

Decision 08-10-019

October 2, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
California-American Water Company
(U210W) for an Interest Rate of 8.33% for
Allowance for Funds Used During
Construction (AFUDC) for its
San Clemente Dam Memorandum.

Application 07-02-023
(Filed February 20, 2007)

ORDER DENYING REHEARING OF DECISION (D.) 08-05-036

I. INTRODUCTION

In this Order we dispose of the application for rehearing of Decision (D.) 08-05-036 (“Decision”), filed by Monterey Peninsula Water Management District (“MPWMD”).

On February 20, 2007 California-American Water Company (“Cal-Am”) filed application (A.) 07-02-023 regarding its operation of the San Clemente Dam. The application sought Commission approval of a higher Allowance for Funds Used During Construction (“AFUDC”) rate, and authorization to move the memorandum account balance (with accrued interest), into rate base.¹

The San Clemente Dam was constructed in 1921 and has been operated by Cal-Am since the 1960’s.² Due to sedimentation, the reservoir’s capacity has declined

¹ Specifically, Cal-Am requested a 8.33% interest rate, which is its currently authorized cost of capital and that the accrued interest be moved into rate base when the project becomes more certain. (See D.08-05-036, p. 2.)

² The ratemaking history of the dam is set out in *In the Matter of the Application of California American Water Company for an order authorizing it to increase rates for water service in its Monterey District (“Application of Cal-Am Water”)* [D.06-11-050] (2006) ___ Cal.P.U.C.3d ___, at pp. 39-45 (slip op.)

from 2,260 acre feet to 137 acre feet, and Cal-Am's only use of the dam is as a point of diversion during the winter months. (See D.08-05-036, p. 4.) The dam requires seismic safety retrofits which are estimated to cost \$47 million. (See D.08-05-036, p. 4.)

Between 2003 and 2006, amounts associated with the San Clemente Dam Seismic Safety Project were recorded in construction work in progress ("CWIP") receiving the authorized rate of return. (See D.08-05-036, p. 1.)

In 2004, the Commission directed Cal-Am to remove the San Clemente Dam retrofit project costs from rate base and place the amount in a memorandum account for later reasonableness review.³ The Commission further authorized the application of an AFUDC rate as the carrying cost.⁴ The Commission did not, however, define the appropriate AFUDC rate at that time, and instead directed Cal-Am to file a separate application addressing the AFUDC methodology that should be applied.⁵ As an interim measure, the Commission authorized the account to accrue interest at the 90-day commercial paper rate, but allowed Cal-Am the opportunity to request, by subsequent application, a different carrying cost.⁶

On May 29, 2008, the Commission issued D.08-05-036 (or "Decision.") In D.08-05-036, the Commission approved the authorized rate of return as the appropriate carrying cost for the amounts properly recorded in Cal-Am's San Clemente Dam Memorandum Account. (See D.08-05-036, p. 1.)

³ See *Application of Cal-Am Water Company* [D.06-11-050], *supra*, at p. 112 (slip op.).

⁴ *Id.*

⁵ *Id.*

⁶ See D.08-05-036, p. 2; citing *Application of Cal-Am Water Company* [D.06-11-050], *supra*, at p. 112 (slip op.) which states: "The account shall accrue AFUDC at the 90-day commercial paper rate, subject to true-up, until the Commission completes a review of the appropriate AFUDC rate for this project. Cal-Am is directed to file within 60-days an application addressing the AFUDC methodology that should be applied to the San Clemente Dam retrofit memorandum account."

MPWMD filed a timely application for rehearing of D.08-05-036. MPWMD alleges the following legal error: (1) the Commission failed to follow its own direction as stated in D.06-11-050; (2) the Commission is unclear whether this decision is a case-specific determination or Commission precedent; and (3) the Decision is predicated on findings of fact and conclusions of law in violation of due process. (See Rehearing App., p. 1.)

We have carefully considered each and every argument raised in the application for rehearing and are of the opinion that good cause has not been established to grant rehearing. Accordingly, the application for rehearing of D.08-05-036 is denied.

