

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY & COMPLIANCE DIVISION

RESOLUTION NO. E-3238
July 24, 1991

R E S O L U T I O N

RESOLUTION E-3238. ORDER AUTHORIZING ALL UTILITIES TO ESTABLISH CATASTROPHIC EVENT MEMORANDUM ACCOUNTS, AS DEFINED, TO RECORD COSTS RESULTING FROM DECLARED DISASTERS.

SUMMARY

This Resolution authorizes each public utility as defined under Section 216 of the Public Utilities Code, except common carriers and toll bridge corporations, to establish a memorandum account to record costs of: (a) restoring utility service to its customers; (b) repairing, replacing or restoring damaged utility facilities; and (c) complying with government agency orders resulting from declared disasters.

BACKGROUND AND DISCUSSION

On October 17, 1989, Northern California was rocked by a major earthquake that wreaked havoc and destruction. Lives were lost and there was extensive damage to public and private facilities over a wide area north and south of the earthquake's epicenter in Santa Cruz County. Regulated utilities' facilities were hit hard along with those of other businesses, government and individuals in the affected area. Our experience in the quake's aftermath revealed that the regulated utilities performed admirably in responding in every way possible to reestablish necessary public services.

Because of the need for immediate repairs and emergency service, several utilities incurred extraordinary and substantial costs for materials and supplies and for payroll, including overtime. The damage, some of which became apparent only as the utilities returned to normal operations, and the related costs were unforeseeable.

After the Loma Prieta earthquake, Pacific Gas and Electric Company, San Jose Water Company, and California Water Service Company requested authority to establish accounts to record all costs associated with the earthquake, and subsequently to recover those costs from their customers. The Commission responded by surveying all regulated utilities in the affected area, determining which ones were impacted, and authorizing all of those that had suffered earthquake damage and incurred extraordinary costs to establish such accounts. The recorded amounts in each utility's account were to be recovered in rates only after further Commission action to

determine their reasonableness. The Commission subsequently determined that only costs incurred after the accounts were authorized were recoverable because to do otherwise would have constituted retroactive ratemaking.

The regulatory constraints imposed by the retroactive ratemaking prohibition can result in an inequity. Utilities that react immediately to repair damage will incur costs that may not be recoverable in rates. In contrast, utilities that decide to wait for the Commission to authorize a memorandum account before initiating repairs and emergency services could record their entire costs for repairs, replacement or restoration, thus preserving the possibility of recovering those costs in rates.

Making available a pre-established memorandum account wherein a utility could immediately record disaster related costs would minimize this inequity. To be equitable and as effective as possible, every utility would have to be given authority to pre-establish such an account and to enter into it all costs resulting from declared disasters. Since many hundreds of utilities could be affected, we believe that it is appropriate for the Commission to establish such accounts on a generic basis.

The Commission's blanket authorization to establish catastrophic event memorandum accounts will ensure that all potentially affected utilities are given the maximum incentive to restore service immediately and completely after declared disasters. Because the intent of such accounts is to capture for consideration for later recovery only those costs associated with truly unusual, catastrophic events such as the Loma Prieta earthquake, their use will be restricted to events declared disasters by competent state or federal authorities. Other events not so officially designated are outside the scope and intent of this authority and will not be considered for recovery under this mechanism.

The costs eligible for entry into such a memorandum account are those necessary for: (a) restoring utility service to customers; (b) repairing, replacing or restoring damaged utility facilities; and (c) complying with government agency orders resulting from declared disasters. In addition to direct expenses, utilities could also book capital-related costs such as depreciation and return on capitalized additions. Whether such costs are ultimately recoverable in rates would await a Commission finding of their reasonableness.

It is important to stress that authorizing the recording of costs associated with a disaster should not be construed as a prejudgment of the appropriateness of recovery of any amounts so accumulated. The purpose of the Commission's authorizing memorandum accounts in anticipation is to ensure that these utilities are not precluded by the retroactive ratemaking prohibition from recovering the extraordinary additional costs they may incur immediately after a disaster but before the Commission can act to authorize such accounts.

