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Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of Missouri-American Water Company, St. Louis County Water Company d/b/a Missouri-American Water Company and Jefferson City Water Works Company d/b/a Missouri-American Water Company for an accounting authority order relating to security costs.	)))))))	Case No. WO-2002-273

SUGGESTIONS IN SUPPORT OF ST. JOSEPH INDUSTRIAL INTERVENORS' MOTION FOR REHEARING AND REQUEST FOR LEAVE TO FILE SUGGESTIONS OUT OF TIME

COMES NOW, the Office of the Public Counsel, and respectfully presents the following suggestions in support of St. Joseph Industrial Intervenors' (Intervenors') Motion for Rehearing filed in this case. The Intervenors timely filed their motion on December 19, 2002. Public Counsel filed a Motion for Rehearing on December 20, which, inadvertently, was not timely filed, but, in the same pleading, did timely file a motion for reconsideration (see 4 CSR 240-2.050). Both those motions were denied on procedural grounds by an Order issued December 30. 2002.

However, no order has issued regarding the merits of the Intervenors' Motion for Rehearing. The following suggestions would have been filed prior to the decision of December 30 had Public Counsel known that the Commission would reject the Motion for Reconsideration. In addition, after the filing of the Motions for Rehearing and Reconsideration, Public Counsel discovered a decision by the California Public Utilities Commission, *Re California-American Water Company,* 220 PUR4th 556 (2002), in which a similar application by a

sister company of Missouri-American Water Company to establish a special account for security costs was denied. A copy of that case is attached to this motion.

The following suggestions are filed as soon as possible after the decision issued, as undersigned counsel became aware of this decision on January 2, 2003. Wherefore, leave to file these suggestions is respectfully requested.

SUGGESTIONS IN SUPPORT OF MOTION

1. In its Report and Order in this case, issued Dec. 10, 2002, the Commission granted Missouri-American Water Company an AAO for costs incurred in the course of its evaluation and improvement of security of its Missouri water treatment, transmission and distribution systems. That AAO will allow the Company to defer costs incurred between September 11, 2001 and September 11, 2003. A sister company, California-American Water Company, filed a similar application in California, seeking to establish "a special and temporary Security Cost Memorandum Account" which appears to be an accounting device similar to the Missouri Accounting Authority Order (AAO).

2. An AAO is a mechanism which allows a regulated utility to deviate from generally accepted accounting standards by deferring costs from one period to another. Because a regulated utility's rates are set on the basis of costs determined in a designated test period, deferrals of costs from one period to another distort the true cost a company incurs to provide service. As the Commission stated in of *In the Matter of the Application of St. Joseph Light &*

Power Company for the issuance of an Accounting Authority Order, Case No. EO-2000-845 (Dec. 14, 2000):

> "The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates whereby the Commission considers all relevant expenses in a particular historical test year to determine a reasonable revenue requirement for the future. The deferral of costs distorts the expenses recognized in that test year by importing costs from a previous period. For that reason, the Commission has considered requests for AAOs on a case-by-case basis and has **granted them only under limited circumstances**." (emphasis added.) EO-2000-845, Slip Op. at p. 8.

3. Public Counsel and other parties opposed the Company's request for this AAO. In reaching this position, Public Counsel analyzed the request of the water company under the prevailing standard for granting AAOs. Public Counsel reviewed a number of cases, beginning with *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991) (the *Sibley* rebuild case). In that case, the stated that "the test that the Commission has used for determining whether or not to grant an AAO is whether the expense to be deferred is "extraordinary, unusual and unique and not recurring." 1 MPSC 3d, at 205. In the *Sibley* rebuild case, the Commission found that costs of rebuilding a power plant were extraordinary, but that the costs of purchased power, which the company also sought to defer, were not. As a result an AAO issued only for the rebuilding costs, not the ordinary, recurring costs of purchased power, even though the level of purchased power may have been higher during the period for which deferral was sought.

