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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-4835  
August 12, 2010

R E S O L U T I O N

(RES. W-4835), CALIFORNIA WATER SERVICE COMPANY  
(CAL WATER) ORDER GRANTING AUTHORITY TO  
ESTABLISH A TORT LITIGATION MEMORANDUM  
ACCOUNT (TLMA) IN THE WRONGFUL DEATH CASE *VICTOR  
GUERRERO AND HORTENCIA GUERRERO V. CALIFORNIA  
WATER SERVICE COMPANY, CASE NO. FCS034481.*

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SUMMARY

By Advice Letter No. 1968, filed on December 23, 2009, Cal Water seeks authority to establish a Tort Litigation Memorandum Account to record costs associated with the wrongful death complaint brought against it by the parents of a fifteen year old deceased boy. Cal Water requests authority to establish the TLMA pursuant to the authority granted by the Commission in Resolution W-4094 which authorized all water companies to file water contamination litigation memorandum accounts. This resolution instead grants Cal Water authority to establish a Tort Litigation Memorandum Account under the commonly applied criteria for establishing a memorandum account.

NOTICE AND PROTEST

In accordance with Section 4.3 of General Order (G.O.) 96-B, Advice Letter No. 1968 was sent to Cal Water's G.O. 96-B service list attached to Advice Letter No. 1968. The Division of Water and Audits received no protests to this filing. Notably, the Division of Ratepayer Advocates did not protest this filing.

BACKGROUND

Cal Water seeks to establish the TLMA to record various costs associated with a wrongful death case filed on October 14, 2009 in Solano County Superior Court: *Victor Guerrero and Hortencia Guerrero v. California Water Service Company*, Case No. FCS034481. The costs Cal Water proposes to record in the Tort Litigation Memorandum Account include: 1) legal fees and costs; 2) insurance proceeds; 3) a monetary judgment or

settlement in favor of Cal Water; and/or 4) a monetary judgment against Cal Water. Cal Water proposes to seek recovery of costs recorded in the TLMA in its next general rate case.

The wrongful death complaint (Complaint) relates to the death of Samuel Guerrero, the deceased fifteen year old son of the plaintiffs, who died on December 19, 2008 as the result of E. coli sepsis. The Complaint alleges that as a result of a Cal Water pipe break on or about November 30, 2008 at or near the residence of the deceased there was "the potential to allow sewage, coliform bacteria, or other harmful microorganisms to enter the water supply." (Complaint at p. 2) The Complaint seeks damages for negligence, including negligent failure to maintain the water system and negligent failure to warn, and intentional concealment causes of actions.

Cal Water requests authorization to establish the TLMA pursuant to the authority granted by the Commission in Resolution W-4094. In the alternative, Cal Water requests that the Commission find that the proposed TLMA meets the commonly applied criteria for establishing a memorandum account. Resolution W-4094, dated March 26, 1998, authorized all water utilities under Commission jurisdiction to establish memorandum accounts for the litigation expenses as discussed in Resolution W-4094. Resolution W-4094 followed an earlier Resolution W-4089 (January 21, 1998). There the Commission authorized Southern California Water Company (now Golden State Water Company) to establish a memorandum account for litigation expenses associated with a lawsuit on alleging that Southern California Water Company provided and continued to provide contaminated water from wells located in the area of the San Gabriel Valley that had been designated a federal environmental superfund site.<sup>1</sup>

Southern California Water Company and Citizens Utilities Company of California subsequently informed the Commission that additional lawsuits similar to those described in Resolution W-4089 had been filed against the utilities for the contamination of ground water in the Sacramento Valley Basin. The Commission concluded in Resolution W-4094 that "this leads us to believe that water contamination lawsuits of this nature could become widespread throughout the State in the coming years." (Res. W-4094 at p. 1) In authorizing the establishment of memorandum accounts, the Commission found "Complaints by numerous plaintiffs have been filed in the Superior

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<sup>1</sup> The Commission noted "that this contamination issue is not just SCWC's. Suburban Water Company and San Gabriel Water Company also pump from the Main San Gabriel Water Basin and either have had suits brought against them or expect them to be filed shortly." Due to this fact, the Commission allowed Suburban Water Company and San Gabriel Water Company "to file similar advice letters to establish memorandum accounts for water contamination litigation expenses in the San Gabriel Valley Basin should they become involved in similar litigation." (Res. W-4089 at p. 5)

