

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA



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Application of Suburban Water Systems
(U339W) for Authority to Increase Rates
Charged for Water Service by \$19,234,576 or
35.85% in 2012, by \$3,032,827 or 4.18% in
2013, and by \$1,973,200 or 2.61% in 2014.

Application 11-02-002
(Filed February 1, 2011)

**OPENING BRIEF
OF THE DIVISION OF RATEPAYER ADVOCATES**

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BEFORE THE PUBLIC UTILITIES COMMISSION
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Application of Suburban Water Systems (U339W) for Authority to Increase Rates Charged for Water Service by \$19,234,576 or 35.85% in 2012, by \$3,032,827 or 4.18% in 2013, and by \$1,973,200 or 2.61% in 2014.

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I. INTRODUCTION

Pursuant to Rule 13.11 of the California Public Utilities Commission's ("Commission) Rules of Practice and Procedure ("Rules") and the schedule developed by Administrative Law Judge ("ALJ") Douglas Long in a Ruling dated April 20, 2011, the Division of Ratepayer Advocates ("DRA") hereby files its Opening Brief to Suburban Water Systems ("Suburban") Application ("A.") 11-02-002 for authority to increase its rates charged for water service. In its Application Suburban requests: (1) an increase of \$19,234,576 or 35.85% in test year 2012; (2) an increase of \$3,032,827 or 4.18% in 2013; and (3) an increase of \$1,973,200 or 2.61% in 2014.

DRA would like to first thank ALJ Long for his patience and efforts during this proceeding, including conducting various "Monday morning" calls to address discovery disputes. Both DRA and Suburban appreciate ALJ Long's assistance in helping the parties efficiently deal with various discovery conflicts.

A. Procedural History

Suburban filed its Application on February 1, 2011, and the Application appeared on the Commission's Daily Calendar on February 4, 2011. DRA filed its Protest on March 7, 2011.

ALJ Long held a Pre-Hearing Conference on March 24, 2011, and ALJ Long and Assigned Commissioner Catherine J.K. Sandoval issued the Scoping Memo & Ruling on April 20, 2011.

The Commission did not hold any Public Participation Hearings in this proceeding.

The Commission's Department of Water & Audits' water quality expert issued the Commission's water quality finding on May 11, 2011 and DRA issued its Comments on June 10, 2011.

DRA served its testimony on June 10, 2011. Suburban's Rebuttal testimony was served on July 1, 2011.

Parties conducted settlement discussions from July 5-7th, 2011. The Commission held evidentiary hearings from July 12-13th, 2011.

B. Burden of Proof

All charges demanded or received by any public utility must be "just and reasonable." *See* Public Utilities Code Section 451. Existing rates are presumed to be reasonable and lawful and a utility seeking to increase those rates has "...the burden of showing by clear and convincing evidence that it is entitled to such increase." *See* Re PG&E 2000 CalPUCLEXIS 239; D.00-02-046. The standard applicable to the approval of rate increases is "clear and convincing" evidence:

Clear and convincing evidence must be clear, explicit, and unequivocal. It should be clear as to leave no substantial doubt, or sufficiently strong to demand the unhesitating assent of every reasonable mind. *Id.*

Suburban has not met its burden of proof in justifying its rate request related to its Four Factor allocation costs to Suburban, taxes, and regulatory expenses. *See* Exhibit DRA-1, p.8-34-8-37; p.9-2-9-3; & p.3-27-3-28.

Suburban's justification for the rate increases associated with the Four Factor, taxes, and regulatory expenses are unpersuasive and thus, Suburban fails to meet its

burden of providing “clear and convincing” evidence that the rate increases are reasonable and legitimate.

II. TAXES

A. **The Commission should adopt DRA’s amount for Suburban’s State Income Tax Expense when calculating its Federal Income Tax Expense**

Suburban is seeking \$1,001,108 for its state income tax expenses. DRA’s recommendation is \$798,848 for Test Year 2012. Both Suburban and DRA used the California Corporate Franchise Tax (“CCFT”) rate of 8.84% in calculating the state income tax expense. *See* Exhibit DRA-1, p. 9-2.

Under applicable tax law, a utility’s prior year CCFT expense is used as a deduction to reduce its gross federal taxable income. The Commission stated in D.84-05-036: “The state income tax deduction for federal tax purposes is the amount of tax paid in the prior year. The state tax deduction computed for ratemaking purposes is the amount of tax paid in the prior year. The state tax deduction computed for ratemaking purposes has been based on the current year test-year...” p. 33.

A number of Commission decisions have stated that using the prior year CCFT expense is the methodology that should be employed to calculate federal income tax expense. For example, the Commission stated in D.89-11-058: “...we adopt the DRA/San Diego position that the test year CCFT number used is really an approximation for the prior year. Our conclusion is based on an understanding of what it takes to prepare a result of operations for a test year. The preparation of a results of operations for one test year is a major undertaking. The preparation of an additional results of operations for the year prior to the test year is likewise no small task. To do the work required to prepare the additional results of operations, solely for the purpose of deriving one number, arguably a more accurate CCFT number, for the test year federal income tax calculation, does not make sense if the test year CCFT number is available and it is a reasonable approximation.” p. 12.

The Commission also stated in D.89-11-058: "...since the prior years' CCFT number is now available from Commission adopted records, the Commission finds that a change in method to flow-through for the treatment of the CCFT deduction would alleviate the utilities' concerns over the timing of the benefit of the CCFT deduction. Therefore, the prior year CCFT number should be used in future income tax expense." p. 2.

The Commission concluded in D.89-11-058: "1. The Commission concludes that ratemaking should reflect the value of the CCFT deduction. Since the prior year's CCFT ratemaking amount is now readily available from the recent Commission adopted records, flow through treatment for the CCFT deduction shall be used in setting rates." p. 24. "4. In the future, all results of operations for all utilities shall reflect the flow-through treatment for the CCFT deduction in computing federal income taxes." Id.

In May 1990, the then Commission Large Water Utilities Section issued a memorandum notifying a list of water utilities of the change made in D.89-11-058 regarding using the prior year CCFT expense in ratemaking calculations for federal income tax expenses and other affected ratemaking matters. *See* Exhibit SUB-28 1990 CPUC Memorandum.

Here, the question is whether to use Suburban's prior year CCFT *negative* \$617,939 or DRA's \$831,400 estimate or another amount from the most readily available source, such as Suburban's recent Advice Letter 279W in calculating federal income tax expenses for Test Year 2012?

In November 2010, Suburban requested a step rate increase in Advice Letter No.279W using a lower than authorized rate increase of 1.8% or \$1,054,018 for 2011. Advice Letter No. 279W became effective January 2011. DRA referred to this Advice Letter during hearings. (Tr.Vol.3, Matsuoka,/DRA, p. 202)

In its Application, Suburban uses a *negative* \$617,939 for its prior year CCFT expense in calculating its federal income tax expense for Test Year 2012. This negative amount represents the CCFT expense for 2011. The table below shows a swing from adopted CCFT expense of \$831,400 for 2010 to *negative* \$617,939 for 2011. The

negative swing is suspect because D.09-03-007 (Suburban’s last GRC) adopted positive numbers for all three years and the last year step increase effective in Advice Letter No. 279W is positive, but for the purpose of this proceeding the 2011 CCFT expense is *negative \$617,939*. (Tr.Vol.3, Matsuoka/DRA, p. 228)

CCFT EXPENSE					
ITEM	ADOPTED 2009	ADOPTED 2010	AL 279W 2011	DRA ESTIMATE	SUBURBAN ESTIMATE
CCFT TAX	\$791,300	\$831,400	Unknown	\$831,400	-\$617,939

Consistent with applicable Commission precedents, DRA uses the estimate of \$831,400 for Suburban’s prior year CCFT expense to calculate Suburban’s federal income tax expense for Test Year 2012. DRA uses 2011 as the prior year and \$831,400 as the CCFT expense, which was the Commission’s adopted amount as shown in the table for 2010.