4. The evidence in this Missouri-American case demonstrated that the costs for which the Company sought deferral were ordinary security costs, and are and will be recurring. The evidence also demonstrated that the level of these costs increased due to an increased awareness of the need for security measures adequate to protect the drinking water supply, an awareness gained after the events of September 11, 2001. The evidence further demonstrated that the Company suffered no actual harm during the attacks of September 11, and that no state or federal agency had mandated any of the improvements the Company implemented for which deferral of cost recognition was requested here. The evidence did demonstrate that a number of recommendations were made to all utility companies for best practices, and that the few practices on that list that the Company did not already have in place were included in the improvements. However, this evidence does not establish that the Company incurred extraordinary costs.

5. In *State ex. rel. Missouri Office of the Public Counsel v. Public Service Commission*, 858 S.W. 2d 806, 810 (Mo. App. W.D. 1993). (affirming the Commission's decision in the *Sibley* rebuild case), the Missouri Court of Appeals (Western District) found that the Commission's decision to grant an AAO was lawful and based on substantial and competent evidence because the Commission, in evaluating the evidence, found that the amounts sought to be deferred were "extraordinary."

6. Utility company applications for AAOs in which the Commission based its decision on the "extraordinary" requirements of *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991), include:

- *In Re Union Electric Company,* No. EO-92-179 (June 12, 1992).
- *In Re UtiliCorp United, Inc.,* No. ER-93-37 (June 18, 1993).
- *Missouri Gas Energy v. Public Service Commission*, 978 S.W.2d 434 (Mo. App. W.D. 1998).
- *In re Application of United Water Missouri, Inc.*, Mo. PSC Case No. WA-98-187 (April 30, 1999).
- *In the Matter of the Application of St. Joseph Light & Power Company for the issuance of an Accounting Authority Order,* Case No. EO-2000-845, Slip Op. at p 8. (Dec. 14, 2000).[1]
- *The matter of the Consideration of An Accounting Authority Order for St. Louis County Water Company*, No. WO-98-223 (Feb. 13, 2001).
- *In the Matter of Missouri Public Service and St. Joseph Light and Power,* GO-2002-175 (Nov. 14, 2002). (the *Aquila* case.)
- In addition, several AAO applications were resolved by stipulated agreements. In those cases, Public Counsel evaluated the applications in light of the "extraordinary" standard in the Sibley rebuild case, and considering whether any recurring expenses met the "act of god" or governmental mandate exceptions that the Commission has allowed in the past.

Cases in which the Commission declined to base its decision on *In the Matter of Missouri Public Service*, 1 MPSC 3d 200 (1991), choosing instead to rely on a

[1] "The test that the Commission has used for determining whether or not to grant an AAO is whether the expense to be deferred is "extraordinary, unusual and unique and not recurring." *In the Matter of Missouri Public Service*, 1 MPSC 3d 200, 205 (1991). However, the simple fact that an expense is extraordinary and nonrecurring is not enough to justify the deferral of that expense. Implicit in the Commission's previous orders regarding requests for AAOs is a requirement that there must be some reason why the expense to be deferred could not be immediately included for recovery in a rate case." *St. Joseph Light & Power Co., Slip* Op. at p. 8.

determination that "the requested AAO is reasonable under all the circumstances" include:

- This case (Report and Order, at 28.)

Clearly, the parties who argued to the Commission that an AAO should not be granted unless the Applicant could establish that the expenses were "extraordinary" based that claim on a number of clear decisions by the Commission that this was the appropriate test— a standard used for a decade by the Commission in evaluating applications for AAOs. This hardly makes such a position and argument "driven by a basic misunderstanding of AAOs." (R&O, at 30.)

7. The company had the burden of proving that its request was necessary, and that it met the criteria for an AAO. It failed to meet its burden of proving that the costs it incurred were the result of an extraordinary event, and that the costs were extraordinary, unusual, unique and non-recurring. The company further failed to prove that it was required to incur the costs as the result of a governmental mandate or "act of god." The Company could only present evidence that recommendations were made by a number of governmental and private entities concerning the need to enhance security.