The Commission will examine closely all costs recorded in a utility's catastrophic event memorandum account before allowing their recovery in customers' rates. While costs incurred for repairs may well be significant, they may not necessarily all be properly recoverable from ratepayers. Recovery may be limited by consideration of the extent to which losses are covered by insurance, the level of loss already built into

existing rates, and possibly other factors relevant to the particular utility and event. Before authorizing recovery from customers of any costs, the Commission will examine how they relate to the overall costs currently authorized for these types of repairs. The costs recorded in the account will not be recoverable in rates without a request by the affected utility, a showing of their reasonableness, and approval by the Commission. Such a request must be made by a formal application specifically for that purpose, by inclusion in a subsequent general rate case or other ratesetting application, or, for utilities eligible to request general rate increases by advice letter as specified in General Order 96-A, Section VI, by filing an advice letter request with an appropriate showing. As with any rate increase request, the Commission staff will review the basis for the increase request and make a recommendation to the Commission as to the amount in the account to be recovered in rates.

Because recovery in rates is not guaranteed by the creation of memorandum accounts and parties would have an opportunity to review any such costs in the future, it is appropriate to authorize public utilities to establish such memorandum accounts prospectively without hearing.

Consistent with the Commission's usual practice for memorandum accounts, each energy utility desiring to avail itself of a Catastrophic Event Memorandum Account (CEMA) will be required to file and make effective on thirty days' notice an advice letter with tariff sheets reflecting its establishment. Telecommunications, water and other utilities which do not include such accounts in their tariffs will be required to inform the Director of Commission Advisory and Compliance Division (CACD) in advance in writing of the effective date such an account is to be established. Consistent with the purpose of memorandum accounts, no utility will be allowed to make entries into its CEMA for costs incurred before its establishment.

Should a declared disaster occur, each affected utility which has previously established a CEMA would be required to inform the Commission's Executive Director by letter within 30 days after the catastrophic event, if possible, if it has started booking costs in the CEMA. Costs booked in connection with events which competent state or federal authorities do not subsequently officially declare to be disasters would not be eligible for later amortization in rates. Copies of the letter should be mailed to the Director of CACD and the CACD branch chief for that industry. The letter should specify the declared disaster, date, time, location, service area affected, impact on the utility's facilities, and an estimate of the extraordinary costs expected to be incurred, with expense and capital items shown separately.

As part of CACD's development of this proposal, it held informal discussions with the Joint Energy Tariff Review Committee which is composed of representatives of the regulated energy utilities with CACD Energy Branch providing an informal member. The utilities all indicated strong support for the CEMA as described in this resolution. They also, however, suggested characterizing the mechanism as a balancing account rather than a memorandum account because they believe that this significantly affects the way it may be presented in their financial statements. In essence, balancing account treatment would provide a presumption of recovery sufficient to enable untested CEMA amounts to be reflected as income on their income statements and current assets on their balance sheets.

CACD observes that there is a substantial difference between an established, active regulatory balancing account such as the Energy Cost Adjustment Clause (ECAC) or the Electric Revenue Adjustment Mechanism (ERAM) and the proposed mechanism for catastrophic events. ECACs, ERAMs and other active balancing accounts are the subjects of standard regulatory reviews and usually handle only the differences between projected and actual results in a future period. They also address the most significant of all of the utilities' business risks. CEMA, in contrast, may never be used; the full scope and content of what may be deemed prudent for recovery are quite unknown and it would be premature to presume or imply that there is assurance of full recovery of any or all costs included in the account.

CACD also notes that under generally accepted accounting principles the utilities have the option of reflecting CEMA amounts on their financial statements through booking potential recoverables as deferred debits, longer term assets which lack the detailed procedures and assurances of the active regulatory balancing accounts. Deferred debit account treatment provides the opportunity to recover reasonable costs which would otherwise be lost forever without the advance approval of the CEMA mechanism.

The utilities' desire to characterize CEMA as a balancing account, thus allowing them to include it in their income statements with implications of guaranteed recovery absent Commission action to the contrary, is understandable. However, our intent in establishing the CEMA mechanism is to resolve the problem of timely obtaining a Commission order following a catastrophic event to record costs which would otherwise be lost due to the retroactive ratemaking prohibition. The CEMA mechanism requires only that the utility link its costs to a declaration of a disaster in order to make entries. This is a far less rigorous test than any ECAC or ERAM and argues strongly for CEMA's characterization as a memorandum account.

FINDINGS:

1. Following the Loma Prieta earthquake of 1989, those utilities which immediately incurred substantial costs to restore service, repair, replace or restore damaged facilities, and comply with resulting government agency orders found that the retroactive ratemaking prohibition kept them from recovering a portion of those costs which were incurred prior to the Commission's authorization of a memorandum account.
2. By authorizing utilities to establish Catastrophic Event Memorandum Accounts in advance to accumulate such costs, the Commission can remove a potential disincentive to utilities' prompt response to future declared disasters.
3. A catastrophic event should be defined as one which results in the official declaration of a disaster by competent state or federal authority.