As stated above, DRA uses 2011 as the prior year. At the evidentiary hearing, DRA affirmed that Exhibit No. SUB-28 1990 CPUC Memorandum recommends going back to the prior year too instead of two years back. (Tr.Vol.3, Matusoka/DRA, p. 204-205) DRA confirmed seeing Exhibit SUB-28 1990 CPUC Memorandum and affirmed that it remains the guiding policy for DRA. *Id.* at p. 223.

If Suburban uses the 2011 CCFT expense it cites in Advice Letter 279W to replace its *negative \$617,939* or DRA’s \$831,400, then DRA would agree that Suburban is consistent with D.89-11-058.

DRA has a major concern with Suburban’s use of a *negative \$617,939* CCFT expense for 2011. The table above shows that the Commission adopted CCFT expenses of \$791,300 for 2009 and \$831,400 for 2010. D.09-03-007 adopted a rate increase of 2.19% or \$1,262,780 for 2011. The dramatic drop from the adopted \$831,400 of CCFT expense for 2010 to *negative \$617,939* for 2011 is inconsistent with Suburban’s actual

anticipated earnings for 2011. DRA considers \$831,400 as the best CCFT available estimate expense for 2011.

When Suburban filed for a lesser rate increase of 1.8% or \$1,054,018 for 2011 than it was authorized to request through Advice Letter No. 279W, Suburban did not show the CCFT expense for 2011 in the filing. Suburban's Advice Letter filing seeking a lower rate increase than was authorized indicates that Suburban's CCFT expense for 2011 would be a positive number, but less than or about the level of \$831,400 for 2010 instead of the *negative \$617,939*. Thus, DRA considers \$831,400 to be the best estimate available CCFT expense for 2011.

In summary, DRA has consistently followed the guidelines in D.89-11-058 and Exhibit SUB-28, 1990 CPUC Memorandum in general rate cases. For example, the last general rate case addressing the same issue of using prior year CCFT expense in calculating federal income tax expense in the Test Year was Golden State Water Company's A.08-07-010. In that case DRA contended that the prior year CCFT expense in Advice Letter 1302W was readily available to calculate federal income tax expenses for the Test Year. Golden State Water Company asserted that the calculated current year CCFT expense should be used instead.

D.10-11-035 states: "Ultimately the heart of the issue here is the availability of accurate information. There is no reasonable basis for using an approximation when actual costs are readily accessible." p. 46. "An estimate using some actual expense figures is more accurate than a total approximation and therefore we find merit in DRA's position." *Id.* at 47. Thus, DRA's recommended figure utilizing the prior year's CCFT is the most appropriate.

B. The Commission should adopt DRA's Domestic Production Activities Deduction ("DPAD") amount in calculating Suburban's Federal Income Tax expense

The DPAD expense reduces Suburban's total income including its federal taxable income. The Commission stated in D.84-05-036: "We are convinced that the separate return method [for a utility rather than its parent] is the more reasonable basis for

calculating test-year income tax expense. Therefore, we provide for no change from the present practice.” p. 25. The Commission stated in Findings of Fact: “12. It is the practice of the Commission, in calculating test-year income tax expenses, to assume as separate return basis considering solely utility operations.” p. 49. The Commission stated in Conclusions of Law: “3. The separate return method is the most reasonable basis for calculating test-year income tax expense.” p. 53. Here, the Commission states its policy on treating a utility’s taxes on a stand-alone basis. Thus, the Commission should calculate Suburban’s tax expense as a stand-alone entity regardless of whether its parent, Southwest, can take certain deductions such as the DPAD or not.

Suburban Water Systems requests \$1,001,108 of state income tax expense and \$4,171,964 of federal income tax expense for Test Year 2012 in this Application. Both income tax expenses are included in the revenue requirement for this Application, but Suburban did not provide an estimate for a DPAD deduction because of Southwest’s inability to take this DPAD. (Tr.Vol.3, Matsuoka/DRA, p. 208)

Southwest’s poor financial performance is not the Commission’s concern. Setting up its holding company structure with Southwest as its parent company, Suburban assumed the risk that its other subsidiaries may be less lucrative than anticipated. Southwest’s financial troubles should not be considered in calculating Suburban’s tax liability. What is clear is that Suburban earned significant profits in 2010 and thus qualified to take the DPAD deduction. Suburban’s ratepayers should realize the benefit of that deduction, not Southwest’s shareholders.

DRA’s DPAD estimate, however, is \$706,905. Suburban qualifies to take this deduction because of its qualifying gross receipts and income and its DPAD is not more than 50% of its Form W-2 wages.

DRA’s imputed estimate of \$706,905 for DPAD is smaller than Suburban’s \$3,119,540 estimate, which represents 50% of Form W-2 wages. *See* Exhibit DRA-1 DRA Report, p. 9-2. Lastly, Suburban did not challenge the reasonableness of DRA’s imputed \$706,905 estimate. Suburban’s argument was Southwest’s net operating loss

prohibits Suburban from taking the DPAD deduction. The Commission should adopt DRA's imputed DPAD estimate for Suburban.

III. 2011 GENERAL RATE CASE EXPENSE

A. The Commission should disallow Suburban's request for the recovery of regulatory expenses for this rate case

In addition to the regulatory commission expenses adopted in D.09-03-007 to file this current GRC, A.11-02-002, Suburban requests \$512,865 in additional regulatory commission expenses incurred for this proceeding to be recovered over a 3 year period, or \$170,955 each year from Test Year 2012 – Escalation Year 2014. The Commission adopted a reasonable level of expenses in D.09-03-007 to provide Suburban the funds necessary to fulfill the requirements of filing this current GRC. DRA recommends disallowing \$512,865 because Suburban's ratepayers would be paying twice for this expense if this request is allowed. *See Exhibit DRA-1, p. 3-27.*

The Commission has consistently conducted ratemaking on a prospective basis. For example in D.04-06-018, the Commission cited D.92-03-094 by stating, "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 account or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking." p. 26.

D.05-07-044 stated: "Our practice for regulatory commission expense is to include an allowance in rates sufficient to cover the utility's reasonable level of expense averaged over the rate case cycle (typically 3 years). Our estimates are forward-looking; the amount we will allow for test year 2005/2006 is not intended to amortize San Gabriel's actual costs of this general rate case, although those costs are an important factor to consider in determining what is a reasonable future level." p. 15-16.

D.09-07-021 stated: "The Commission's task instead is to forecast regulatory expense for the upcoming three-year rate period." And, Conclusion of Law, p. 149,

stated “24. Regulatory expense is included in revenue requirement on a forecasted basis.” p. 73-74. These various Commission decisions demonstrate how utilities should only recover expenses in rates prospectively.