II. DISCUSSION

A. The Commission complied with D.06-11-050.

MPWMD contends that the Decision errs because the Commission failed to follow its own direction in D.06-11-050, and the Background section of D.08-05-036 fails to provide a full history of why this separate application was required. (See Rehearing App., pp. 1-4.) These contentions have no merit. MPWMD's claims are vague and fail to establish that the authorized rate of return awarded in D.08-05-036 is unlawful. Public Utilities Code section 1732 requires that the application for a rehearing shall set forth specifically the ground or grounds on which the rehearing applicant considers the decision or order to be unlawful. (See Pub. Util. Code, §1732.) Rule 16.1 further requires that applications for rehearing must make specific references to the record or law. (Rule 16.1 of the Commission's Rules of Practice and Procedure, Code of Regs., tit. 20, §16.1.) Because MPWMD's allegations fail to provide the requisite specificity and do not show legal error consistent with Rule 16.1 or Public Utilities Code section 1732, they should be rejected.

MPWMD further maintains that D.06-11-050 directed the Commission to do two things: (1) address the assumption that energy projects generally use an AFUDC interest rate that also reflects long term debt and equity; and (2) resolve the application of

energy AFUDC financing and whether it is applicable to and appropriate for water utilities. (See Rehearing App., p. 4.) This argument is without merit.

D.08-05-036 is consistent with the Commission's intent in D.06-05-011.

As set forth in the scoping memo, the Decision specifically addressed:

“The scope of this proceeding shall be to determine the AFUDC methodology that should be applied to the San Clemente Dam retrofit memorandum account as directed by the Commission in D.06-11-050.”⁷

Consistent with this scope and D.06-05-011, the Decision looked at whether the carrying costs should be recorded based on the 90-day commercial paper rate or as the rate of return,⁸ and determined the authorized rate or return as the appropriate carrying cost for the amounts recorded in Cal-Am's memorandum account. (See D.08-05-036, p. 17.)

In examining these issues, we have discretion to determine which methodology to apply. MPWMD points to no legal requirement that we apply any one methodology.² We note that while MPWMD's argument for the 90-day commercial

⁷ See *Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge Determining the Scope, Schedule, and Need for Hearing in this Proceeding*, dated May 18, 2007, p. 3 (*emphasis added*).

⁸ Moreover, we reviewed the issue of the appropriate interest rate for the San Clemente Dam retrofit memorandum account at MPWMD's request. Specifically, “MPWMD urges the Commission to thoroughly review the project in a separate proceeding, or in the alternative, adopt DRA's recommendation to place the costs in a memorandum account for later review.” (See *Application of Cal-Am Water*, [D.06-11-050], *supra*, at p. 43 (slip op).)

² The Commission has said that “there are no explicit statutory guidelines for our decisions regarding interest rates, and we have broad flexibility in reviewing the facts of a particular situation and broad discretion to make appropriate findings of fact and conclusions of law...these factors provide a rational basis for our adopted interest rate. A proper exercise of our discretion is not subject to judicial review.” (See *In the Matter of the Investigation on the Commission's own motion into Pacific Telesis Group's spin off proposal* [D.95-03-021] (1995) 59 Cal.P.U.C.2d 54, 58, citing *Northern California Association to Preserve Bodega Head and Harbor, Inc. v. Public Utilities Commission* (1964) 61 Cal.2d 126, 135; see also *California Manufacturers Association v. Public Utilities Commission* (1979) 24 Cal.3d 251, 258-259.)

paper rate as the appropriate carrying costs for the San Clemente Dam retrofit memorandum account is plausible, it is by no means the only legally sustainable approach.

The Commission has also faced this issue before. We have previously determined that the memorandum accounts for a water utility project of long duration could accrue interest at either the 90-day commercial paper rate or the authorized rate of return. (See D.08-05-036, p. 11.)¹⁰ And the Decision clearly explains the basis to use the authorized rate of return in this instance. For example, the Decision reasons:

“that due to the certainty of the project as expressed in the final EIR and the policy objective of matching of the regulatory costs with actual costs,” are reasons which support the interest on the San Clemente Dam memorandum account to accrue at the authorized rate of return.” (See D.08-05-036, p. 9.)

