Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of CALIFORNIA WATER SERVICE COMPANY (U60W), a California corporation, for an order from the California Public Utilities Commission authorizing a memorandum account to record asbestos litigation expenses.	Application 14-09-003 (Filed September 3, 2014)

DECISION ADOPTING THE SETTLEMENT AGREEMENT REACHED BY CALIFORNIA WATER SERVICE COMPANY AND THE OFFICE OF RATEPAYER ADVOCATES

Summary

We adopt the settlement agreement attached hereto as Appendix A (Settlement). The Settlement allows California Water Service Company (Cal Water) to establish the Asbestos Litigation Memorandum Account to track costs related to litigation arising from alleged exposure to asbestos from asbestos cement water pipes in Cal Water's service areas and requires Cal Water to record certain agreed upon costs as detailed in the Settlement. In addition, the Settlement, inter alia, requires Cal Water to subsequently seek recovery of the recorded costs before the Commission and acknowledges that the Commission's subsequent consideration of such request would include review of those recorded costs for reasonableness for recovery. The Settlement resolves all of the disputed issues in this proceeding. This proceeding is closed.

1. Background

On September 3, 2014, California Water Service Company (Cal Water) filed an application seeking authorization to establish the Asbestos Litigation Memorandum Account (ALMA) to track costs related to litigation arising from alleged exposure to asbestos from asbestos cement (AC) water pipes in Cal Water's service areas. These lawsuits arise from alleged exposure to asbestos while working with AC pipes in Cal Water's service areas.

On October 13, 2014, the Office of Ratepayer Advocates (ORA) filed its protest (Protest). ORA questions the reasonableness of certain costs Cal Water proposes to track in the requested memorandum account and objects to Cal Water's proposed schedule for this proceeding. On October 20, 2014, Cal Water timely filed a reply to the Protest.

On November 21, 2014, the Commission held a prehearing conference (PHC) in this matter. Following the PHC, Cal Water and ORA (Parties) submitted their joint request to the assigned Administrative Law Judge (ALJ) requesting that this matter be referred to the Commission's Alternative Dispute Resolution Program, and the matter was promptly so referred.

On January 30, 2015, the Parties filed a joint motion (Joint Motion) requesting that their settlement agreement (Settlement) be adopted by the Commission.

On March 5, 2015, the Assigned Commissioner and the ALJ issued the scoping memo ruling, *inter alia*, to establish the proceeding schedule and to set forth the issues to be examined in the proceeding:

1. Should the Commission authorize Cal Water to establish the ALMA to track costs related to litigation arising from alleged exposure to asbestos from asbestos cement water pipes in Cal Water's service areas?

2. If the Commission authorizes Cal Water to establish the ALMA, what requirements and conditions should the Commission adopt for the ALMA?

3. If the Commission authorizes Cal Water to establish the ALMA, what other requirements and conditions should the Commission set forth for any recovery of the costs recorded in the ALMA?

4. If the Commission authorizes Cal Water to establish the ALMA, what other requirements and conditions, if any, should be imposed on Cal Water to promote public interest?

2. Settlement

The Parties have reached mutually agreeable positions on the issues in dispute in this matter and reached the Settlement. The Settlement addresses all of the issues set forth in the March 5, 2015 Scoping Memo Ruling, including all of the disputed issue between Cal Water and ORA in this proceeding. The Parties agree that the Settlement is in their best interests, in the public interest, and more cost-effective for all concerned, including the Commission, than undertaking the expense, delay, and uncertainty of further litigation.

Accordingly, the Parties moved for approval of the Settlement.[1] The Settlement[2] has been presented as an integrated package; the Parties have

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[1] Joint Motion of California Water Service Company and the Office of Ratepayer Advocates for the Adoption of a Settlement Agreement, filed on February 6, 2015 (Joint Motion).

[2] The Parties note that they have entered into this Settlement on the basis that it not be construed as an admission or a concession by them regarding any fact or matter of law in

Footnote continued on next page

agreed to the Settlement as whole, as opposed to agreeing to specific elements of the Settlement. The Parties note that if the Commission adopts the Settlement with modifications, the Parties would need to subsequently reconsider the Settlement and the Settlement may become void. The notable terms of the Settlement are as follows:

- The Commission should authorize Cal Water to establish the ALMA to track costs[3] related to litigation arising from alleged exposure to asbestos from AC water pipes in Cal Water's service areas.[4]

- The establishment of the ALMA does not guarantee recovery of the recorded costs and the establishment of the ALMA does not equate to a finding by either ORA or the Commission that costs recorded in the ALMA are reasonable.[5]

- Cal Water would record certain agreed upon costs as detailed in I-A of the Settlement, Appendix A to this decision.[6]

- Cal Water would request recovery of the recorded costs, at a later time for the Commission's consideration, and at that time, the

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dispute in this proceeding. Furthermore, as contemplated by the Commission's Rules of Practice and Procedure (Rule) 12.5, the Parties do not intend that the Commission's adoption of this Agreement be construed as any statement of precedent or policy of any kind for or against either of them, in the current or in any future proceedings.