IV. FOUR FACTOR

A. The Commission should adopt DRA’s recommendations on suburban’s four factor allocation

To forecast its allocable costs of Southwest, Suburban used the Commission’s Four Factor Allocation Method to distribute these estimated costs between various subsidiaries, including Suburban. Suburban requests that 32.7% of its parent company’s allocable costs should be assigned to Suburban’s ratepayers. Suburban’s approach toward its use of the Commission’s Four Factor Allocation Method is inappropriate and that Suburban should only be allocated 14.7% of the parent company’s expenses. *See* Exhibit DRA-1, p. 8-34.

In 1956, the Commission issued a Subject Reference, H32, titled: Allocation of Administrative and General Expenses and Common Utility Plant, which later came to be known as the Commission's Four Factor Allocation Method. In this reference, the Commission delineated procedures for the allocation of administration and general expenses and common utility plant among departments, districts and states. While describing the allocation of indirect costs, the Commission stated:

Indirect Allocations

Indirect general expenses which have a significant relationship to a particular factor, such as pension expenses to payroll, should be segregated and prorated on the basis of an appropriate single factor. The remaining indirect expenses may be so general in nature as to require prorations based on a combination of several pertinent factors. Considering the relative complexity and magnitude of the operations usually involved, it is believed that the application of the arithmetic average of the percentages derived from the use of four factors listed below produces results within the range of reasonableness in most instances. The four factors are as follows:

1. Direct operating expenses, excluding uncollectibles, general expenses, depreciation and taxes.
2. Gross Plant.
3. Number of employees (using direct operating payroll, excluding general office payroll, as the best measure of this component).
4. Number of customers (subscribers of telephone).” (emphasis added)

Suburban applied the Commission’s Four Factor Allocation Method to allocate its Southwest-associated expenses between 18 different affiliates including Suburban. The following table shows the details of Suburban’s workpapers:

Southwest Cost Allocations											
COMPUTATION OF ALLOCATION PERCENT											
Company	Direct Operating Expense		End of Year Gross Plant		Customer		Payroll		Total Percent	Average (Percent)	
	Recorded 2009		Recorded 2009		Recorded 2009		Recorded 2009				
	Amount, \$	Percent	Amount, \$	Percent	Number	Percent	Amount, \$	Percent			
ALLOCATION FACTORS											
Suburban Water Systems	27,221,789	18.2%	181,567,267	41.4%	75,392	57.8%	6,361,682	13.5%	130.9%	32.7%	
Texas Utilities											
Monarch Utilities	14,144,170	9.5%	115,286,257	26.3%	27,110	20.8%	4,149,724	8.8%	65.4%	16.4%	
Windmere	3,850,973	2.6%	43,321,714	9.9%	10,093	7.7%	371,671	0.8%	21.0%	5.3%	
Hornsby Bend	1,172,707	0.8%	19,787,710	4.5%	3,593	2.8%	129,900	0.3%	8.4%	2.1%	
Diamond	309,195	0.2%	2,635,182	0.6%	713	0.5%	57,649	0.1%	1.4%	0.4%	
Water Services Inc	1,154,965	0.8%	5,798,378	1.3%	1,904	1.5%	342,687	0.7%	4.3%	1.1%	
Huntington	27,945	0.0%	649,846	0.1%	126	0.1%	9,904	0.0%	0.2%	0.1%	
Inverness	158,138	0.1%	1,688,352	0.4%	129	0.1%	48,431	0.1%	0.7%	0.2%	
Midway	140,485	0.1%	1,007,688	0.2%	396	0.3%	18,565	0.0%	0.6%	0.2%	
SW Utilities	20,225	0.0%	46,347	0.0%	42	0.0%	5,123	0.0%	0.0%	0.0%	
Tenkiller	119,868	0.1%	1,069,188	0.2%	521	0.4%	32,902	0.1%	0.8%	0.2%	
Metro - Continued Operation	457,952	0.3%	8,751,124	2.0%	1	0.0%	8,218	0.0%	2.3%	0.6%	
Southeast Utilities											
SW Alabama Onsite	118,155	0.1%	4,405,544	1.0%	154	0.1%	-	0.0%	1.2%	0.3%	
Riverview Wastewater	2,940,970	2.0%	28,079,171	6.4%	4,200	3.2%	369,991	0.8%	12.4%	3.1%	
North Shelby & Other	1,953,689	1.3%	10,558,819	2.4%	4,717	3.6%	226,572	0.5%	7.8%	2.0%	
North County Water	87,087	0.1%	1,330,081	0.3%	197	0.2%	-	0.0%	0.6%	0.2%	
SW Mississippi	129,878	0.1%	68,288	0.0%	669	0.5%	-	0.0%	0.6%	0.2%	
Non-Utility	95,256,928	63.8%	12,660,996	2.9%	547	0.4%	35,011,360	74.3%	141.4%	35.4%	
Total	149,265,119	100%	438,711,952	100%	130,504	100%	47,144,378	100%	400%	100%	

All of Suburban’s affiliates are regular utilities, except one, the Non-Utility Group. This affiliate is one of the largest affiliates in terms of both “Direct Operating Expenses” and “Payroll.” The Utility-Group currently provides a spectrum of services to 547 service contracts. Id. at p. 8-35-8-36.

DRA's review of Suburban's cost allocation calculation, demonstrates that Suburban applies these factors in such a way that shifts most of its parent company cost allocations towards its captive ratepayers. The following discussion describes Suburban's inappropriate application of these factors:

1. Number of Customers Factor

For the "Number of Customers," factor Suburban included the number of service connections for Suburban's own operations and therefore used a value of 75,392 as the number of customers. However, for one of its largest affiliates, Non-Utility Group, Suburban used the "Number of Contracts" equaling only 547 service contracts. By applying this particular allocating factor this way, Suburban shifts most of its parent company cost allocations toward Suburban's captive ratepayers.

For example, by using 75,392 for its number of customers, Suburban receives 57.8% of the parent company costs. By equating individual contracts with individual customers, i.e., one contract is comparable to one customer in Suburban's methodology. Suburban allocates only 0.4% of its overhead costs toward the Non-Utility Group. This approach is unreasonable because the two values do not reflect the same level of activity and hence skew the allocations toward Suburban's operations.

In fact, the Commission's Four Factor Allocation Method specifically noted that the factor used should be "pertinent" and should provide results in the "range of reasonableness." Suburban's use of "Number of Contracts" instead of using "Number of Customers" served under the contracts for one of its largest affiliates- Non-Utility is neither pertinent nor reasonable in this Application.

"Number of Contracts" does not compare equitably with the "Number of Customers" because the two concepts relate to two very different levels of activities. Suburban's 75,392 "Number of Customers" relates to the level of operations Suburban needs to maintain in order to serve each individual customer in its service territory. Therefore, when Suburban uses the value of its 547 "Number of Contracts" for its Non-Utility Group, it erroneously implies that the activity level of Non-Utility Group in

maintaining 547 contracts is equal to the amount of activity required to serve 547 Suburban customers. *Id.* at p. 8-37.

This is not a fair comparison. In addition, the use of “Number of Contracts” leads to unreasonable results that grossly skew Suburban’s parent company cost allocations toward the regulated operations even though the Non-Utility Group serves more customers under its 547 contracts using the general/usual meaning of the term “customers.”

The use of “Number of Contracts” for one entity and the use of “Number of Customers” for the other entity runs contrary to the basic principles of Cost Accounting as well. For example, Cost Accounting describes costs allocation factors in the terms of Cost Drivers, which are identified to establish the cause-effect relationship between a Cost Object and an Activity it creates. For, parent company cost allocations, the Cost Objects are Suburban and other affiliates and the Activity is the level of allocable costs they create at the parent company level. However, the cause-effect relationship between these affiliates and the parent company’s allocable costs is measured in terms of the Cost Driver, “Number of Customers.” Therefore, the parent company’s allocable costs are allocated to Suburban in proportion to its Cost Driver, i.e., “Number of Customers.”