8. By changing the test by which it decides whether to grant an AAO, the Commission acted arbitrarily. A decision is "arbitrary" when it is not made "according to reason or judgment; depending on the will alone." *Black's Law Dictionary,* 5th Ed. In its report and order, the Commission suggested that Public Counsel and the Staff, along with the other Intervenors, were operating under a

fundamental misunderstanding of what an AAO is and the requirements for granting an AAO. The Commission stated that an AAO may be granted whenever, in consideration of all the surrounding circumstances, the Commission believes an AAO would be appropriate. This contradicts prior Commission decisions which caution that AAO deferrals should only be granted in limited circumstances. While prior Commission decisions do not have the force of *stare decisis* on subsequent Commission cases, the Commission cannot arbitrarily and discriminatorily change its policy. *In Re Otter Tail Power v. FERC,* 583 F.2d 399, 408 (8th Cir. 1978.) Rather, the Commission must have a rational basis for changing its policy. No rational basis was presented in the Report and Order in this case. Denying that a standard exists does not constitute a rational basis for a changing policy.

9. In its discussion of the "extraordinary, unusual, unique, non-recurring" expense criteria for granting an AAO, the commission noted that these criteria were "encompassed by the reasonable-under-the-circumstances standard." However, the commission failed to recognize that "reasonable under the circumstances" could easily include recurring, non-unique, ordinary costs, and that the adoption of the new standard invited all regulated utilities to a fire sale of AAO's as long as they can convince a majority of commissioners that the request is "reasonable."

10. On November 14, 2002, the Commission reiterated the extraordinary, unique, non-recurring standard for granting AAOs, and denied Aquila an AAO for authority to defer certain bad debt expenses. Aquila's request

was denied because the Commission determined "that the expenses are not extraordinary." This order issued 26 days before the order in the Missouri-American case in which the Commission denied that it followed the extraordinary standard. In the Aquila case (GO-2002-175) in its conclusions of law, the Commission stated that:

> "The test that the Commission has used, and continues to use here, for determining whether or not to grant an AAO is whether the expense to be deferred is extraordinary and not recurring:
>
> The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates. Rates are usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. *State ex rel. Union Electric Company v. PSC,* (UE), 765 S.W.2d 618, 622 (Mo. App. 1988).
>
> Allowable operating expenses are those which recur in the normal operations of a company, and a company's rates are set for the future based upon its past experience for a test year with adjustments for annualizations, normalizations and known and measurable changes. Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case causes this consideration and should be allowed only on a limited basis.
>
> This limited basis is when events occur during a period which are extraordinary, unusual and unique and not recurring. These types of events generate costs which require special consideration.
>
> *In the Matter of Missouri Public Service,* 1 MPSC 3d 200, 205 (1991).
>
> **The Commission's initial inquiry is whether the costs sought to be deferred are indeed extraordinary. If they are not, the inquiry is at an end, and the other**

> **questions are moot. Because the Commission concludes that the costs Aquila seeks to defer are not extraordinary, it will not address the other issues identified by the parties."** (emphasis added.)

The test relied on by the Commission in the *Aquila* decision is the same test relied on and litigated by Public Counsel in this Missouri-American case.

11. In this Missouri-American case, however, the Commission said this:

> The arguments raised against Missouri-American's request may be summarized as follows: First, the expenditures in question are not eligible for deferral because they are normal business expenses in that utilities always have a duty to provide appropriate security for their facilities. Second, **the expenditures in question are not eligible for deferral because they are not extraordinary**, either in amount or in purpose, as shown by the fact that Missouri-American's management chose to make them and was not required to make them. These arguments are driven by **a basic misunderstanding of AAOs. The test, as explained above, is whether deferral is reasonable under all the circumstances**. (emphasis added.)