The Decision also points out that authorizing a carrying cost less than the rate of return would not reflect the risks of actual project costs, and thus, would not reflect the Commission’s policy of matching regulatory costs with actual costs. (See D.08-05-036, p. 9.)¹¹

¹⁰ The Decision notes that the 90-day commercial paper rate has been found appropriate for *In the Matter of the Application of California American Water Company (U 210 W) for a Certificate that the Present and Future Public Convenience and Necessity Requires Applicant to Construct and Operate the 24,000 acre foot Carmel River Dam and Reservoir in its Monterey Division and to Recover All Present and Future Costs in Connection Therewith in Rates (“Coastal Water Project”)* [D.03-09-022] (2003) __ Cal.P.U.C.3d __, whereas the authorized rate of return has been used for a project like *In the Matter of the Application of Southern California Water Company, (“Calipatria”)* [D.04-03-039], (2004) __ Cal.P.U.C.3d __.

Again, “there are no explicit statutory guidelines for our decisions regarding interest rates, and we have broad flexibility in reviewing the facts of a particular situation and broad discretion to make appropriate findings of fact and conclusions of law...these factors provide a rational basis for our adopted interest rate. A proper exercise of our discretion is not subject to judicial review.” (See *In the Matter of the Investigation on the Commission’s own motion into Pacific Telesis Group’s spin off proposal* [D.95-03-021], *supra*, 59 Cal.P.U.C.2d at p.58 citing *Northern California Association to Preserve Bodega Head and Harbor, Inc. v. Public Utilities Commission, supra*, 61 Cal.2d at p. 135.)

¹¹ The Decision further makes clear that “protection is given to ratepayers in the form of a reasonableness review when the dollars are transferred out of the memorandum account into

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We noted that in 1992, the Department of Water Resources Division of Safety of Dams required Cal-Am to upgrade the Dam so that it would comply with current seismic safety standards. (See D.08-05-036.) And, that since that time, it has become more certain that a project will be needed to bring the dam into seismic compliance. (See D.08-05-036, p. 9.) In fact, the final EIR issued in January 2008, made clear that “a do nothing action would not comply with current standards.” (See D.08-05-036, p. 10.) Thus, we found “there is no question whether a project will ensue... There will be a project entailing significant capital investment on the part of Cal-Am... While the specific alternative has not yet been selected, it is clear that a project will take place and that we should review the final project costs.” (See D.08-05-036, p. 10.)

Our Decision also explains that the arguments for extending the temporary carrying cost at the 90-day commercial paper rate are not persuasive, because for most part, while the current EIR has been underway the dollars associated with the project have been recorded in CWIP and received a carrying cost equal to the authorized rate or return. (See D.08-05-036, p. 9.)

We further distinguished this circumstance from that of typical memorandum accounts. Memorandum accounts typically are used to record expenses that are not anticipated or readily quantifiable at the time (i.e., litigation or water quality costs). The cost factor applied is the 90-day commercial paper rate since it involves only expenses occurring in the course of doing business, rather than the cost of capital projects. (See D.08-05-036, p. 11.)

However, when dealing with the accrual of AFUDC and significant capital costs, the Commission should decide the interest rate treatment based upon the circumstances at hand and the type of financing used to fund the project. (See D.08-05-

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ratebase. Specifically, if it can be shown that actual carrying costs are less than the authorized rate of return, (i.e. closer to the cost of debt) we can make adjustments in the relevant general rate case proceeding.” (See D.08-05-036, p. 9.)

036, p. 11.) The fact that we did not agree with MPWMD's requested treatment of the carrying costs does not constitute legal error.¹²

Lastly, MPWMD contends that the Decision fails to adequately address the separate application requirement. We disagree. MPWMD disregards our explanation that in D.06-11-050, we declined to define the appropriate AFUDC rate and only authorized the account to accrue interest at the 90-day commercial paper rate as an interim measure. Cal-Am was specifically allowed the opportunity to request, by subsequent application, a different carrying cost. (See D.08-05-036, p. 2.) While our explanation may be brief, we believe it adequately apprises the parties of our reasoning on this issue.