Similarly, these allocable costs should also be assigned to another Cost Object, the Non-Utility Group in similar proportion to number of customers being served under the contracts, rather than treating one-single contract as a customer. As the “Number of Contracts” value is drastically lower than the value of the “Number of Customers,” the proportion of parent company’s allocable costs assigned to the Non-Utility Group is grossly skewed. Therefore, the basic cause-effect relationship is violated. In order to maintain the integrity of cause-effect relationship, one must use the “Number of Customers” for the Non-Utility Group as well.

In addition, it should also be noted that the Commission has recently authorized a common set of Affiliate Transaction Rules for all Class-A water companies, and has stressed the need for cost allocation based on the cost-causation principle and stated that the allocation method does not cause utility ratepayers to subsidize any costs of its parent

or its other affiliates.¹ Suburban's use of "number of contracts" for its largest affiliate, Non-Utility Group, violates the cost-causation principle and thus results in cross subsidies. *Id.* at p. 8-38.

DRA tried to obtain information regarding the total number of customers being served by the Non-Utility Group under its 547 contracts, but Suburban refused to provide such information because it contended that the requested information was not available. However, it should be noted that Suburban's refusal to provide such information was not due to its inability to obtain such information. Instead, Suburban's parent company, Southwest's official website has the following claim regarding the operations of Non-Utility Group. *See* Exhibit DRA-2, Attachment-I (Page from Southwest's website, dated 5/19/2011):

Our contract service divisions partner under contract with cities, municipal utility districts, private companies and developers. They serve over 400 contracts and oversee more than 350,000 connections in eight states: Alabama, California, Colorado, Georgia, Mississippi, South Dakota, Texas and Wyoming.” (Emphasis Added)

Thus, it appears that the “Number of Customers” information is readily available for the Non-Utility Group, but Suburban simply refuses to provide this information to DRA contrary to Section 309.5 of the Public Utility. Code. Please note that for all practical purposes, the number of service connections relates to the individual number of customers. However, Suburban failed to provide this information to DRA when DRA requested it.

As discussed earlier, the use of “Number of Contracts” instead of “Number of Customers” skews the allocations away from one of the largest Suburban affiliates, Non-Utility Group. Therefore, the Commission should not allow use of the erroneous 547 value as “Number of Customers” for cost allocation purposes. The Commission should either use “Number of Service Connections” for the Non-Utility Group or not use the “Number of Customers” factor completely. *Id.* at p. 8-39.

¹ D.10-10-019, Appendix-A, Rule II.F (3) and Rule IV.B.

In previous decisions, the Commission has decided to use fewer factors when the needed information was not available for any of the four factors.

For example, in Suburban's 2003 GRC application (A.02-05-033), the Commission ordered in D.03-05-078 the use of only three factors instead of applying all four factors. This same issue is being litigated today, and in D.03-05-078 the Commission found using the "Number of Customers" factor for allocating costs from the parent was not reliable:

In allocating parent company expenses to subsidiaries, the Commission generally follows a four-factor approach, measuring each subsidiary's (1) direct operating expenses, (2) end-of-year gross plant, (3) total customers, and (4) payroll. The results are applied to determine a subsidiary's share of its parent company expenses. Suburban applied these four factors to its allocation. ORA applied a three-factor test, eliminating "customers" of each subsidiary because non-regulated subsidiaries like ECO reported that they had clients rather than customers. By entering "0" for ECO customers, ECO's share of parent company costs was reduced, and Suburban's share was increased, despite ECO's annual revenue of \$62 million or more.

ORA notes that it has used two- or three-factor analyses for other Class A water companies where appropriate, most recently in dealing with Park Water Company. ORA's analysis is persuasive, and we adopt the ORA allocation formula in this proceeding. Suburban thus is allocated 32.6% of the parent company costs, rather than the 45.2% recommended by Suburban.²

Currently, Suburban uses 547 for its service contracts instead of the value of zero. However, the Commission's Four Factor Allocation Method's basic premise is still compromised with the use of 547 contracts because it does not equate to the number of customers being served by the contracts, which is more than 350,000 service connections. Relying on just the number of contracts to develop the "Number of Customer" factor is unfair to ratepayers and results in captive ratepayers subsidizing Southwest's non-regulated operations.

² D.03-05-078, p. 21.

Therefore, due to Suburban’s inability to provide pertinent information regarding “Number of Customers” for its largest affiliate, Non-Utility Group, the Commission should either disregard the use of the “Number of Customer” factor as it ordered previously in D.03-05-078.

If, however, the Commission uses the “Number of Customers” factor, DRA recommends using 478,625 service connections to develop this factor. DRA derived this figure by relying on the information listed for the 400 service contracts associated with 350,000 service connections found in Southwest’s Website for its Non-Utility Group. Suburban has estimated a total of 547 service contracts. DRA estimated the value of 478,625 Number of Service Connections for the current 547 number of contracts by keeping the same ratio which 400 contracts have with 350,000 Number of Service Connections.³

Suburban objects to DRA’s recommendation by pointing out that the Non-Utility Group does not provide full services to all of its “number of connections” and therefore, these “numbers of connections” cannot be equated to “number of customers.” However, DRA notes that the burden of proof rests with Suburban in that it has failed to provide any support for such assertions. For example, DRA noticed that the Non-Utility Group does not provide all contracts with a full scale of services, but it is also true that in some instances, the Non-Utility Group provides services above and beyond the services Suburban provides to its typical customer. *Id.* at p. 8-41.

Suburban’s parent company in its 2009 10-K report made the following claims regarding these service contracts:

**“CONTRACT SERVICES—DEVELOPMENT OF BUSINESS,
SERVICES AND REGULATION**

Our contract services businesses, which include both O&M Services and Texas MUD Services segments, are described below. Many of the overall drivers for these two operations are similar, although there are some differences. Although we are operating these utilities on behalf of a governmental agency or industry, the day to day

³ 478,625 = (350,000 x 547) / 400.

issues are much the same as in our owned utilities operations. However, in contract services, some of these drivers can present an opportunity for us to provide additional services for our clients. ...Our contract operations are segmented by contract type into those that are project specific, stand alone operations (“O&M Services”) and those that are small, full service contracts operated by a common team of personnel resulting in a model that apportions a fractional amount of each cost center to each client (“Texas MUD Services”) ...O&M Services contracts are agreements with cities, public entities and private utility owners that provide specific services such as facility operation and maintenance, meter reading, customer billing and collection, upgrades and improvements, municipal public works services and/or management, or management of entire water or wastewater systems... A MUD is created either administratively or legislatively to operate under the rules of the TCEQ to provide water supply, wastewater treatment and drainage services to areas where existing municipal services are not available. At December 31, 2009, we had more than 320 contracts with more than 270 MUDs in the suburbs of Houston, Austin, Dallas and El Paso, Texas. Under a typical MUD contract, we bill a monthly base fee to the MUD to provide a specified level of services. We typically provide water and/or wastewater facility operations and maintenance services, equipment maintenance, meter reading, billing and collection services and customer service functions.”⁴ (Emphasis Added)

Therefore, it is clear that even though there might be some contracts for which the Non-Utility Group would provide stand-alone specific Operations & Maintenance services, there are also instances where the Non-Utility Group will provide additional services that Suburban does not provide to its typical customer, i.e. wastewater services etc. Mr. Aslam, DRA’s analyst, verified this fact during hearings. (Tr.Vol.2, Aslam/DRA, p.169-180.) Therefore, due to the lack of full details regarding the Non-Utility Group’s number of customers/connections, the Commission should not give any weight to Suburban’s objection concerning the Non-Utility Group’s provision of non-full scale services to its customers since the burden of proof rests with Suburban to clarify this ambiguity.

