STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

September 29, 2003

Agenda ID #2791
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 03-08-009

This is the draft decision of Administrative Law Judge (ALJ) Walker. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:hf1

Attachment

Decision **DRAFT DECISION OF ALJ WALKER** **Mailed 9/29/2003**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U 210 W) for Authorization to Establish a Memorandum Account to Track Costs Associated With Federal or State Legislation for the Purpose of Increasing Security Measures or Preventing Acts of Terrorism.	Application 03-08-009 (Filed August 13, 2003)

O P I N I O N

1. Summary

This order denies the request of California-American Water Company (Cal-Am) to establish a special Security Costs Memorandum Account (SCMA). In the absence of a showing of critical need, requests dealing with security costs should be made in a utility's general rate case, where the costs can be established with greater precision.

2. The Applicant

Cal-Am is a public utility water corporation serving more than 165,000 customers located in counties from San Diego County to Placer County. The water supply sources of Cal-Am include ground water wells, surface water supplies, and purchased water. Its infrastructure includes thousands of miles of pipeline; large numbers of water treatment plants with related water production and transmission facilities; two water quality laboratories; extensive rolling stock and computer systems; and offices and corporate yards in each of its divisions.

. Request

Cal-Am seeks authority to establish an SCMA to record future expenditures for security programs and projects in the wake of the September 11, 2001 terrorist attacks. Cal-Am states that it is incurring those additional expenditures in direct response to government recommendations and mandates, citing particularly the recent Public Health Security and Bioterrorism Preparedness and Response Act of 2002 (Security and Bioterrorism Act). (Public Law 107-188 [H.R. 3448].) This legislation requires water utilities to undertake a security risk assessment and requires investments for improving security, especially in the source water and distribution system. Cal-Am believes that the Security and Bioterrorism Act is just the first piece of legislation enacted to address the threat of terrorist attacks on water systems, and it anticipates additional federal and state legislation in the future.

4. The Office of Ratepayer Advocates' (ORA) Protest

ORA opposes the request on the basis that the government mandates and Commission threshold requirements that Cal-Am relies on do not demonstrate a need for the memorandum account.

ORA notes that last year Cal-Am made a nearly identical request for authority to establish a security memorandum account. The application was denied in Decision (D.) 02-07-011 on grounds that Cal-Am had failed to meet threshold requirements for establishment of a memorandum account, and that utility management has the discretion to allocate funds for security purposes as necessary. The Commission also held that requests for additional security costs should be addressed in Cal-Am's upcoming general rate cases (GRC).

5. Discussion

The Commission has established a four-prong test to see if a memorandum account is appropriate. In Resolution W-4276, the Commission stated, memorandum accounts are appropriate when the following conditions exist:

> a. The expense is caused by an event of an exceptional nature that is not under the utility's control;
>
> b. The expense cannot have been reasonably foreseen in the utility's last GRC and will occur before the utility's next scheduled rate case;
>
> c. The expense is of a substantial nature in the amount of money involved; and
>
> d. The ratepayers will benefit by the memorandum account treatment. (Resolution W-4276, 2001 Cal. PUC LEXIS 685, *5.)

There are essentially two differences between Cal-Am's 2002 and 2003 requests for establishing a security memorandum account. In its current application, Cal-Am cites the recently enacted Security and Bioterrorism Act as the source of its duty to spend the funds it seeks to record. As we read this legislation, Cal-Am is required to perform a vulnerability assessment and seek certification of that assessment from federal authorities. Later, Cal-Am will be required to prepare an emergency response plan and consider basic security enhancements. Federal funds may or may not be available for some of this work.

We agree with ORA that costs of compliance with the Security and Bioterrorism Act can be reasonably foreseen and included in Cal-Am's GRCs, particularly since compliance with the federal act is now well under way. As ORA points out, Cal-Am currently has general rate cases pending for four of its northern California water districts and its Los Angeles division. (*See*, Application (A.) 02-09-030 through A.02-09-033 and A.03-07-036.) Cal-Am's

San Diego division is due to file its GRC application in January 2004. Cal-Am has included a request for security costs in four of its five pending rate cases. Thus, under the second prong of the threshold tests for establishing a memorandum account, Cal-Am has not shown that security costs cannot be reasonably estimated for inclusion in its GRCs.