B. In adopting the authorized rate of return as the appropriate carrying cost, the Commission did not adopt new rule applicable to all water cases.

MPWMD requests the Commission clarify whether D.08-05-036 applies solely to this matter or is precedent for all water cases. (See Rehearing App., p. 4.) MPWMD further challenges the Commission's reliance on *In the Matter of the Application of Southern California Water Company*, ("Calipatria") [D.04-03-039], (2004)___ Cal.P.U.C.3d ___ and whether *Calipatria* supports the Commission's decision. (See Rehearing App., p. 4.)¹³

We interpret MPWMD's request as in the nature of an advisory opinion. Like courts, we have a long-standing policy against issuing advisory opinion in the

¹² See *Southern California Edison Company v. Public Utilities Commission* (2005) 128 Cal.App.4th, 1, 8 ["the fact that Edison does not like the Commission's findings and conclusions simply does not provide grounds for reversal"].

¹³ MPWMD further alleges that we ignored our own directive to examine whether energy utilities AFUDC approach provides a better alternative for carrying costs on long-term projects requiring financing over multiple years. (See Rehearing App., p. 4.) That is wrong. The scoping memo clearly set forth the relevant objective; namely "to determine the AFUDC methodology that should be applied to the San Clemente Dam retrofit memorandum account as directed in D.06-11-050." (See Scoping Memo, p. 3.) D.08-05-036 fully discusses parties' positions with respect to this issue.

absence of a case or controversy, unless there are extraordinary circumstances presented.¹⁴ There is no showing of such circumstances here.

Notwithstanding that fact, the applicability of D.08-05-036 was addressed in the categorization of the proceeding. Specifically, the Commission categorized this proceeding as rate setting. (See Resolution ALJ-176.) Rate setting proceedings are typically “cases in which rates are established for a specific company...” (See Pub. Util. Code, §1701.1, subd. (c)(3).) By contrast, quasi-legislative proceedings are “cases that establish policy, including, but not limited to, rulemaking and investigations which merely establish rules affecting an entire industry...” (See Pub. Util. Code, §1701.1, subd. (c)(1).) Consistent with the categorization, we did not intend to establish policy regarding AFUDC for all long-term water projects. However, as we indicated in our Decision, we will decide the interest rate treatment based upon the circumstances at hand and the type of financing being used to fund the project. (See D.08-05-036, p. 11 (emphasis added).)

The Decision is also consistent with *Calipatria*. That said, we did not use *Calipatria* as precedent or to set a rule of law or way of doing things.¹⁵ We referenced

¹⁴ See *Rulemaking to Establish Rules for Enforcement of the Standards of Conduct Governing Relationships Between Energy Utilities and Their Affiliates Etc.* [D.00-01-052] (2000) ___ Cal.P.U.C.2d ___, at pp. 12-13 (slip op.), citing *Pacific Legal Foundation v. California Coastal Com.* (1982) 33 Cal.3d 158, 170; *Re Pacific Gas and Electric Company* [D.00-06-002] (2000) ___ Cal.P.U.C.2d ___ at pp. 3-4 (slip op.).

¹⁵ MPWMD also generally argues: “should every settled issue from prior cases be re-opened, what impact will this have on settlement negotiations; and the instant decision has the potential to discourage settlement and increase the workload for all party participants.” (See Rehearing App., p. 5.) While the exact nature of MPWMD’s argument is unclear, DRA offers some possible clarity as to MPWMD’s intent. DRA claims it was improper for the Commission to rely on *Calipatria* as that decision involved a settlement and Rule 12.5 of the Commission’s Rules of Practice and Procedure provides that adoption of a settlement does not constitute approval of, or precedent regarding any principle or interest in any future proceeding. (See DRA Response to MPWMD’s Application for Rehearing, pp. 1-2.) We find this allegation without merit. As explained, we did not rely on *Calipatria* as precedent or as establishing a fixed way of determining the issues in this proceeding. As explained, we merely noted *Calipatria* to show a similar circumstance and approach.