⁴ Southwest 2009 10-k, p. 13.

For example, if Suburban had provided information regarding number of customers served by its affiliate, Non-Utility Group for each of 547 contracts, the Commission could calculate an alternative value of Weighted Number of Customers, as it has done with Golden State Water Company (D.07-10-034):

In view of the variation in services that ASUS provides to the entities with which it contracts, there is clearly a need to develop a methodology for determining a “weighted” number of customers for these entities that reasonably reflects the level of service ASUS actually provides. In the next section, we suggest one such method and then apply it to the data in the record...the most challenging of the three factors – both conceptually and computationally – is the weighted percentage of customers that should be attributed to the affiliate. In the case of CCWC, the computation is easy because it is a full-service utility, and 100% is appropriate. In the case of ASUS, however, the computation is more difficult, because – as noted above – ASUS provides varying levels of service to those entities with which it now contracts.

In cases where ASUS is providing less-than-full utility services, determining the weighted number of customers is more complex, because the extent of the services offered to the contracting parties – most of which are medium- to small-sized municipal utilities – varies from contract to contract. However, an appropriate discount factor can be developed using the ratios that O&M expenses minus supply costs, A&G expenses, amortization and depreciation, and taxes paid by GSWC bear to GSWC’s net operating revenues (minus supply costs and cost of capital) in recent rate cases.

... The next task is to apply the company-wide A&G and O&M percentages thus derived to particular ASUS contracts. In the case of ASUS’s contract with the City of Torrance, for example, ASUS has agreed to provide a full range of A&G support services (including billing, cash processing and call handling), but it has not agreed to provide any other services. Since A&G expenses comprise 30.1% of GSWC’s net operating revenues less supply expenses and cost of capital for the company’s three regions, it therefore makes sense to attribute 30.1% of the 34,000 customers shown for the City of Torrance on Exhibit 46 to the ASUS contract for purposes of

the allocation formula we will be using. Using this approach, the appropriate weighted number of customers attributable to the ASUS-Torrance contract amounts to 10,234 (30.1% x 34,000 = 10,234).”⁵ (Emphasis Added).

In order to calculate Weighted Number of Customers, the Commission requires complete disclosure regarding the service contracts in question, and especially the information regarding number of customers served under each individual contract--- information that Suburban failed to provide.

Because DRA acknowledged that not *ALL* of the service contracts includes a full array of services, DRA also requested that Suburban provide the information regarding the number of end-users (Number of Connections) for each contract so that a “Weighted Number of Customer” value could be calculated pursuant to D.07-10-034. However, Suburban refused to provide such information. *See* Exhibit DRA-1, p. 8-42.

Thus, without information regarding the Number of Connections, DRA could not accurately calculate the Weighted Number of Customers per D.07-10-034 for Suburban’s non-regulated affiliate, Non-Utility Group.

In the end, DRA managed to find that Suburban’s parent company’s website provides an *Overall Number of Connections* value of 350,000, which the Non-Utility Group serves. *See* Exhibit DRA-1 p. 8-40 & DRA-2, Attachment –I. Thus, this refutes Suburban’s claim that Suburban does not know the number of connections the Non-Utility Group serves under each contract. Despite Suburban’s lengthy line of questioning for DRA’s witness, Mr. Aslam, to allegedly demonstrate that selected copies of four Non-Utility Group’s contracts do not list the number of connections information, the mere fact that Southwest lists a value of 350,000 Number of Connections on its website refutes Suburban’s claim that such information is not available. (Tr.Vol.2, Aslam/DRA, p. 169-180.)

Because the burden of proof rests with Suburban, the Commission should exclude the “Number of Customers” factor from the four-factor calculation or rely on DRA’s

⁵ D.07-10-034, pp. 32-37.

estimate of 478,625 for number of service connections serviced under the Non-Utility Group's 547 service contracts. *See* Exhibit DRA-1, p. 8-43.

2. Gross Plant Factor

When it comes to the use of the Gross Plant allocation factor, Suburban uses the actual value of gross plant for its various affiliates including itself. However, Suburban's use of the Non-Utility Group's own gross plant value is inappropriate for the Commission's Four Factor Allocation Method because the use of the Non-Utility Group's own gross plant violates the cause-effect or cost-causation principle of cost allocation.

The Commission's Four Factors work well with the indirect costs of the regulated utility's General Office or the indirect costs of its parent company, which allocate between various affiliates who work on approximately the same business model as that of the regulated utility. However, if the business model of a few affiliates differs drastically from that of the regulated utility, one cannot compare the allocation factors in an equitable and proportional manner.

The Non-Utility Group's business model-- Suburban's largest affiliate--is drastically different than that of Suburban's or all other affiliates, which are regulated by their respective states. The Non-Utility Group provides contract services to more than 500 clients that include various cities, municipal districts, and private water and wastewater systems. In order to serve its clients' operating systems, the Non-Utility Group does not own these plant assets as it is only responsible for their operations and maintenance needs. However, a regular utility, such as Suburban actually owns the operating assets in order to serve its customers. Therefore, due to this difference in the business model, there is an inherent disparity in the amount of Gross Plant for the Non-Utility Group and that of a regular utility such as Suburban. Not capturing the amount of Gross Plant values associated with the Non-Utility Group's 547 contracts would inherently skew parent company cost allocations toward regulated utilities including Suburban. *Id.* at p. 8-44.

In this context, the Gross Plant factor will fail to appropriately measure the cost-causation relationship between the Activity (parent company allocable costs) and the Cost Object (Non-Utility Group). All other Cost Objects (other affiliates) would receive the parent company allocations in proportion to their Gross Plant values which they own and have to maintain and operate, but the Non-Utility Group would receive the parent company's allocations in proportion to its own Gross Plant, and not for the Gross Plant values it has to operate and maintain for its various clients under contracts. This difference in calculating Gross Plant figures means that, the Non-Utility Group will receive a much lower allocation from the parent company's costs. The skewing of this factor results in Suburban cross-subsidizing Southwest's Non-Utility Group.

The Commission's purpose with using multiple factors (four factors) is not to compensate for any of the operating differences within the regulated utility's affiliates' business models. Therefore, Suburban cannot claim that the deficiency of the "Gross Plant" factor can be compensated by using the other three factors. Instead, the Commission's Four Factor Method is intended to allocate a reasonable level of costs to regulated operations and to address any potential for cross-subsidization by ensuring non-regulated operations appropriately bear their fair share of allocated costs.

