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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS
Water and Sewer Advisory Branch

RESOLUTION NO. W-4793
December 3, 2009

R E S O L U T I O N

(RES. W-4793), CALIFORNIA-AMERICAN WATER COMPANY (CAL AM). ORDER REJECTING REQUEST TO ESTABLISH TWO MEMORANDUM ACCOUNTS: (1) A 2009 GENERAL RATE CASE MEMORANDUM ACCOUNT; AND (2) A 2010 GENERAL RATE CASE MEMORANDUM ACCOUNT.

By Advice Letter (AL) 796, filed on August 18, 2009.

SUMMARY

This Resolution denies Cal Am the authority requested in AL 796 to establish two memorandum accounts to track regulatory expenses that it incurs to prepare and process its 2009 and 2010 general rate cases.

Cal Am submitted this advice letter with a Tier 2 designation in accordance with Industry Rule 7.3.2 of General Order 96-B. Cal Am requested that this Advice Letter become effective September 16, 2009. In Decision (D.) 08-02-036, as reaffirmed in D.09-06-053 on rehearing, the Commission stated that further requests for memorandum accounts to track costs associated with participating in generic proceedings shall be made by advice letter and the Division of Water and Audits (DWA) shall prepare a resolution for the Commission's consideration. See D.09-06-053, Ordering Paragraph No. 3 at p.27. Based on this direction, AL 796 is being processed as a Tier 3 filing requiring Commission resolution. On September 9, 2009, DWA suspended AL 796 to provide time for this Resolution to be drafted for the Commission's consideration.

BACKGROUND

Cal Am is requesting establishment of two memorandum accounts: (1) a 2009 General Rate Case Memorandum Account, and (2) a 2010 General Rate Case Memorandum Account. Cal Am is making this request because of alleged disparate treatment of regulatory expenses in recent Commission decisions. Because of the alleged disparate treatment, Cal Am argues that it is unable to predict with any degree of certainty how

the Commission will treat the regulatory expenses Cal Am has incurred, and will continue to incur, as a result of its 2009 and 2010 general rate case applications. Cal Am also alleges that the Commission's treatment of regulatory expense could leave Cal Am without the ability to recover prudently incurred expenses. Cal Am supports its request by analyzing the five criteria for establishing memorandum accounts set forth in Standard Practice U-27-W, *Standard Practice for Processing Rate Offsets and Establishing and Amortizing Memorandum Accounts* (Standard Practice U-27-W).

The Division of Ratepayer Advocates (DRA) protested AL 796 on September 4, 2009. In its protest DRA argues that Cal Am's request is contrary to long-standing Commission policy of using future test-year cost projections in establishing prudent expenses. DRA further argues that Cal Am's request does not meet the criteria for establishment of memorandum accounts. DRA cites to D.02-08-054 where the five criteria outlined in Standard Practice U-27-W are used in reviewing a request for a memorandum account.

Cal Am filed a response to DRA's protest on September 15, 2009. Cal Am's response was one day late. DWA accepted Cal Am's response for filing.¹ Cal Am responds that its request is consistent with the criteria the Commission has used for establishing memorandum accounts. Cal Am also reiterates that its request is not contrary to forward-looking test-year ratemaking. The 2009 and 2010 regulatory expense memorandum accounts are being sought because of what Cal Am characterizes as "the confusion surrounding the Commission's treatment of regulatory expenses." (Response at p. 3)

DISCUSSION

We need not reach a determination of whether Cal Am's request has or has not satisfied the five criteria set forth in Standard Practice U-27-W. Cal Am's justification for establishing these two memorandum accounts rests on its mistaken view that D.09-07-021, Cal Am's most recent general rate case decision, "marks a fundamental shift in policy for recovery of regulatory expenses." (AL 796 at p.2) Cal Am argues that D.09-07-021 changed Commission policy from an explicit amortization of past regulatory expenses for recovery in rates during the subsequent general rate case cycle to forecasting future regulatory expenses for recovery in rates during a general rate case cycle.

Cal Am's reading of the various general rate case decisions cited in AL 796 is fundamentally flawed. D.09-07-021 *does not* mark a shift in our policy for recovery of regulatory expenses. As DRA points out, we have and will continue to set prudent regulatory expense levels on a forecasted basis. Our policy has always been to set these

¹ Cal Am's September 15, 2009 response letter has eleven footnote references, though none of the footnotes are provided.

expenses using future test-year cost projections.² It is the case that past levels of operating expenses often inform our judgment of future prudent expenses. However, instances where our forecast of prudent future regulatory expenses is based on the actual past regulatory expense should not be interpreted as an explicit amortization of these past expenses. This is the fundamental flaw with Cal Am's interpretation of various past Commission decisions.