4. Because recovery in rates is not guaranteed by the creation of and booking into memorandum accounts and parties would have an opportunity to review the costs included in them in the future, it is appropriate to authorize public utilities, except common carriers and toll bridge corporations, to establish Catastrophic Event Memorandum Accounts prospectively without hearing.
5. Each energy utility desiring to avail itself of a Catastrophic Event Memorandum Account should be required to file and make effective on thirty days' notice an advice letter with proposed tariff sheets reflecting its establishment. Telecommunications, water and other utilities which do not include such accounts in their tariffs should be required to inform the Director of CACD in advance in writing of the effective date such an account is to be established. Consistent with the purpose of memorandum accounts, no utility should be allowed to make entries into its Catastrophic Event Memorandum Account for costs incurred before its establishment.
6. Should a declared disaster occur, each affected utility which has previously established a Catastrophic Event Memorandum Account should be required to inform the Executive Director by letter within 30 days after the catastrophic event, if possible, if it has started booking costs in the CEMA. Costs booked in connection with events which competent state or federal authorities do not subsequently officially declare to be disasters should not be eligible for later amortization in rates. Copies of the letter should be mailed to the Director of CACD and the CACD branch chief for that industry. The letter should specify the declared disaster, date, time, location, service area affected, impact on the utility's facilities, and an estimate of the extraordinary costs expected to be incurred, with costs due to expense and capital items shown separately.
7. The costs recorded in the account should only be recoverable in rates following a request by the affected utility, a showing of their reasonableness, and approval by the Commission. Such a request should be made by a formal application specifically for that purpose, by inclusion with a subsequent general rate case or other ratesetting request, or, for utilities eligible to request general rate increases by advice letter as specified in General Order 96-A, Section VI, by filing an advice letter request with an appropriate showing.

THEREFORE, IT IS ORDERED that:

1. Each regulated public utility as defined in Section 216 of the Public Utilities Code, except common carriers and toll bridge corporations, is authorized to establish a Catastrophic Event Memorandum Account and to record therein its costs of: (a) restoring utility services to its customers; (b) repairing, replacing or restoring damaged utility facilities; and (c) complying with governmental agency orders in connection with events declared disasters by competent state or federal authority. Each energy utility desiring to establish a Catastrophic Event Memorandum Account shall file to become effective on thirty days' notice an advice letter with proposed tariff sheets reflecting its establishment. Each other utility which does not include such accounts in its tariffs shall

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inform the Director of Commission Advisory and Compliance Division in advance in writing of the effective date such an account is to be established. No utility shall make entries into its Catastrophic Event Memorandum Account for costs incurred prior to its establishment.

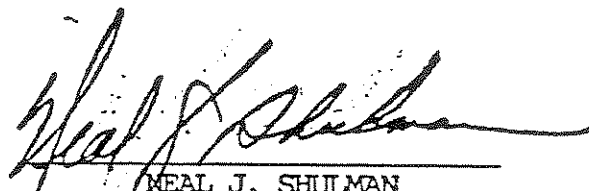
2. Should a declared disaster occur, each affected utility which has previously established a Catastrophic Event Memorandum Account shall, if possible, inform the Executive Director by letter within 30 days after the catastrophic event if it has started booking costs in the Catastrophic Event Memorandum Account. Costs booked in connection with events which competent state or federal authorities do not subsequently officially declare to be disasters shall not be eligible for later amortization in rates through the Catastrophic Event Memorandum Account mechanism. Copies of the letter shall be mailed to the Director of the Commission Advisory and Compliance Division and the Commission Advisory and Compliance Division branch chief for that industry. The letter shall specify the declared disaster, date, time, location, service area affected, impact on the utility's facilities, and an estimate of the extraordinary costs expected to be incurred, with costs due to expense and capital items shown separately.

3. The costs recorded in a utility's Catastrophic Event Memorandum Account may be recovered in rates only after a request by the affected utility, a showing of their reasonableness, and approval by the Commission. Such a request may be made by a formal application specifically for that purpose, by inclusion with a subsequent general rate case or other ratesetting request, or, for utilities eligible to request general rate increases by advice letter as specified in General Order 96-A, Section VI, by filing an advice letter request with an appropriate showing. Amounts which the Commission does not find reasonable shall not be included in rates.

The effective date of this Resolution is today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on July 24, 1991. The following Commissioners approved it:

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners


NEAL J. SHULMAN
Executive Director