The Commission's Four Factor Allocation Method calls for the use of an Arithmetic Average of all four factors, and thus each factor carries its true weight. In addition, while explaining the use of multiple allocation factors, the Commission stated its position on why multiple factors are deemed necessary. *See* Exhibit DRA-2, Attachment-K (Copy of the Commission's Subject Reference H32 "Allocation of Administrative and General Expenses and Common Utility Plant):

The use of both operating expenses and gross plant as factors provides for the equitable allocations of indirect expenses where the commodity served may in some instances be purchased for resale and in other instances produced by utility plant. The gross plant factor appears more appropriate than net plant as general office activities are considered more closely related to total plant. (Emphasis Added)

The Commission guidelines regarding use of the four factors clearly shows that use of multiple factors such as Operating Expenses, and Gross Plant is an effort to capture the true nature of the Cost Drivers (four factors) of the Cost Objects (generally in the case of allocation of utility's General Office costs: the regulated utility and its various service regions, or in case of allocation of utility's parent company's costs: the regulated and non-regulated affiliates) and their "equitable" relation to the allocations of indirect costs. Similarly, the above excerpt stresses the need for determining the relationship between the Activity of General Office, in the current case, the Activity of parent company, and the allocation factors. *Id.* at p. 8-46.

Therefore, Suburban's use of the Non-Utility Group's own Gross Plant values within the cost allocation calculations fails to determine the true relationship between the parent company's allocable costs and the Non-Utility Group's gross plant. It is not the Non-Utility's gross plant, but the gross plant of its clients that determines the scope of the Non-Utility Group's operations and in turn would determine the level of Activity and the corresponding amount of cost allocations from its parent company.

As Suburban failed to provide the information relating to the gross plant values of the Non-Utility Group's clients, the use of the "Gross Plant" factor is inappropriate. Therefore, DRA recommends excluding this factor for the purpose of assessing the value of cost allocations of Suburban's parent company, Southwest.

As previously stated, DRA also notes that the ultimate objective of a cost allocation method employed is to prevent cross-subsidy. The use of the Non-Utility Group's own gross plant values will skew the cost toward Suburban. For example, in D.01-06-077 the Commission noted that using the traditional cost allocation method when substantial growth is taking place at a utility's new, unregulated affiliates can produce unreasonable results. In that decision one of the issues was whether the Commission should use a three-factor allocation formula advocated by Roseville Telephone Company ("RTC"), or a general allocator based on expenses that had been approved by the FCC and was favored by Office of Ratepayer Advocates ("ORA"), DRA's predecessor. ORA opposed the three-factor formula RTC favored on various

grounds. In particular, ORA found that plant values placed undue emphasis on past asset accumulation, since RTC's new affiliates had not had time to accumulate significant assets. The Commission agreed with ORA:

We are persuaded by ORA that RTC's three-factor formula does not reflect cost causation and instead over-allocates costs to RTC. ORA correctly points out that the three-factor formula over emphasizes asset accumulations, both through the gross plant factor and through depreciation expense reflected in the expense factor. As a mature company, RTC has accumulated considerable assets over a long period of time. In contrast, in a dynamic and fast changing period in the telecommunications industry, most of RTC's affiliates . . . were just coming into existence during the audit period. Even though these affiliates obviously required the expenditure of general and administrative costs, they have had little time to accumulate assets. Consequently, the use of accumulated assets as a significant factor in allocating common costs – as reflected in the gross plant factor and the depreciation component of the expense factor – does not provide a reasonable approximation of the extent to which affiliates caused common costs to be incurred.” p. 47.

Despite Suburban's arguments to the contrary, the RTC decision addressed the growth of non-regulated affiliates. (Tr.Vol.2, Kelly/Suburban, p. 107.) And here DRA objects to using the gross plant factor also because of anticipated growth in Southwest's non-regulated affiliates. Southwest's 10K report states the “Non-Utility Group” is where growth will be centered. *See* Exhibit DRA-1, pp .8-55-8-56.

Even though the scenario discussed in D.10-06-077 regarding use of the Gross Plant factor is somewhat different, the Commission has often recognized the need to make exceptions when the traditional Four Factor Allocation Method will result in inappropriate and unreasonable allocations to regulated operations. The current case (with Suburban's parent company cost allocations between its various regulated and non-regulated subsidiaries) present a similar example where the traditional use of Gross Plant will not produce reasonable results unless Suburban provides the information regarding Gross Plant values associated with the contracts the Non-Utility Group serves. Thus, the

Commission should not apply the Gross Plant factor in developing the four-factor allocation to allocate costs from Southwest to Suburban. *Id.* at p. 8-47.

3. Payroll Factor

In order to assess its parent company cost allocations between its various affiliates, Suburban uses the recorded payroll value as the “Payroll” factor. With the Commission’s Four Factor Method, the “direct operating payroll” factor is used instead of “Number of Employees.” However, for a few of its affiliates, Suburban used no payroll value at all. For example, for its three utilities listed under its Southwest Utilities segment: SW Alabama Onsite; North County Water; and SW Mississippi, Suburban listed no payroll amount. Later, while responding to DRA’s data requests, AMX-02 and AMX-02 Follow-Up SWS, Suburban stated that these three utilities receive operational and management services from the O&M Services business segment (this segment is part of Non-Utility Group) and hence have no direct employees. Suburban also provided in discovery:

Texas Utilities is the only business segment where indirect payroll allocation amongst various entities occurs in the four factor calculation. Indirect payroll is allocated based on direct payroll.

In the Utilities segment, SW Alabama Onsite, North County, and SW Mississippi are semi-regulated affiliates whose rates are contractually determined. As a result, these affiliates are managed based on process costing rather than on the work order costing concept that is used by Texas Utilities. As a consequence, these affiliates do not use a classic work order system to track direct or indirect payroll services received from other affiliates.⁶

The organizational relationship between Suburban’s various business affiliates is clearer if one reviews the organizational chart that depicts the operating relationship amongst various affiliates. *See* Exhibit DRA-2, Attachment–A. According to the organizational chart, the three utilities in question receive operating services for field work, billing, collection, customer services, and back-office services from the Non-

⁶ Suburban’s Response to DRA’s data request, AMX-02 Follow-Up SWS (Question-1(ii)b)).

Utility Group’s business segments: SG (Service Group) O&M-Alabama; and SG (Service Group) O&M-Management. The Non-Utility Group provides services to 547 contracts, but it also serves three of its own affiliates: SW Alabama Onsite; North County Water; and SW Mississippi.

With the Non-Utility Group serving these affiliates, Suburban claims they don’t have direct employees of their own and hence the Payroll allocation factor is “Zero” for these three affiliates. This sort of interpretation and manipulation of the Commission’s Four Factor Allocation Method demonstrates an inappropriate and troubling disregard for obtaining reasonable allocations and to avoiding prohibited cross-subsidies.

Suburban’s three affiliates received the following amount of services from the Non-Utility Group during 2009:

SW Alabama Onsite:	\$45,156
North County Water:	\$39,528
SW Mississippi:	\$88,470

Suburban also stated that these above listed amounts were included in the recorded amounts of \$118,155, \$87,087, and \$129,878 for another allocation factor, “Direct Operating Expenses” for SW Alabama Onsite, North County Water, and SW Mississippi respectively. Since Suburban’s Southwest Utility segment also provides operating and management services to these affiliates as well, it is interesting to note that between the Southwest Utility segment and Non-Utility Group, no payroll is identified for these affiliates.

Thus, in short, Suburban believes that because these affiliates are served by other affiliates, these three affiliates do not have employees of their own and thus a value of “Zero” is sufficient enough for the purpose of cost allocations toward these affiliates.

Suburban’s approach is inappropriate and should be rejected. It is unlikely there is no element of labor involved in operating and managing these affiliates. Allocating “Zero” grossly skews the allocations toward other affiliates including Suburban. *Id.* at p. 8-49.