One cannot read these two decisions together without coming to the inescapable conclusion that the Commission has decided that, from now on, it will have NO STANDARD for granting AAOs and will grant or deny an AAO based upon the subjective belief of at least three commissioners that a utility's request for a deferral is reasonable. Abandoning an objective standard and allowing utilities to deviate from Generally Accepted Accounting Principles based on subjective factors, when the company cannot meet the objective test, is arbitrary and capricious. The Company's customers in this case were denied the due process guaranteed them by the Fifth and Fourteenth Amendments to the U.S. Constitution and Art. I, Sec. 10 of the Missouri Constitution, because their representatives litigated the case under an existing, long-established objective

standard, only to be told that the standard no longer exists. Indeed, the Commission denied that such a standard ever existed. This disregard for the company's customers is detrimental to the public interest.

12. In *Re California-American Water Company*, 220 PUR4th 556 (2002), the California Public Utilities Commission denied a similar request to that filed by MAWC in this case. The California Commission determined that California-American failed to establish that it had a need to establish a special account. That opinion is attached to this motion, and incorporated by reference.

13. There is some language in the report and order that suggests that the commission may have wished to grant the AAO in this case because, while there is no current governmental mandate for utilities to upgrade security, security upgrades were encouraged, and may be a good idea. The State of Missouri's security task force released a list of recommended security procedures for utility companies. The witnesses for Missouri-American, at the hearing in this case, testified that, prior to September 11, Missouri-American already had most of those security procedures in place. The witness further testified that all of those procedures would be in place by the end of the upgrade period. If the Commission wanted to carve out another type of case in which an AAO could be considered--security upgrades in light of the greater awareness of security issues following Sept. 11--it could have done so without disavowing the existing test for granting AAOs.

CONCLUSION

The Commission's decision in granting Missouri-American's application for an AAO is arbitrary and capricious and not based upon substantial and competent evidence. The Commission's decision to abandon a test it had consistently used to evaluate AAO requests for over a decade was arbitrary. The case presented by Missouri-American failed to meet the "extraordinary, unique, unusual and non-recurring" objective test relied on by the Commission and parties who practice before the Commission for a decade. No rational basis was provided for deviating from that standard. Worse, the Commission, in its Report and Order disavowed the standard it has used consistently since 1991, without providing a rational basis for doing so.

WHEREFORE, the Commission should reconsider its decision in this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 3rd day of January 2003:

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EDITOR'S APPENDIX

PUR Citations in Text

[ILL.] Re Commonwealth Edison Co., 158 PUR4th 458, D. 94-0065, Jan. 9, 1995.
[ILL.] Re Illinois Power Co., 135 PUR4th 448, No.91-0147, Aug. 7, 1992.
[ILL.] Re Iowa-Illinois Gas & E. Co., 145 PUR4th 1, Nos. 92-0292, 92-0357, July 21, 1993; as amended Aug. 4, 1993.

Re California-American Water Company

Decision 02-07-011
Application 02-03-019

California Public Utilities Commission
July 17, 2002

ORDER denying a request by a water utility to establish a memorandum account to record for later recovery expenditures for security programs initiated after the September 11, 2001 terrorist attacks.

Commission finds that the establishment of a memorandum account to track the security expenditures is not justified inasmuch as the utility failed to prove: (1) that the expenditures are clearly required by government mandate; and (2) that the total amount of the expenditures is substantial.

1. EXPENSES, § 144
[CAL.] Water utility — Security measures — Expenditures following September 11, 2001 terrorist attacks — Request for memorandum account — Grounds for denial.
p. 557.

2. WATER, § 11
[CAL.] Water utility — Security measures — Expenditures following September 11, 2001 terrorist attacks — Request for memorandum account — Grounds for denial.
p. 557.

3. VALUATION, § 286
[CAL.] Water utility — Anti-terrorism security measures — Request for memorandum account — Grounds for denial.
p. 557.

Before Lynch, president and Duque, Wood, Brown and Peevey, commissioners.

BY THE COMMISSION:

Summary

This order denies California-American Water Company's (Cal-Am) request to establish a special and temporary Security Cost Memorandum Account.

