claim all costs associated with Cal-Am only facilities incurred on or before January 17, 2012 irrespective of the date on which payment was made.¹⁹ Since it is the established practice of the Commission's Division of Water and Audit to base construction costs on the date incurred, not the date paid, there is no need for that particular modification sought by Cal-Am's petition.

5. Comments on Proposed Decision

The proposed decision of the Administrative Law Judge in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments by Cal-Am were filed on November 19, 2012.

In its Comments (at 1) Cal-Am stated that it "greatly appreciates the clarifications in the PD and believes that the findings generally clarify the process that [it] must follow to seek recovery of costs related to the Regional Desalination Project (RDP)."

Cal-Am did request, however, revisions that would remove 2011 legal costs from the requirement that it seek recovery of RDP related legal costs separately from other RDP related costs. The revisions it recommends would:

¹⁹ Costs for any Cal-Am only projects that were initiated before January 17, 2012 but not completed by that date should be pro-rated to January 17, 2012.

first, modify the reference in Ordering Paragraph 2 of the PD to RDP related legal costs “incurred before and after January 17, 2012” by deleting the words “before and”; secondly, it would add at a couple of places the statement: “Nothing herein prohibits [Cal-Am] from recovering 2011 RDP related costs through A. 12-10-003.” We are not making those suggested revisions as it is our position that there ought to be a separate application filing for recovering RDP related legal costs, apart from pre-construction costs, irrespective of whether the RDP related legal costs were incurred before or after January 17, 2012.

6. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Gary Weatherford is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.03-09-022 clearly provides existing authority for Cal-Am to track post-2010 Regional Desalination Project pre-construction costs for potential recovery.
2. By letter of July 6, 2012, the Division of Water and Audits directed Cal-Am “to track separately all legal and legal-related expenses for the [Regional Desalination Project].”
3. It is the established practice of the Commission’s Division of Water and Audits to base pre-construction costs on the date incurred, not the date paid.
4. Today’s decision should be made effective immediately.

Conclusions of Law

1. The Commission should deny Cal-Am’s request for a modification of D.12-07-008 to clarify that Cal-Am has authorization to track post-2010 Regional Desalination Project pre-construction costs for potential recovery because that authority already clearly exists pursuant to D.03-09-022.

2. The Commission should grant Cal-Am's request to clarify that under D.12-07-008 Cal-Am can track legal costs incurred after January 17, 2012, concerning Regional Desalination Project-related mediation and litigation in a segregated manner in the memorandum account established in D.03-09-022. The Commission should deny, however, Cal-Am's request to clarify that under D.12-07-008 Cal-Am can seek recovery of such legal costs as part of the annual pre-construction cost review applications; rather the Commission should order that the recovery of such legal costs be sought through a separate application, distinct from any application seeking recovery of disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement of the Regional Desalination Agreement.

3. The Commission should deny Cal-Am's request for a modification of D.12-07-008 to clarify that costs incurred on or before January 17, 2012 for the California-American Water Company-only facilities are recoverable because it is the established practice of the Commission's Division of Water and Audits to base pre-construction costs on the date incurred, not the date paid.

O R D E R

IT IS ORDERED that:

1. The request of California American Water Company for a modification of Decision (D.) 12-07-008 to clarify that Cal-Am has authorization to track post-2010 Regional Desalination Project pre-construction costs for potential recovery is denied because that authority already clearly exists pursuant to D.03-09-022.

2. The request of California American Water Company for a modification of Decision (D.) 12-07-008 to clarify that legal costs incurred after January 17, 2012,

concerning Regional Desalination Project-related mediation and litigation should be tracked and recorded in the existing memorandum account established in D.03-09-022 is granted. The Company's request that the cost recovery of such costs be part of the annual applications for recovery of pre-construction costs is denied, as the recovery instead shall be sought by a separate and distinct application. Accordingly, Ordering Paragraph 2 at 25 of D.12-07-008 is hereby modified to read (revisions in italic font).

2. To the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement of the Regional Desalination Project (other than legal costs mentioned next), and associated cost recovery must be addressed by this Commission, Cal-Am should file a new application. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. In regards to all Regional Desalination Project related legal costs (including mediation and litigation costs, those costs shall be tracked in a segregated manner in the memorandum account established by D.03-09-022²⁰ and later be subject to reasonableness review for cost recovery through a distinct application, separate from the

²⁰ Cal-Am has been tracking RDP-related costs in the memorandum account established in D.03-09-022. By letter of July 6, 2012, the Division of Water and Audits indicated to Cal-Am that:

Legal and related expenses that Cal-Am may claim for the Regional Desalination Project (RDP) will be subject to a prudency review by the Commission. The Division of Water and Audits therefore directs Cal-Am to track separately all legal and legal-related expenses for the RDP. The expenses leading up to Cal-Am's decision to terminate the Water Purchase Agreement and related agreements on September 28, 2011 and beyond should be identified separately.

aforementioned application for recovery of disputed costs. California-American Water Company should not claim any costs incurred for the California-American Water Company-only facilities after January 17, 2012, the date California-American Water Company announced its withdrawal from the Regional Desalination Project, in connection with the authorization in D.10-12-016. The recoverability of costs that have been incurred in Application (A.) 04-09-019 related to the Regional Desalination Project will be examined in other proceedings. Nothing herein is intended to prevent California-American Water Company from incurring reasonable costs related to its current application A.12-04-019, nor does it limit any more general authorization California-American Water Company received prior to the selection of the Regional Desalination Project.

Further, the last sentence of first full paragraph on page 20 of the text of D.12-07-008 is hereby modified by substituting the following language (revision in italic font):

To the extent that there are disputed costs related to the Reimbursement Agreement or the Line of Credit under the Water Purchase Agreement of the RDP (other than legal costs mentioned next), and associated cost recovery must be addressed by this Commission, Cal-Am should file a new application. However, the Division of Water and Audits should continue processing all currently unprocessed Advice Letters dealing with rate base offsets for California-American Water Company only facilities discussed in Decision (D.) 10-12-016. In regards to RDP-related legal costs (including mediation and litigation costs) incurred before and after January 17, 2012, those costs shall be tracked in a segregated manner in the memorandum account established by D.03-09-022²¹ and later

²¹ Cal-Am has been tracking RDP-related costs in the memorandum account established in D.03-09-022. By letter of July 6, 2012, the Division of Water and Audits indicated to Cal-Am that:

Legal and related expenses that Cal-Am may claim for the Regional Desalination Project (RDP) will be subject to a prudency review by the Commission. The Division of Water and Audits therefore

Footnote continued on next page

be subject to reasonableness review for cost recovery through a distinct application, separate from the aforementioned application for recovery of disputed costs.

3. The request of California American Water Company for a modification of Decision 12-07-008 to clarify that costs incurred on or before January 17, 2012 for the California-American Water Company-only facilities are recoverable is denied because it is the established practice of the Commission's Division of Water and Audits to base pre-construction costs on the date incurred, not the date paid.

4. Any other pending requests and motions are denied.

5. Application 04-09-019, having been reopened, is once again closed.

This order is effective today.

Dated _____, at San Francisco, California.

directs Cal-Am to track separately all legal and legal-related expenses for the RDP. The expenses leading up to Cal-Am's decision to terminate the Water Purchase Agreement and related agreements on September 28, 2011 and beyond should be identified separately.