Calipatria only as a point of guidance, since it raised similar issues.¹⁶ *Calipatria* illustrates that computing carrying costs via 90-day commercial paper rate or rate of return is not a novel issue. (See D.08-05-036, p. 11.)¹⁷ *Calipatria* merely highlights similarities with respect to the status of both projects. In that regard, we noted “like the seismic dam safety project, the *Calipatria* treatment plant’s specific form was not certain, but the fact that it was a required project was quite certain, and it was going to require substantial investment...the Commission concluded appropriately that the authorized rate of return was the appropriate AFUDC cost factor to apply to the project costs.” (See D.08-05-036, p. 13.)¹⁸ There is nothing unlawful in looking at past Commission decisions on similar issues and circumstances.

C. The Commission complied with due process and notice requirements in its issuance of D.08-05-036.

MPWMD contends the Decision errs because it contains substantive modifications to the findings of fact and conclusions of law which constitute another alternate decision that should have been subject to further review and comment under

¹⁶ Our Decision is clear on this point, stating: “We find guidance in another case: The Commission granted the authorized ROR to Southern California Water...for its AFUDC memorandum accounts in D.00-06-074 and D.04-03-039....” (See D.08-05-036, p. 12.)

¹⁷ The Decision discusses *Calipatria*, wherein the Commission granted the authorized rate of return to Southern California Water (now Golden State Water) for its AFUDC memorandum accounts in D.00-06-074 and D.04-03-039. (See D.08-05-036, p. 12). Both those decisions relate to the construction of the *Calipatria* treatment plant project. D.00-06-074 adopted a settlement, and D.04-03-039 affirmed the settlement results in the context of a general rate case proceeding. (See D.08-05-036, p. 13.)

¹⁸ We also referenced “*Coastal Water Project*” [D.03-09-022], *supra*, in which we determined that a 90-day commercial rate was appropriate due to the uncertain nature of the project, and in particular, due to the uncertainty whether construction would occur at all. (See D.08-05-036, p. 11, citing *Coastal Water Project* [D.03-09-022], *supra*, at pp. 22 and 30 (slip op.)) D.03-09-022 illustrates the differences between the Coastal Water Project and San Clemente Dam project. In that regard, we noted that the CWP was very different from the current seismic dam safety case because the company had not yet begun physical construction, the environmental review process had not begun and there were questions regarding whether the project would ever be undertaken. (See D.08-05-036, p. 12.) Accordingly, we rejected that case here. (See D.08-05-036, pp. 12-13.)

Public Utilities Code section 311(e).¹⁹ (See Rehearing App., p. 5.) These claims lack merit.

Section 311(e) states:

“Any item appearing on the commission’s public agenda as an alternate item to a proposed decision subject to subdivision (g) shall be served upon all parties to the proceeding without undue delay and shall be subject to public review and comment before it may be voted upon. For purposes of this subdivision, “alternate” means either a substantive revision to a proposed decision that materially changes the resolution of a contested issue or any substantive addition to the findings of fact, conclusions of law, or ordering paragraphs...”

(Pub. Util. Code, §311, subd. (e).)

Similarly, Rule 14.1 of the Commission’s Rules of Practice and Procedure states:

“A substantive revision to a proposed decision or draft resolution is not an ‘alternate’ if the revision does no more than make changes suggested in prior comments on the proposed decision or draft resolution.”

(Rule 14.1 of the Commission’s Rules of Practice and Procedure, Code of Regs., tit. 20 §14.1.)

Further, as defined in Rule 14.1(d), an “alternate” is a “substantive revision by a Commissioner to a proposed decision.” (Cal. Code Regs., tit. 20, §14.1, subd. (d).)

While D.08-05-036 includes findings of fact and conclusions of law that do not appear in the proposed alternate decision, they are not substantive revisions and do not materially change the resolution of any contested issue. Instead, the additional findings and conclusions merely restate language and concepts that were already included in the body of the proposed alternate decision. These findings and conclusions were

¹⁹ MPWMD points to the fact the Proposed Alternate Decision contained four findings of fact and four conclusions of law, while D.08-05-036 contains fifteen findings and eleven conclusions. (See Rehearing App., p. 6.)

added to provide clarity to the Commission’s determinations on this issue as set forth in the discussion.²⁰

MPWMD specifically challenges finding of fact (“FOF”) number 7. FOF 7 states:

“the proper carrying cost of the dollars associated with the seismic safety project is a project specific cost of capital reflecting the risks of this investment.” (See D.08-05-036, p. 15.)