The second difference between Cal-Am's 2002 and 2003 applications is that the Commission in May 2003 approved the request of Suburban Water Systems (Suburban) for authority to establish a memorandum account for security costs to prevent acts of terrorism. Cal-Am argues that the decision sets a precedent for its application here.

The Suburban decision (D.03-05-078) is distinguishable. First, Suburban made its request for a security memorandum account as part of its GRC, where all of its anticipated expenses for the next three years could be examined. Second, Suburban claimed that security costs presaged by the Security and Bioterrorism Act were certain but could not be reasonably estimated at the time its application was prepared. Third, Suburban claimed that because of its relatively small size (74,000 connections), security costs were likely to be substantial in relation to its projected annual expenses. Fourth, Suburban as a single-district utility would not have another GRC for three years and security costs during that time could not be recovered retroactively. Finally, in contrast to the application here, because the request came as part of a general rate case, the Commission had before it evidence of all costs that Suburban was forecasting for its two test years. The Commission and ORA were able to ascertain that costs likely to be recorded in the memorandum account were not also included in standard rate case cost classifications. While ORA opposed establishment of a memorandum account for Suburban, the Commission decided on the evidence

before it that Suburban had established a need to track and record security costs for later review and recovery through surcharge.

ORA also contends that Cal-Am's current application fails to meet the third and fourth prongs of Commission requirements for establishing memorandum accounts, i.e., that substantial amounts of money are involved and that the memorandum account will serve the public interest. We agree that those showings have not been made. The public interest is better served by analyzing likely security costs (with provision for confidentiality, as necessary) as part of the GRCs that Cal-Am now has under way. Cal-Am of course is free to seek establishment of a memorandum account for security costs in those rate cases by showing that such costs cannot be reasonably forecasted in existing cost classifications, that substantial costs are involved, and that ratepayers will benefit from memorandum account treatment.

Cal-Am has not substantiated the need to establish the SCMA. Its security costs should be and are being addressed in current general rate cases for Cal-Am. The request of Cal-Am for authority to establish a SCMA is denied.

6. Procedural Matters

Pursuant to Rule 6(a)(1), Cal-Am requested that this matter be classified as a ratesetting proceeding and that hearings not be held, asserting that all necessary information to issue a decision has been included in its application or has been incorporated by reference. By Resolution ALJ 176-3118, dated September 4, 2003, the Commission preliminarily determined that this was a ratesetting proceeding and that no hearings were expected.

Notice of this application appeared in the Commission's Daily Calendar of August 15, 2003. Although a protest was filed by ORA, we find no reason to hold a public hearing and no reason to change the preliminary determinations

made in Resolution ALJ 176-3118. The preliminary ratesetting categorization set forth in Resolution ALJ 176-3118 is affirmed.

The scope of this proceeding is set forth in the application. Our order today confirms that Administrative Law Judge (ALJ) Walker is the presiding officer.

7. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____.

8. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Glen Walker is the assigned ALJ in this proceeding.

Findings of Fact

1. Cal-Am seeks authority to establish an SCMA to record future expenditures for security programs and projects.
2. Cal-Am utilizes the memorandum account threshold requirements set forth in Resolution W-4276 to justify establishing the memorandum account.
3. The Security and Bioterrorism Act relied on by Cal-Am requires water utilities to undertake a security risk assessment and requires investments for improving security.
4. Cal-Am's compliance with the federal act is well under way.
5. Cal-Am has GRCs pending for four of its northern California water districts and its Los Angeles division, and Cal-Am's San Diego division is due to file its GRC application in January 2004.

6. Cal-Am has included a request for anticipated security costs in four of its five pending rate cases.

Conclusions of Law

1. Cal-Am has not substantiated the need to establish an SCMA.
2. Approval of an SCMA for the smaller Suburban utility in D.03-05-078 is distinguishable from this application.

O R D E R

IT IS ORDERED that:

1. California-American Water Company's request to establish a Security Costs Memorandum Account is denied.
2. Application 03-08-009 is closed.

This order is effective today.

Dated _____, at San Francisco, California.