Courts of California alleging, among other things, that certain Commission regulated water utilities have provided and continue to provide its [sic] customers with contaminated water.” (Res. W-4094, Finding #1)

Resolution W-4094 went on to find that “All water utilities under Commission jurisdiction should be authorized to establish memorandum accounts for recording expenses resulting from water contamination litigation. (Finding #4) Ordering Paragraph #1 of W-4094 went on to grant authority “to establish memorandum accounts for the litigation expenses as discussed in this resolution and incurred after March 26, 1998, the effective date of this resolution.” Ordering paragraphs #2 and #3 extended such authority unconditionally to all Class A, B, C, and D utilities throughout California.

The Division of Water and Audits (DWA) initial review of Advice Letter No. 1968 determined that Cal Water’s reliance on Resolution W-4094 was misplaced given the differing nature of the Complaint at issue in Advice Letter No. 1968 from those that caused the Commission to issue Resolutions W-4089 and W-4094. On January 28, 2010, the Division of Water and Audits informed Cal Water in writing that Advice Letter No. 1968 was being rejected.<sup>2</sup> In addition, DWA noted that Cal Water did not make any showing that the TLMA met any of the criteria as outlined in Resolution W-4276 used by the Commission to establish a memorandum account. Subsequent to the DWA’s rejection letter, the Commission issued Res. W-4824 (April 8, 2010) which provides further guidance on how it applies these criteria in determining whether to authorize a memorandum account.

On February 8, 2010, pursuant to General Order 96-B, Rule 7.7.1, Cal Water filed a timely request for Commission review of the Division of Water and Audits disposition of Advice Letter No. 1968. Cal Water argues that the Division of Water and Audits incorrectly chose to narrowly limit the scope of Resolution W-4094 in its review of Advice Letter No. 1968.

## **DISCUSSION**

Upon review of this matter, and in consideration of the issues brought to our attention by Cal Water in its comments, we grant Cal Water authority to establish the TLMA as requested in Advice Letter No. 1968. We agree with DWA that Cal Water’s request for a Tort Litigation Memorandum Account is not within the scope of memorandum accounts we authorized in Resolutions W-4089 and W-4094. Nonetheless, we find that Cal Water’s request for a TLMA meets the Commission’s criteria for establishing a

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<sup>2</sup> On January 12, 2010, the Division of Water and Audits suspended Advice Letter No. 1968 so that additional information requested could be reviewed.

memorandum account and is consistent with our recent discussion of when memorandum accounts should be authorized. (Resolution No. W-4824)

A memorandum account allows a utility to track costs arising from events that were not reasonably foreseen in the utility's last general rate case. By tracking these costs in a memorandum account, a utility preserves the opportunity to seek recovery of these costs at a later date without raising retroactive rate-making issues.

In this instance, we find that a memorandum account should be authorized to track these costs associated with the TLMA. In reaching this determination, we consider a number of factors. (See, e.g., D.02-08-054, Res. W-4276, and Res. W-4824.) The Commission in these orders described that memorandum accounts are appropriate when the following conditions exist:

- The expense is caused by an event of an exceptional nature that is not under the utility's control,
- The expense cannot have been reasonably foreseen in the utility's last GRC and will occur before the utility's next scheduled rate case,
- The expense is of a substantial nature in the amount of money involved, and
- The ratepayers will benefit by the memorandum account treatment.

When the Commission has applied these factors, it has not always applied all of them or required that they all be met before authorizing a memorandum account. Thus, at different times, the Commission has considered all these factors, considered only some of these factors, or relied on other public policy considerations in determining whether to authorize a memorandum account. Regardless of the specific factors considered, the question presented to the Commission in all instances is whether a utility should be permitted to seek recovery of these costs at a later date without encountering retroactive ratemaking issues.

We find that the *Guerrero v. California Water Service Company* complaint is an event of an exceptional nature and is beyond Cal Water's control. In rare instances does a water utility face a complaint of this nature. While "boil water" notices are commonplace when water utility system repairs are made, it is uncommon in these occurrences for sickness or injury to occur.

The expense associated with the *Guerrero v. California Water Service Company* complaint could not have been reasonably foreseen in Cal Water's last general rate case and will occur before Cal Water's next scheduled general rate case. Cal Water filed its most recent general rate case on July 2, 2009, while the complaint was filed more than three

months later, on October 14, 2009. And Cal Water is scheduled to file its next general rate case in 2012. With a tentative trial date set for October 2011, it is likely that the expenses incurred by Cal Water will occur before its next scheduled general rate case.