4. The Payroll Factor’s effects on Allocation of Utility Group costs toward Suburban

While the use of no payroll costs for these three affiliates would skew the parent company cost allocations under the Payroll Factor toward other affiliates including Suburban, the impact is even more pronounced for the Utility Group’s cost allocations. For example, in the cost allocation of its Utility Group’s common costs, Suburban applied the same values for all four factors it used for the cost allocations of its parent company costs. However, as Suburban’s Utility Group currently does not serve the Non-Utility Group, the Utility Group costs are only allocated amongst the “Utility” affiliates. Therefore, Suburban eliminates the Non-Utility Group for the purpose of allocation of its Utility Group common costs. The following table shows the details of the four factors and their respective values that Suburban uses for the purpose of allocating Utility Group common costs:

Utility Group Cost Allocations											
COMPUTATION OF ALLOCATION PERCENT											
Company	Direct Operating Expense		End of Year Gross Plant		Customer		Payroll		Total Percent	Average (Percent)	
	Recorded 2009		Recorded 2009		Recorded 2009		Recorded 2009				
	Amount, \$	Percent	Amount, \$	Percent	Number	Percent	Amount, \$	Percent			
ALLOCATION FACTORS											
Suburban Water Systems	27,221,789	50.4%	181,567,267	42.6%	75,392	58.0%	6,361,682	52.4%	203.5%	50.9%	
<u>Texas Utilities</u>											
Monarch Utilities	14,144,170	26.2%	115,286,257	27.1%	27,110	20.9%	4,149,724	34.2%	108.3%	27.1%	
Windermere	3,850,973	7.1%	43,321,714	10.2%	10,093	7.8%	371,671	3.1%	28.1%	7.0%	
Hornsby Bend	1,172,707	2.2%	19,787,710	4.6%	3,593	2.8%	129,900	1.1%	10.7%	2.7%	
Diamond	309,195	0.6%	2,635,182	0.6%	713	0.5%	57,649	0.5%	2.2%	0.6%	
Water Services Inc	1,154,965	2.1%	5,798,378	14%	1,904	15%	342,687	2.8%	7.8%	19%	
Huntington	27,945	0.1%	649,846	0.2%	126	0.1%	9,904	0.1%	0.4%	0.1%	
Inverness	158,138	0.3%	1,688,352	0.4%	129	0.1%	48,431	0.4%	12%	0.3%	
Midway	140,485	0.3%	1,007,688	0.2%	396	0.3%	18,565	0.2%	10%	0.2%	
SW Utilities	20,225	0.0%	46,347	0.0%	42	0.0%	5,123	0.0%	0.1%	0.0%	
Tenkiller	119,868	0.2%	1,069,188	0.3%	521	0.4%	32,902	0.3%	1.1%	0.3%	
Metro - Continued Operations	457,952	0.8%	8,751,124	2.1%	1	0.0%	8,218	0.1%	3.0%	0.7%	
<u>Southeast Utilities</u>											
SW Alabama Onsite	118,155	0.2%	4,405,544	10%	154	0.1%	0	0.0%	14%	0.3%	
Riverview Wastewater	2,940,970	5.4%	28,079,171	6.6%	4,200	3.2%	369,991	3.0%	18.3%	4.6%	
North Shelby & Other	1,953,689	3.6%	10,558,819	2.5%	4,717	3.6%	226,572	1.9%	116%	2.9%	
North County Water	87,087	0.2%	1,330,081	0.3%	197	0.2%	0	0.0%	0.6%	0.2%	
SW Mississippi	129,878	0.2%	68,288	0.0%	669	0.5%	0	0.0%	0.8%	0.2%	
Total	54,008,191	100%	426,050,956	100%	129,957	100%	12,133,018	100%	400.0%	100.0%	

Regarding, the parent company's cost allocations, it can be argued that while the Non-Utility Group does not allocate any payroll costs toward these three affiliates, the value of its own payroll expenses capture the amount of payroll that it should have allocated to these three affiliates. The impact of the Payroll factor on the parent company costs allocations is reflected in the total value of payroll expenses recorded for the Non-Utility Group instead of by these three individual affiliates.

However, the same is not true for the cost allocations of the Utility Group. Here, the elimination of the Non-Utility Group from the allocation calculations, removes the amount of payroll expenses that ought to be allocated to the three affiliates and recorded at the Non-Utility Group level. Thus, with the elimination of the Non-Utility Group, the payroll for these three affiliates is also removed and the allocations are once again skewed toward other affiliates including Suburban.

One option to deal with this issue is simply excluding the Payroll factor from the allocation calculations. Or the Commission could determine some reasonable estimate for the payroll values for these three affiliates. During discovery, DRA received the cost breakdowns for the "Direct Operating Expenses" factor for the three affiliates in question. These cost breakdowns included \$45,156 and \$39,529 "Intra- Divisional Allocations" for year 2009 for SW Alabama Onsite and North County Water, respectively. In addition, of these "Intra-Divisional Allocations" of \$27,900 and \$16,896 were identified as "Field Labor-Allocated Costs" for SW Alabama Onsite and North County Water, respectively. *See* Exhibit DRA-2, Attachment-K (Suburban's response to DRA's data request, AMX-05 (Questions:1(iii) (vii), and (xi)) for these details. *Id.* at p. 8-51.

DRA recommends using the recorded values of "Field Labor-Allocated Costs" amounts for both SW Alabama Onsite and North County Water as the Payroll factor for the purpose of allocating costs of both Suburban's parent company and the Utility Group amongst the various affiliates including Suburban. The value of Payroll factor for the third affiliate, SW Mississippi should be calculated as an average percent based on the percentages of "Field Labor-Allocation Costs" amount for the remaining two affiliates to

their respective “Intra-Divisional Allocations.” And DRA calculates this percent to be approximately 52%, and the related Payroll factor amount for SW Mississippi as \$45,553.⁷

Additionally, DRA recommends that the Commission order an audit (at Southwest’s shareholders’ expense) of Suburban’s largest affiliate, Non-Utility Group so that appropriate values for the four factors for this affiliate can be determined and verified. In the interim, the Commission should use an adjusted value based on the number of service connections to determine the “Number of Customers” for the Non-Utility Group. Similarly, in the absence of relevant information regarding the gross plant assets of the Non-Utility Group, the Commission should exclude the Gross Plant factor from the allocation calculations. And finally, in the absence of any verifiable Payroll expenses for a few of Suburban’s affiliates, the Commission should make use of estimated payroll expenses for such affiliates as discussed above. Under the above-described parameters, DRA calculated the allocation rate of 14.7% for Suburban for the purpose of its parent company cost allocations:

⁷ 52% = [(27,900/45,156)+ (16,896 /39,528)]/2; \$88, 470 x 52% = \$46,553.

where \$88,470 is the amount of total ‘Intra-Divisional Allocations’ for SW Mississippi in year 2009.