Contrary to MPWMD’s claim, this is not a new substantive modification. It simply reflects language from the Proposed Alternate Decision which states:”

“...in a case that deals with the accrual of AFUDC and significant capital costs, not merely the unanticipated expense of typical memorandum accounts, the Commission should decide the interest rate treatment based upon the circumstances at hand and the type of financing being used to fund the project.” (See Proposed Alternate Decision of Commissioner Bohn, p. 11.)

MPWMD also challenges conclusion of law (“COL”) number 3. COL 3 states: “setting the AFUDC rate below the actual current cost is harmful.” (D.08-05-036, p. 16.) This conclusion reflects discussion in the Proposed Alternate Decision noting Cal-Am’s comment that:

²⁰ Section 1705 requires Commission decisions to contain findings of facts and conclusions of law on all issues material to the order or decision. (Pub. Util. Code, §1705.) D.08-05-036 was modified to better carry through our discussion from the text of the Decision to actual findings and conclusions. Such modifications are appropriate to fully comply with our obligation to “afford a rational basis for judicial review and assist the reviewing court to ascertain the principles relied upon by the [C]ommission and to determine whether it acted arbitrarily, as well as assist parties to know why the case was lost and to prepare for rehearing or review, assist others planning activities involving similar questions, and service to help the [C]ommission avoid careless or arbitrary action.” (*Greyhound Lines, Inc. v. Public Utilities Com.* (1967) 65 Cal.2d 811, 813; see also, *California Manufacturers Association v. Public Utilities Commission*, *supra*, 24 Cal.3d at pp. 258-259.)

“setting the interest rate too low would harm customers by impacting Cal-Am’s ability to attract investment.” (See Proposed Alternate Decision, p. 6.)

Lastly, MPWMD suggests that they did not receive due process because they had no opportunity to comment modifications in the Decision. (See Rehearing App., p. 6.) However, this claim is contradicted by MPWMD’s own acknowledgement that it did in fact receive adequate due process. Specifically, MPWMD stated that the “Commission provided access to the document at the Commission office and did not violate the Escutia requirement.” (See Rehearing App, p. 6.)

We properly followed established Commission procedures for notice and comments accorded to proposed and final decisions. Here, the proposed decision was mailed to the parties in accordance with Section 311 of the Public Utilities Code and Rule 14.3 of the Commission’s Rules of Practice and Procedure. (See D.08-05-036, p. 14.) MPWMD filed comments and reply comments on the proposed decision. MPWMD also filed comments on the Proposed Alternate Decision on May 19, 2008. (See D.08-05-036, p. 14.) Accordingly, MPWMD and the other parties had notice and opportunity to comment on the discussion related to the additional FOFs and COLs. In addition, the Decision acknowledges this fact and states: “We have reviewed the comments and reply comments, all of which substantially reargue positions taken in the briefs, and have made no significant changes to the decision.” (See D.08-05-036, p. 14.)²¹ Accordingly, there was no legal error.

III. CONCLUSION

For the reasons discussed above, rehearing of D.08-05-036 is denied.

THEREFORE, IT IS ORDERED that:

1. Rehearing of D.08-05-036 is hereby denied.

²¹ Specifically, D.08-05-036 states: “In both sets of comments Cal-Am contended that the San Clemente Dam project was more certain than the Coastal Water Project because the dam must be retrofitted. DRA and MPMWD argue that the Coastal Water Project is the most analogous to the San Clemente Dam Project.” (See D.08-05-036, p. 14.)

2. Application (A.) 07-02-023 is closed.

This order is effective today.

Dated October 2, 2008, at San Francisco, California.

MICHAEL R. PEEVEY

President

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

TIMOTHY ALAN SIMON

Commissioners