Cal Water states that it has incurred to date approximately \$148,000 in attorneys' fees and costs. And while Cal Water does have liability insurance, it only pays for costs above its deductible of \$500,000. The last adopted revenue requirement for the Dixon district was \$1,717,000. Thus, the expenses associated with the *Guerrero v. California Water Service Company* complaint could represent a significant percentage of the Dixon district's revenue requirement.

The establishment of a memorandum account does not mean that the Commission has decided that the types of costs to be recorded in the account should be recoverable in addition to rates that have been otherwise authorized. Instead, the utility bears the burden when it requests recovery of the recorded costs, to show that additional recovery of the types of costs recorded in the account is appropriate, that the utility acted prudently when it incurred these costs and that the level of costs is reasonable. Hence, ratepayers benefit from memorandum account treatment in this instance by increased transparency of recorded costs and post Commission review for reasonableness.

Thus, based on our consideration of these factors, we find that Cal Water should be authorized to establish the TLMA.

Cal Water submitted Advice Letter No. 1968 on December 23, 2009 as a Tier 2 advice letter consistent with General Order No. 96-B. Cal Water requested an effective date of December 23, 2009 as well. DWA rejected the filing on January 28, 2010. Cal Water appealed DWA's disposition on February 8, 2010. Eight months have elapsed since Cal Water first requested that its TLMA be made effective. Since then, Cal Water has incurred \$148,000 in legal expenses and costs. As this resolution authorizes the establishment of the TLMA, the question before us is what should the effective date be of the TLMA?

In the Southern California Water Co. Headquarters case, D.92-03-094 (March 31, 1992) 43 Cal. P.U.C. 2d 596, 600, the Commission said:

"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.)”

D.09-06-053 (Conservation OII) at page 9 further finds:

“We note that the statutory prohibition on retroactive ratemaking (Pub. Util. Code, § 728) does not apply to recovery of limited and specific costs previously incurred, where the Commission is not engaging in general ratemaking. By “ratemaking” the Court in *Southern California Edison Co. v. Public Utilities Commission* (“*Southern California Edison*”) (1978) 20 Cal.3d 813, 816 means “general ratemaking.”<sup>3</sup> The conservation OII is not a general ratemaking proceeding, and a memorandum account to track, and potentially recover, the costs of participating in this OII, is for the purpose of recovering a specific, very limited class of costs and thus, is not “general ratemaking.” Further, like *Southern California Edison*, the Decision identified various policy reasons which support our determination. One very important policy consideration is fairness.”

D.09-06-053 goes on to state “ In D.08-02-036 (Conservation OII), we noted that: ...and (5) Cal-Am properly sought by advice letter to establish a memorandum account to track expenses which was improperly rejected by the Commission’s staff. (See D.08-02-036, pp. 43-44.) As such, it would be unjust not to let Suburban track expenses related to its participation in the OII, and thus there is no violation of the rule against retroactive ratemaking and our determination is neither arbitrary nor capricious.”

D.09-06-053 further states “In considering fairness, we look at each situation on a case-by-case basis. We believe that in the instant case, fairness warranted the treatment that was granted for the reasons discussed above.”

Clearly, Cal Water’s request for a proposed TLMA is not general ratemaking. It is a request to simply track expenses for a specific issue not included in general ratemaking. And applying the fairness doctrine in the instant case before us, as extensively discussed in D.09-06-053, the only fair outcome is to authorize an effective date of sometime between when the advice letter was first filed and 30 days after filing—the initial review period for a Tier 2 advice letter. Typically unprotested Tier 2 advice letters are reviewed and made effective by DWA by the 30<sup>th</sup> day. In this situation, had DWA not erroneously rejected Cal Water’s TLMA filing, it would have become effective on January 22, 2010. Thus, we will authorize the TLMA with this effective date.