[3] Under the Settlement, the Parties agree that the Commission should authorize Cal Water to track asbestos litigation-related costs incurred on or subsequent to January 1, 2015, and the ALMA expires by the end of Cal Water's next General Rate Case (GRC) cycle on December 31, 2019, unless the Commission approves an extension.

[4] The Settlement, Appendix A to this decision, Section I-C, at 6.

[5] *Id.* at 2.

[6] *Id.* at 2-4.

> ORA and any other interested parties will have the opportunity to review those recorded costs for reasonableness and recovery.[7]

Cal Water should treat the forecasted cost for asbestos-related litigation in the approved rates for 2015 and 2016 as credits to the ALMA. The Parties agree that $90,000 per year is a reasonable estimate of the forecasted cost for asbestos-related litigation for 2015 and 2016. Cal Water will credit $90,000 to the ALMA each year for 2015 and 2016. In its 2015 GRC filing, Cal Water will clearly identify the recorded costs related to asbestos litigation in the recorded years used to develop a forecast for legal expenses, and exclude those costs from forecasted rates.[8]

3. Discussion

Pursuant to Rule 12.1 (d), the Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest. In addition, the Commission has a well-established policy of approving a settlement if it is fair and reasonable in light of the whole record.[9] This policy reduces the expense of litigation, conserves Commission resources, and allows parties to "reduce the risk that litigation will produce unacceptable results."[10] In

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[7] *Id.* at 4-6, Section I-B.

[8] *Id.* at 6-7, Section II.

[9] Decision (D.) 11-06-023, In the Matter of the Application of Golden State Water Company on Behalf of its Bear Valley Electric Service Division (U913E),for Approval of RPS Contract with Bio Energy Solutions, LLC, and for Authority to Recover the Costs of the Contract in Rates, 2011 Cal. PUC LEXIS 330, **17-18.

[10] *Id.*

reviewing settlements, the Commission also considers the parties' evaluations.[11] As discussed below, the Settlement reflects reasonable compromises on the issues, is supported by all parties' careful case evaluation and the record of this proceeding, is consistent with the law, and is in the public interest.

Here, Cal Water is seeking authorization to track costs in a memorandum account related to litigation arising from alleged exposure to asbestos from AC water pipes in Cal Water's service areas. The exposures are alleged to have incurred as early as the 1950s and as late as the 1990s.[12] Plaintiffs in those cases are individuals that allege that they were exposed to asbestos while working with AC pipes in Cal Water's service areas, or the family-members of those employees.

We recognize that AC pipe was used extensively throughout the water industry during this period, including by Cal Water.[13] We also recognize that the Commission may previously have approved some of the projects using AC pipe, including some of the Cal Water projects, and found that those projects using AC pipe met the standards of General Order 103.[14] To date, Cal Water has

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[11] D.00-09-034, Order Instituting Investigation into the operations and practices of the Southern California Gas Company, concerning the accuracy of information supplied to the Commission in connection with its Montebello Gas Storage Facility, 2000 Cal. PUC LEXIS 694, **29, 31.

[12] Direct Testimony of John S. Tootle (Confidential), dated September 3, 2014 ("Tootle Confidential Testimony") at 2-3.

[13] *Id.* at 2-5.

[14] *See* D.85-05-038, Application of Jackson Water Works, Inc., to modify Decision 90153 to Substitute Completed and Proposed Construction Projects for Certain Projects in the Capital Improvement Plan Ordered in the Decision, 1985 Cal. PUC LEXIS 294, *5; D.85-03-054, Application of California Water Service Company for a General Rate Increase for Water Service for Additional Annual Gross Revenue in Amount of $390,800 in 1985, $289,400 in 1986, and $282,800 in 1987, Bear Gulch District; And Related Matters, 1985 Cal. PUC LEXIS 1120, **76-77; D.93-03-013, Application of California Water Service Company (U60W), a Water Corporation,

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been able to obtain partial monetary contributions to its defense costs and settlements from contractors or developers who employed the plaintiffs. However, with the passage of time and each new lawsuit, the developers and contractors are increasingly found to be bankrupt or out of business.[15] The dollars available under Cal Water's insurance policies for defense costs and settlements are also being exhausted with each new asbestos lawsuit.[16] Therefore, it has become increasingly difficult for Cal Water to continue to pay the costs associated with asbestos litigation. The proceeding record and the above historic circumstances leading to the subject AC pipe litigation support the reasonableness of Cal Water's request for the ALMA and this Settlement.