The Applicant

Cal-Am is a public utility water corporation serving more than 175,000 customers and employing 239 people within ten divisions 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 a Security Memorandum Account to record expenditures for security programs and projects it initiated subsequent to the September 11, 2001 terrorists attacks.[1] 1 Cal-Am states that it is incurring those additional expenditures in direct response to government recommenda-

tions and mandates[2] to address potential terrorist attacks and to Cal-Am management's recognition of its obligation to protect from terrorist activities the water supplies, assets, and facilities of Cal-Am.

Cal-Am argues that none of the security expenditures covered by its application has been included in its prior rate case filings, existing rate case order, or tariffs now in effect. Absent its ability to track and seek recovery of those expenditures through future rates, Cal-Am states that those expenditures will adversely impact its current ability to earn its Commission- authorized rate of return. Also, Cal-Am believes the memorandum account comports with memorandum account threshold requirements, as set forth in the Commission's July 12, 2001 Resolution No. W-4276, which authorized a generator cost memorandum account for all water and sewer system utilities.[3]

Cal-Am concludes that the Security Memorandum Account is the appropriate means for it to seek future recovery of those expenditures not reflected in its rates while avoiding retroactive ratemaking treatment of those security expenditures being incurred since September 11, 2001. Those additional expenditures are estimated to total approximately $2,068,000 and include both capital and expense costs, as summarized in the following tabulation.

Time Period	*Capital*	*Expense*	*Total*
9/12/01 — 12/31/01	$429,000	$143,000	$572,000
1/01/02 — 12/31/02	818,000	678,000	1,496,000
Total	$1,247,000	$821,000	$2,068,000

Protest

The Office of Ratepayer Advocates (ORA) opposes the request on the basis that the inclusion of previously incurred security expenditures constitutes retroactive ratemaking, and that Cal-Am has failed to substantiate that the government recommendations and mandates and Commission threshold requirements it relied on demonstrate need for the memorandum account. ORA concludes that the application should be dismissed.

Discussion

[1-3] It is a well-established principle of this 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.[4]

By its reply to ORA's protest, Cal-Am withdraws its request to include the additional capital costs identified in its application. Such exclusion of capital costs reduces the amount to be included in the memorandum account from $2,068,000 to $821,000.

Cal-Am also uses its reply to clarify that the additional expense costs are not one time costs. Rather, such expense costs are being incurred on an ongoing basis. With the withdrawal of capital costs and clarification of ongoing expense costs, the retroactive ratemaking issue becomes moot, Cal-Am believes. However, the need for the proposed memorandum remains at issue.

We find that the reliance Cal-Am places on specific government recommendations and mandates does not justify the establishment of a memorandum account. The FBI Statement before Congress says that, although it is possible for a water supply to be contaminated with a biological agent that causes illness or death of victims, it is not probable; moreover, the contamination of a water reservoir with a biological agent would likely not produce a large risk to public health because of the dilution effect, filtration, and disinfection of the water.[5]

The other government documents that Cal-Am relied on also fail to provide a basis for

establishing a memorandum account to track extraordinary expenses for security measures. Presidential Executive Order 13228 merely lists the functions of the newly created Office of Homeland Security and the FERC Statement of Policy assures energy companies, not water companies, that the FERC will approve recovery of "prudently incurred costs" necessitated by security measures.[6]

ORA also contends that the proposed memorandum account does not comply with Commission threshold requirements for establishing such accounts because the expenditures fail to satisfy the third condition. That condition requires the expenditures to be of a substantial amount of money. ORA compares the estimated security expense costs for 2002 to forecasted annual operating expenses, Tab E to the application. This comparison shows that the estimated security expense costs amounts to 1.1%[7] of estimated annual expenses, a percentage considered by ORA to be insignificant.

With the subsequent clarification from Cal-Am that those additional expense costs are ongoing, we add the 2001 expense costs to the 2002 expense costs to arrive at a 1.4%[8] impact on the ongoing annual expenses of Cal-Am. This latter result, without reflecting tax benefits to be derived from the additional expense costs, would impact the average customer's monthly bill by less than $0.40.[9]

According to ORA, Cal-Am has or will shortly have General Rate Cases (GRCs) before the Commission for five of its districts comprising more than 47% of the utility's total annual revenue generated in California. ORA contends that, to the extent such expenditures are approved and the GRCs are completed on a timely basis, those security expenditures would be reflected in base rates as of January 1, 2003. ORA concludes that Cal-Am should seek recovery of those security expenditures in its upcoming GRC filings on a prospective basis.