Further, if Cal Am's view of the Commission's treatment of regulatory expenses was accurate, it would have been inconsistent with the Commission's policy on prospective ratemaking. As the Commission said in *Southern California Water Co. Headquarters case*, D.92-03-094 (March 31, 1992) 43 Cal. P.U.C. 2d 597, 600:

It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking. (Emphasis in original.)³

Cal Am implicitly recognizes this in Advice Letter 796 by its request to now establish memorandum accounts to track regulatory expenses for 2009 and 2010 for recovery in future rates; the very regulatory treatment Cal Am alleges was in existence prior to D.09-07-021 minus the memorandum accounts.

Given that there has been no change in our policy for setting prudent regulatory expenses for recovery in rates, there is no possibility that Cal Am will be left without an opportunity for recovering prudently incurred regulatory expenses. As such, there is no need to establish the two memorandum accounts requested by Cal Am.

NOTICE

In compliance with Section 4 of General Order 96-B, a copy of AL 796 was mailed to all interested and affected parties as listed in Attachment A to the Advice Letter 796.

² For some kinds of expenses, we sometimes authorize memorandum or balancing accounts to track (and potentially allow recovery of) actual (rather than forecasted) expenses incurred after the effective date of the account. However, we have not established such accounts for Cal-Am's costs incurred in preparing and processing its GRCs.

³ See also *Pacific Tel. & Tel. Co. v. Public Utilities Com.*, 62 Cal. 2d 634, 650 (Cal 1965); *Southern California Edison Co. v. Public Utilities Com.* 20 Cal. 3d 813 (1978).

COMMENTS ON DRAFT RESOLUTION

This is a contested matter. Pursuant to Public Utilities Code under § 311(g) (1), the draft resolution was mailed for a 30-day period of public review and comment on September 15, 2009. Comments were filed by Cal Am on October 5, 2009. Cal Am reiterates its belief that costs that Cal Am is presently incurring for its 2009 and 2010 GRCs are not included in its current rates. This scenario relies on Cal Am's interpretation that the Commission's policy with respect to regulatory expenses has changed from an explicit amortization of past regulatory expenses to a recovery of forecasted regulatory expenses. As we discuss above, our treatment of regulatory expenses has not changed. Regulatory expenses, like other operating expenses, are established using future test-year cost projections to set prudent regulatory expenses. A regulatory gap that Cal Am alleges between explicit amortization of past expenses and establishing rates based on forecasted expense levels does not exist.

Cal Am uses the majority of its comments to show that it was not aware that the Commission treatment of regulatory expenses was not what Cal Am understood it to be; i.e. an explicit amortization of past regulatory expenses (Comments at pp. 2-5). We cannot correct Cal Am's past misinterpretations. We expect that this Resolution clarifies this matter for Cal Am going forward.

FINDINGS AND CONCLUSIONS

1. California-American Water Company requests authority to establish two memorandum accounts to track regulatory expenses that it incurs to prepare and process its 2009 and 2010 general rate cases.
2. California-American Water Company filed Advice Letter No. 796 as a Tier 2 filing.
3. Pursuant to Decision 08-02-036 as reaffirmed in Decision 09-06-053, Advice Letter 796 should be treated as a Tier 3 filing requiring Commission resolution.
4. The Division of Water and Audits suspended Advice Letter 796 on September 9, 2009, to allow time for a Commission resolution to be drafted and considered.
5. On September 4, 2009, the Division of Ratepayer Advocates filed a timely protest to Advice Letter 796.
6. The Commission policy has been and continues to be to set prudent regulatory expense levels for recovery in rates on a forecasted basis.

7. Decision 09-07-021, in California-American Water Company's most recent general rate case proceeding, does not change the Commission's policy with regard to recovery of prudently incurred regulatory expenses.
8. There is no reason that California-American Water Company will be without a means to recover prudently incurred regulatory expenses for its 2009 and 2010 general rate cases.
9. This is a contested matter subject to the public notice comment provided for in Public Utilities Code § 311(g) (1).
10. California-American Water Company's Advice Letter 796 should be rejected.
11. Tariff sheets 5402-W and 5403-W attached to Advice Letter 796 should be rejected.

THEREFORE, IT IS ORDERED THAT:

1. California-American Water Company's Advice Letter 796 is rejected.
2. California-American Water Company's Tariff Sheets 5402-W and 5403-W attached to Advice Letter 796 are rejected.
3. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on December 3, 2009; the following Commissioners voting favorably thereon:

PAUL CLANON
Executive Director