As the Commission pointed out in D.11-06-023, settlement is often favored, as long as the settlement is "fair and reasonable in light of the whole record."[17] Here, we note that the Settlement has been presented to the Commission with the full support of the Parties. The Parties have fully evaluated the facts and the law relevant to this case and believe they have reached reasonable compromises on the issues. Specifically, ORA was able to address all of its concerns on behalf of ratepayers. Cal Water was able to move forward in the resolution of the underlying Application, under agreed upon

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for a Certificate of Public Convenience and Necessity to Construct a Non-Contiguous Water System in its Salinas District, 1993 Cal. PUC LEXIS 153, *7; D.86-02-017, Application of Alisal Water Corporation for a Certificate of Public Convenience and Necessity to Construct a Public Utility Water System Near Salinas in Monterey County and to Establish Rates for Services, 1986 Cal. PUC LEXIS 72, **2, 9; D.76500, Rate increase requested by Fruitridge Vista Water Co., Sacramento County, 1969 Cal. PUC LEXIS 157, **11-1.

[15] Tootle Confidential Testimony at 11.

[16] *Id.* at 11-12.

[17] D.11-06-023 at 13.

conditions, without a costly and protracted litigation. The approach taken in this Settlement thoughtfully balances Cal Water's needs prompting the Application with the ratepayers' concerns by allowing Cal Water to track these costs and also provides the Commission, ORA, and other interested parties an opportunity for future careful review of Cal Water's cost recovery.

Under D.10-04-031, the Commission typically looks to four factors to determine whether to authorize a memorandum account:[18]

1. The expense is caused by an event of an exceptional nature that is not under the utility's control;

2. The expense cannot have been reasonably foreseen in the utility's last GRC and will occur before the utility's next scheduled rate case;

3. The expense is of a substantial nature in the amount of money involved; and

4. The ratepayers will benefit by the memorandum account treatment.

As discussed below, we have examined the Settlement and the above four factors to determine whether our approval of the ALMA is reasonable and appropriate, and we find that Cal Water's request for ALMA meets the above four requirements.

First, the subject asbestos lawsuits are exceptional in nature and not under Cal Water's control. While Cal Water previously has had to expend its resources to address these lawsuits, the rate of exhaustion of insurance policies has accelerated and contractors and developers (potential co-defendants) are

[18] D.10-04-031 at 44.

increasingly going out of business, making it more difficult for Cal Water to obtain monetary contributions to its defense costs and settlements. Second, these challenges were not and could not have reasonably been foreseen in Cal Water's last GRC (filed in May 2012) and are expected to continue in the period before Cal Water's next scheduled rate case. Third, there is always the potential for significant amounts in verdict or judgment in these asbestos lawsuits, and even a portion of the damages which Cal Water could be found joint and severally liable with other defendants in any one of these lawsuits, could be substantial. Lastly, establishment of this memorandum account "promotes the safety, health, comfort, and convenience of its patrons, employees, and the public" required by Publ. Util. Code § 451, by enhancing California Water Service Company's ability to (1) track these litigation costs, (2) accurately forecast its overall budget needs to support a safe and reliable water service to its customers, and (3) minimize potential budget and operational impacts due to unforeseen litigation costs which could adversely affect the safety and reliability of its water service. Moreover, ratepayers would benefit because the Settlement requires Cal Water to carefully track those costs in the ALMA and it clarifies and limits the types of costs that may be tracked in the memorandum account. Ratepayers also benefit because the Settlement also requires Cal Water to take steps to avoid any overlap between possible forecasted costs of asbestos-related litigation in rates and the costs tracked in the memorandum account and specify Cal Water's requirements for seeking future recovery of those costs. The Settlement would also require any costs related to asbestos litigation tracked in the ALMA to be thoroughly reviewed for reasonableness before recovery at a later time.

In addition to meeting the above four-factor test, including the ratepayer interests, the Settlement also serves other public interests because it provides speedy resolution of contested issues while avoiding the unnecessary litigation expense and waste of Commission resources. Moreover, Cal Water is scheduled to file its Proposed Application for its next general rate case on May 1, 2015. This decision will provide the necessary guidance to allow Cal Water to properly and efficiently address the issue of costs related to asbestos litigation in its application.