Cal-Am subsequently acknowledged that several of its districts are undergoing GRCs. However, it asserts, without providing any details, that a sizeable portion of the expenses are being incurred in districts not the subject of current GRCs.

To assess the need of Cal-Am for establishing the Security Memorandum Account we briefly review our ratemaking process for water utilities. The recovery of expenditures through rates for water utilities is based on future test year rate of return ratemaking.[10] This means that the rates of Cal-Am are based on estimated rate base and expenditures for a future test year. Actual rate base and expenditures can and do change between the time rates are set and the time events occur.

There is no requirement of the utility to spend exactly, or only, the projected amount on each rate base or expenditure component used to set rates. Similarly, there is no requirement or guarantee that the utility earn its authorized rate of return. In other words, if a utility fails to earn its authorized rate of return, ratepayers are not assessed the short-fall, and if the utility earns more than authorized, it does not rebate the excess to ratepayers.[11]

We leave the fine-tuning of a utility's operation to the discretion of its management. Management discretion is exercised in allocating total dollars for capital and expense items to those areas where the capital and expense is most necessary, as dictated by constantly evolving priorities. This discretion also affects whether the utility realizes its authorized rate of return.

As previously discussed, memorandum accounts are available to track specific expenditures for future consideration of their recovery in rates. Based on the criteria used by Cal-Am, those expenditures recorded in a memorandum account for future recovery are: caused by an event of an exceptional nature outside of the utility's control; not reasonably foreseen in the utility's last GRC; substantial in the amount of money involved; and, beneficial to the customers.

Clearly, the terrorists' activities of September 11, 2001, satisfy the exceptional nature and not reasonably foreseen criteria. However, irrespective of whether government recommendations and mandates required Cal-Am to incur additional security expenditures, the amount of expenditures involved is not a substantial amount. Here, we find that the additional

expenditures are not clearly required (at least on the bases cited by Cal-Am) and constitute less than 2.0% of projected operating costs. Our ratemaking assumes that utility management can and will reassess its priorities to deal with developments of this magnitude. Specifically, Cal-Am may utilize management discretion to allocate funds for capital and expense items to those areas where the expenditure is most necessary, and also to attain its authorized rate of return.

Cal-Am has not substantiated the need to establish the Security Memorandum Account. To the extent Cal-Am wishes to pursue recovery of additional security costs, the issue should be addressed in upcoming GRCs. The request of Cal-Am for authority to establish the Security Memorandum Account is denied.

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 been incorporated by reference. By Resolution ALJ 176-3084, dated March 21, 2002, 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 March 20, 2002. 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 176-3084. The preliminary ratesetting categorization set forth in Resolution ALJ 176-3084 is affirmed.

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

Comments on Draft Decision

The assigned Administrative Law Judge's (ALJ) draft decision in this matter was filed with the Docket Office and mailed to all parties of record in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Commission's Rule of Practice and Procedure (Rules).

Rule 77.3 specifically requires comments to focus on factual, legal, or technical errors in the draft decision, and when citing such errors, requires the party to make specific references to the record. Rule 77.4 further requires that comments including the proposal of specific changes to the draft decision also include suggested Findings of Fact and Conclusions of Law that are believed to comport with those changes. Finally, Rule 77.2 requires parties that file comments on a proposed decision to serve a copy on all parties, and to serve separately the assigned Commissioner and ALJ.

ORA timely filed and served a copy of its comments on the proposed decision. Although Cal-Am timely filed its comments, it did not serve a copy on the assigned ALJ. As evidenced by its certificate of service, Cal-Am also did not serve ORA. Irrespective of Cal-Am's improper service of comments; the comments filed by both Cal-Am and ORA were carefully reviewed and considered. Other than correction of a typographical error, no changes have been made to the proposed decision.