Authorization of a memorandum account does not mean that the Commission has decided that the types of costs to be recorded in the account should be recoverable in

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<sup>3</sup> The Court described general ratemaking as a comprehensive review of a utilities rate base, expenses, and earnings, as distinguished from other Commission review of a more limited nature.

addition to rates that have been otherwise authorized, e.g., in a general rate case. Instead, the utility shall bear the burden when it requests recovery of the recorded costs, to show that additional recovery of the types of costs recorded in the account is appropriate, that the utility acted prudently when it incurred these costs and that the level of costs is reasonable. Thus, Cal Water is reminded that just because the Commission has authorized a memorandum account does not mean that recovery of costs in the memorandum account from ratepayers is appropriate. As such, Cal Water will bear the burden of showing that the costs it has incurred are reasonable when seeking to amortize the balance in this account. In particular, if it is ultimately determined that the alleged contamination is attributed to Cal Water's negligence, Cal Water will need to demonstrate why it would be reasonable for ratepayers to bear these litigation expenses. Cal Water should seek to amortize the balance in the TLMA at the time of its next general rate case. This will ensure that DRA will have an opportunity to vet Cal Water's recorded TLMA memorandum account expenses.

### **COMMENTS**

Public Utilities Code § 311(g)(1) provides that resolutions must generally be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. This draft resolution was mailed to California Water Service Company on July 13, 2010. Comment was received on July 29, 2010. In its comments, Cal Water "urges the Commission to modify the Draft Resolution to clarify that the litigation costs that would be tracked in the proposed TLMA fall within the "water contamination litigation expenses" for which memorandum accounts were approved for all water companies in Resolution W-4094. The Commission should therefore grant Cal Water's request as a "compliance filing" consistent with Resolution W-4094, and deem the advice letter effective upon December 23, 2009, the date of submission."

Cal water further requests that "In the alternate, the Commission should determine that the proposed TLMA meets the Commission's criteria for establishing a memorandum account..." with an effective date of December 23, 2009.

We have considered Cal Water's comments and to the extent that changes were required, they have been made herein.

### **FINDINGS AND CONCLUSIONS**

1. California Water Service Company filed Advice Letter No. 1968 on December 23, 2009 requesting authority to establish a Tort Litigation Memorandum Account pursuant to the authority granted in Resolution W-4094.

2. No protests were received by The Division of Water and Audits.
3. The Division of Water and Audits rejected Advice Letter No. 1968 on January 28, 2010 on the basis that it was not a compliance filing consistent with Resolution W-4094.
4. California Water Service Company filed a timely request for Commission review of the Division of Water and Audits' disposition of Advice Letter No. 1968 on February 8, 2010.
5. California Water Service Company filed Advice Letter No. 1968 in response to a wrongful death complaint case, *Victor Guerrero and Hortencia Guerrero v. California Water Service Company*, Case No. FCS034481 (Complaint).
6. Cal Water requests a Tort Litigation Memorandum Account to record legal expenses in the *Guerrero v. California Water Service Company* complaint.
7. Cal Water's request for a Tort Litigation Memorandum Account is not within the scope of memorandum accounts we authorized in Resolutions W-4089 and W-4094.
8. We find that the proposed Tort Litigation Memorandum Account meets the commonly applied criteria for establishing a memorandum account.
9. We find that the *Guerrero v. California Water Service Company* complaint is an event of an exceptional nature and is beyond Cal Water's control.
10. The expense associated with the *Guerrero v. California Water Service Company* complaint could not have been reasonably foreseen in Cal Water's last general rate case and will occur before Cal Water's next scheduled general rate case.
11. The expenses associated with the *Guerrero v. California Water Service Company* complaint could represent a significant percentage of the Dixon districts revenue requirement.
12. Ratepayers benefit from memorandum account treatment in this instance by increased transparency of recorded costs and post Commission review for reasonableness.
13. Cal Water's request for a proposed TLMA is not general ratemaking.
14. The effective date of the TLMA filing will be January 22, 2010.



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15. Cal Water will bear the burden of showing that the costs it has incurred are reasonable when seeking to amortize the balance in this account.
16. Cal Water should seek to amortize the balance in the TLMA at the time of its next general rate case.

**THEREFORE IT IS ORDERED THAT:**

1. California Water Service Company may file an advice letter to establish a Tort Litigation Memorandum Account as described herein, with an effective date of January 22, 2010.
2. 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 August 12, 2010; the following Commissioners voting favorably thereon:

/s/ PAUL CLANON

Paul Clanon  
Executive Director

MICHAEL R. PEEVEY  
President

DIAN M. GRUENEICH

JOHN A. BOHN

TIMOTHY ALAN SIMON

NANCY E. RYAN

Commissioners