We are also mindful that the ALMA is very similar to those memorandum accounts previously approved by the Commission. As with the water contamination litigation,[19] Cal Water could incur substantial costs to defend asbestos lawsuits, which are increasingly unlikely to be recoverable through insurance, even if the lawsuits have no basis. Similar to those prior Commission approvals of water contamination litigation, the Parties here agree that Cal Water should be able to track costs related to asbestos litigation in a memorandum account so that Cal Water may seek recovery of these costs at a later date without encountering retroactive rate-making issues. We agree.

Furthermore, as noted in the Settlement, General Order 96-B and Commission precedent allow utilities to track costs in a memorandum account as of the date of the request for the account, or other date specified by the

[19] *See* Water Division Resolution No. W-4094, Order Authorizing the Establishment of a Memorandum Account for Water Contamination Litigation Expenses for All Water Utilities, 1998 Cal. PUC LEXIS 1107.

utility.[20] Here, Cal Water's request for authorization of the ALMA (the Application) was filed on September 3, 2014 to begin tracking on January 1, 2015, and the Parties' agreed-upon effective date of the ALMA, January 1, 2015, as set forth in the Settlement. We find this agreed-upon effective date of the ALMA reasonable and consistent with the law.

Procedurally, pursuant to Commission Rule 12.1 (b), seven days advance notice of the date, time, and (telephonic) location of a settlement meeting must be provided. Here, the Parties have so provided the required notice of the settlement meeting via email. *See* Joint Motion at 3.

Based on the foregoing and upon review of the entire proceeding record, including the Joint Motion and the accompanying Settlement, we find that the Settlement and its terms are reasonable, consistent with the law, in the public interest and fully supported by the record of this proceeding. For the foregoing reasons, we approve the Settlement.

4. Proceeding Category and Need for Hearings

In Resolution ALJ 176-3342, dated September 11, 2014, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that hearings are not needed.

5. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Section 311(g)(2) of the Public Utilities Code

[20] *See* General Order 96-B, General Rules 7.3.3 and 7.5.3; D.08-02-036, Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities, et al., 2008 Cal. PUC LEXIS 72, **64-69.

and Rule 14.6(c)(2), the otherwise applicable 30-day period for public review and comment is waived.

6. Assignment of the Proceeding

President Michael Picker is the assigned Commissioner and Kimberly H. Kim is the assigned Administrative Law Judge

Findings of Fact

1. On September 3, 2014, Cal Water filed an application seeking authorization to establish the ALMA to track costs related to litigation arising from alleged exposure to asbestos from AC water pipes in Cal Water's service areas.

2. On October 13, 2014, the ORA filed its Protest and questioned the reasonableness of certain costs Cal Water proposes to track in the requested memorandum account and objects to Cal Water's proposed schedule for this proceeding.

3. On January 30, 2015, the Parties filed the Joint Motion and requested that their Settlement be adopted by the Commission.

4. The Settlement resolves all of the disputed issues in this proceeding, including all of the issues set forth in the March 5, 2015 Scoping Memo Ruling.

5. In compliance with the Commission Rule 12.l (b), the Parties have provided the required notice of the settlement meeting.

6. Pursuant to Rule 12.l (d), the Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

7. The Commission has a well-established policy of approving a settlement if it is fair and reasonable in light of the whole record.

8. The Settlement reflects reasonable compromises on the issues.

9. Under D.10-04-031, the Commission typically looks to four factors to determine whether to authorize a memorandum account.

10. General Order 96-B and Commission precedent allow utilities to track costs in a memorandum account as of the date of the request for the account, or other date specified by the utility.

11. Establishment of this memorandum account "promotes the safety, health, comfort, and convenience of its patrons, employees, and the public" required by Publ. Util. Code section 451, by enhancing California Water Service Company's ability to (1) track these litigation costs, (2) accurately forecast its overall budget needs to support a safe and reliable water service to its customers, and (3) minimize potential budget and operational impacts due to unforeseen litigation costs which could adversely affect the safety and reliability of its water service.

12. The ALMA will benefit ratepayers because it will allow any costs related to asbestos litigation to be subsequently reviewed for reasonableness before recovery.

13. The Settlement clarifies the types of costs that may be tracked in the memorandum account and clearly prescribes the information that Cal Water must provide in order to seek recovery of these costs.

14. Commission approval of the Settlement will provide speedy resolution of contested issues, and will result in significant savings in time, resources, and expense for all the Parties, including the Commission and the ratepayers.