Findings of Fact

1. Cal-Am seeks to include in the Security Memorandum Account approximately $821,000 of the $2,068,000 estimated additional security expenditures it has incurred or expects to incur since the September 11, 2001 terrorist attacks and in response to government recommendations and mandates. The additional security expenditures were not included in prior rate case filings, existing rate case orders, or tariffs now in effect.

2. The prohibition of retroactive ratemaking precludes Cal-Am from recovering through future rates its additional security expenditures incurred from September 11, 2001 to the effective date of this order.

3. Cal-Am utilizes the memorandum account threshold requirements set forth in Resolution W-4267 to justify establishing the Security Memorandum Account.

4. The FBI statement relied on by Cal-Am

finds that it is not probable for a water supply to be contaminated with a biological agent that causes illness or death of victims. The FBI statement also finds that the contamination of a water reservoir with a biological agent would likely not produce a large risk to public health.

5. The Presidential Executive Order relied on by Cal-Am lists the functions of the newly created Office of Homeland Security.

6. The FERC Statement of Policy relied on by Cal-Am assures energy companies that the FERC will approve the recovery of prudently incurred costs necessitated by security measures.

7. The additional security expenditures represent less than 2.0% of total operating expenses and impact the average customer's monthly bill by less than $0.40.

8. The recovery of expenditures through rates for Commission- regulated water utilities is based on future test year rate of return ratemaking.

9. There is no requirement that a utility to spend exactly, or only, the projected amount on each rate base or expenditure component used to set rates.

10. If a utility fails to earn its authorized rate of return, ratepayers are not assessed the shortfall, and if the utility earns more than authorized, it does not rebate the excess to ratepayers.

11. Management discretion is exercised in allocating total dollars for capital and expense items to those areas where the capital and expense is most necessary, and in attaining the utility's authorized rate of return.

12. Today's order should be made effective immediately, so that Cal-Am's ratemaking issues can be clarified.

Conclusion of Law

Cal-Am has not substantiated the need to establish the Security Memorandum Account.

ORDER

IT IS ORDERED that:

1. California-American Water Company's request to establish the Security Costs Memorandum Account is denied.

2. Application 02-03-019 is closed.

This order is effective today.

Dated July 17, 2002, at San Francisco, California.

FOOTNOTES

[1]Although Cal-Am did not provide specific details of its new security measures or associated costs, if requested, it will provide such details under seal.

[2]The government recommendations and mandates relied on by Cal-Am are the October 10, 2001 Federal Bureau of Investigation (FBI) Statement to Congress, the October 8, 2001 Presidential Executive Order 13228, and the September 14, 2001 Federal Energy Commission (FERC) Statement of Policy.

[3]The conditions are that the expenditure is caused by an event of an exceptional nature that is not under the utility's control; the expenditure cannot have been reasonably foreseen in the utility's last general rate case and will occur before the utility's next scheduled rate case; the expenditure is of a substantial nature in the amount of money involved; and, the customers will benefit by the memorandum account treatment.

[4]*See,* for example, *Southern California Water Co.*, 43 CPUC2d, 596 at 600 (1992).

[5]Page 3 of Exhibit D to the application.

[6]Exhibit C to the application and page 4 of the application, respectively.

[7]2002 expense costs totaling $678,000 divided by forecasted annual operating expenses totaling $61,240,782.

[8]Ongoing expense costs totaling $821,000 (2001 expense costs of $143,000 plus 2002 expense costs totaling $678,000) divided by annual operating expenses totaling $61,240,782.

[9]Ongoing expense costs totaling $821,000 divided by 175,000 customers and divided by twelve months.

[10]*See,* for example, *Financial and Operational Risks of Commission-regulated Water Utilities*, 43 CPUC 2d, 568 at 600 (1992).

[11]*See,* for example, *All Water and Sewer System Utilities, Order Authorizing a Generator Cost Memorandum Account,* Resolution W-4276 at 4 and 5.