Conclusions of Law

1. The Settlement and its terms are reasonable, consistent with the law, and in the public interest.

2. The Settlement and its terms are consistent with the provisions of the Public Utilities Code, prior Commission decisions, and other applicable laws.

3. The Settlement, attached hereto as Appendix A, should be approved and adopted.

4. Cal Water should be authorized to track costs related to asbestos litigation in a memorandum account as conditioned in the Settlement, Appendix A to this decision.

5. The agreed-upon effective date of the ALMA, January 1, 2015, at set forth in the Settlement is reasonable and consistent with the law.

6. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement of California Water Service Company and the Office of Ratepayer Advocates, attached to this decision as Appendix A, is approved and adopted.

2. California Water Service Company (Cal Water) is authorized to establish the Asbestos Litigation Memorandum Account to track costs related to litigation arising from alleged exposure to asbestos from asbestos cement water pipes in Cal Water's service areas, by filing a Tier 2 advice letter to add the Asbestos Litigation Memorandum Account to the Prehearing Statement in its tariffs.

3. California Water Service Company shall comply with each and every term and condition set forth in the Settlement Agreement attached to this decision as Appendix A.

4. The establishment of the Asbestos Litigation Memorandum Account (ALMA) does not guarantee recovery of the recorded costs, and the

establishment shall not be construed to mean that costs recorded in the ALMA are reasonable.

5. California Water Service Company (Cal Water) shall record in the Asbestos Litigation Memorandum Account only those costs detailed in Section I.A. of the Settlement Agreement of Cal Water and the Office of Ratepayer Advocates, attached as Appendix A to this decision.

6. California Water Service Company (Cal Water) shall seek recovery of costs recorded in the memorandum account if triggered under Standard Practice (SP) U-27-W, or at the end of the five-year term of the memorandum account. The request shall be in a filing that is in accordance with SP U-27 and General Order 96-B, Water Industry Rule 7.3.3, and shall provide the following information in any advice letter, general rate case, or application filing seeking recovery of costs recorded in the Asbestos Litigation Memorandum Account (ALMA):

   a. The number of active cases pending against Cal Water involving claims related to alleged asbestos exposure.

   b. For each active case currently pending against Cal Water, the status of each case and a description of the claims made against Cal Water.

   c. The amount of costs that Cal Water has spent to date for each case, specified by year.

   d. An estimate of the amount that Cal Water anticipates it will incur in further asbestos litigation expenses for each case listed above.

7. California Water Service Company (Cal Water) shall demonstrate in any filing seeking recovery of any costs that have been recorded in the Asbestos Litigation Memorandum Account (ALMA) that Cal Water has taken all

reasonable actions and legal recourse to recover insurance funds and funds from contractors, developers or other parties partially or wholly responsible for asbestos exposure. If Cal Water has not undertaken any of the actions listed below, it must provide an explanation and justify why such step(s) were not taken. The actions include but are not limited to:

a. Cal Water has contractually required all developers and contractors to defend, indemnify, and hold Cal Water harmless.

b. Cal Water contractually requires contractors to add Cal Water as an additionally insured party to contractors' general liability insurance.

c. Cal Water has filed a cross-complaint against any developers, contractors, or other pertinent parties in any litigation.

d. Cal Water has determined the insurance policies in effect at the time of the alleged exposure and analyzed any limitations or exclusions.

e. Cal Water has tendered all asbestos claims to its insurance carriers.

f. As an additional insured, Cal Water has directly tendered a claim to the contractor's insurance carrier regarding claims arising from alleged asbestos exposure.

g. Cal Water and/or its insurers, have pursued other parties and their insurance regarding any claims arising from alleged asbestos exposure. This includes demonstrating that Cal Water has determined the identity of any contractors or developers who may have been involved, researched the ability to recover costs from those parties and/or or their insurers, and then taken steps to pursue such recovery. If a developer or contractor fails to indemnify Cal Water or the developer or contractor's insurers decline to cover Cal Water's tendered

claim, Cal Water has taken legal action against the responsible party. For any settlement agreements whereby Cal Water has agreed to pay any amount for claims related to asbestos exposure, Cal Water must provide a confidential copy of the settlement agreement and an explanation as to why the agreement was reasonable and the payment should be recovered from ratepayers. For judgments against Cal Water, Cal Water must provide a copy of the court's decision and an explanation as to why it is reasonable for the judgment amount to be recovered from ratepayers.

8. Application 14-09-003 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A

SETTLEMENT AGREEMENT