Southwest Cost Allocations											
COMPUTATION OF ALLOCATION PERCENT											
Company	Direct Operating Expense		End of Year Gross Plant		Customer		Payroll		Total Percent	Average (Percent)	
	Recorded 2009		Recorded 2009		Recorded 2009		Recorded 2009				
	Amount, \$	Percent	Amount, \$	Percent	Number	Percent	Amount, \$	Percent			
ALLOCATION FACTORS											
Suburban Water Systems	27,221,789	18.2%	0	0.0%	75,392	12.4%	6,361,682	13.5%	44.1%	14.7%	
<u>Texas Utilities</u>											
Monarch Utilities	14,144,170	9.5%	0	0.0%	27,110	4.5%	4,149,724	8.8%	22.8%	7.6%	
Windermere	3,850,973	2.6%	0	0.0%	10,093	1.7%	371,671	0.8%	5.1%	1.7%	
Hornsby Bend	1,172,707	0.8%	0	0.0%	3,593	0.6%	129,900	0.3%	1.7%	0.6%	
Diamond	309,195	0.2%	0	0.0%	713	0.1%	57,649	0.1%	0.4%	0.1%	
Water Services Inc	1,154,965	0.8%	0	0.0%	1,904	0.3%	342,687	0.7%	1.8%	0.6%	
Huntington	27,945	0.0%	0	0.0%	126	0.0%	9,904	0.0%	0.0%	0.0%	
Inverness	158,138	0.1%	0	0.0%	129	0.0%	48,431	0.1%	0.2%	0.1%	
Midway	140,485	0.1%	0	0.0%	396	0.1%	18,565	0.0%	0.2%	0.1%	
SW Utilities	20,225	0.0%	0	0.0%	42	0.0%	5,123	0.0%	0.0%	0.0%	
Tenkiller	119,868	0.1%	0	0.0%	521	0.1%	32,902	0.1%	0.3%	0.1%	
Metro - Continued Operations	457,952	0.3%	0	0.0%	1	0.0%	8,218	0.0%	0.3%	0.1%	
<u>Southeast Utilities</u>											
SW Alabama Onsite	118,155	0.1%	0	0.0%	154	0.0%	27,900	0.1%	0.2%	0.1%	
Riverview Wastewater	2,940,970	2.0%	0	0.0%	4,200	0.7%	369,991	0.8%	3.5%	1.2%	
North Shelby & Other	1,953,689	1.3%	0	0.0%	4,717	0.8%	226,572	0.5%	2.6%	0.9%	
North County Water	87,087	0.1%	0	0.0%	197	0.0%	16,896	0.0%	0.1%	0.0%	
SW Mississippi	129,878	0.1%	0	0.0%	669	0.1%	46,553	0.1%	0.3%	0.1%	
Non-Utility	95,256,928	63.8%	0	0.0%	478,625	78.6%	35,011,360	74.1%	216.5%	72.2%	
Total	149,265,119	100%	0	0.0%	608,582	100%	47,235,727	100%	300%	100%	

Regarding the Utility Group cost allocations, DRA notes that because the Utility Group does not provide services to the Non-Utility Group, the issues DRA raised with the Non-Utility Group's values for various allocation factors, such as Gross Plant and Number of Customers do not exist for the Utility Group's costs allocations. However, the issue with the Payroll factor is problematic and should be addressed according to DRA's recommendations discussed earlier. DRA calculated the allocation rate of 50.8% for Suburban for the purpose of determining the Utility Group's cost allocations for Suburban:

Utility Group Cost Allocations											
COMPUTATION OF ALLOCATION PERCENT											
Company	Direct Operating Expense		End of Year Gross Plant		Customer		Payroll		Total Percent	Average (Percent)	
	Recorded 2009		Recorded 2009		Recorded 2009		Recorded 2009				
	Amount, \$	Percent	Amount, \$	Percent	Number	Percent	Amount, \$	Percent			
ALLOCATION FACTORS											
Suburban Water Systems	27,221,789	50.4%	181,567,267	42.6%	75,392	58.0%	6,361,682	52.0%	203.0%	50.8%	
Texas Utilities											
Monarch Utilities	14,144,170	26.2%	115,286,257	27.1%	27,110	20.9%	4,149,724	33.9%	108.1%	27.0%	
Windermere	3,850,973	7.1%	43,321,714	10.2%	10,093	7.8%	371,671	3.0%	28.1%	7.0%	
Hornsby Bend	1,172,707	2.2%	19,787,710	4.6%	3,593	2.8%	129,900	1.1%	10.7%	2.7%	
Diamond	309,195	0.6%	2,635,182	0.6%	713	0.5%	57,649	0.5%	2.2%	0.6%	
Water Services Inc	1,154,965	2.1%	5,798,378	1.4%	1,904	1.5%	342,687	2.8%	7.8%	1.9%	
Huntington	27,945	0.1%	649,846	0.2%	126	0.1%	9,904	0.1%	0.5%	0.1%	
Inverness	158,138	0.3%	1,688,352	0.4%	129	0.1%	48,431	0.4%	1.2%	0.3%	
Midway	140,485	0.3%	1,007,688	0.2%	396	0.3%	18,565	0.2%	1.0%	0.3%	
SW Utilities	20,225	0.0%	46,347	0.0%	42	0.0%	5,123	0.0%	0.0%	0.0%	
Tenkiller	119,868	0.2%	1,069,188	0.3%	521	0.4%	32,902	0.3%	1.2%	0.3%	
Metro - Continued Operations	457,952	0.8%	8,751,124	2.1%	1	0.0%	8,218	0.1%	3.0%	0.7%	
Southeast Utilities											
SW Alabama Onsite	118,155	0.2%	4,405,544	1.0%	154	0.1%	27,900	0.2%	1.5%	0.4%	
Riverview Wastewater	2,940,970	5.4%	28,079,171	6.6%	4,200	3.2%	369,991	3.0%	18.2%	4.5%	
North Shelby & Other	1,953,689	3.6%	10,558,819	2.5%	4,717	3.6%	226,572	1.9%	11.6%	2.9%	
North County Water	87,087	0.2%	1,330,081	0.3%	197	0.2%	16,896	0.1%	0.8%	0.2%	
SW Mississippi	129,878	0.2%	68,288	0.0%	669	0.5%	46,553	0.4%	1.1%	0.3%	
Total	54,008,191	100%	426,050,956	100%	129,957	100%	12,224,367	100%	400%	100%	

5. The Commission should adopt a uniform application of its Four Factor Allocation Method

Approving a uniform set of Affiliate Transaction Rules (“ATR”), demonstrates the Commission’s focus in providing needed regulatory guidance to deal with the complex issues of regulated utilities’ business transactions with their various affiliates. These affiliates are not only spread over the entire nation, but at times have business models that differ markedly from that of a regulated utility. The business model of Suburban’s largest affiliates, Non-Utility Group is a classic example. *Id.* at p. 8-54.

Even though the currently established uniform ATRs allow for shared services amongst the regulated utility and its various affiliates, the rules equally emphasize the need for a regulated utility to provide full access to the books of its various affiliates and to their officers. ATRs equally stressed the application of reasonable cost allocation

methodologies that are based on sound Cost-Causation principles in the case of allocation of common costs amongst the various affiliates and regulated utilities.⁸

However, with Suburban, Commission access to affiliates' books and records can be a difficult task especially given the time restrictions of a typical GRC schedule. Similarly, even though the Commission's Four Factor Allocation Method is based on sound Cost-Causation principles, a regulated utility can manipulate and skew the application of these factors under the guise of different interpretations and still claim its adherence to these rules. This poses particular problems when these allocation factors are applied toward affiliates that are working under different business models than that of the regulated utility, such as the Non-Utility Group.

In addition, these very affiliates, often times, are the largest operating units of the business. And in the today's world of constrained municipal budgets and deteriorating utility infrastructure, increasing numbers of cities, municipalities, and small operators are looking toward the regulated utilities to provide services to their systems. Thus, these affiliates are likely to continue growing in these types of business activities. And often times they are the most revenue-generating entities for the regulated utilities' parent companies. Thus, the Commission should carefully review these affiliates and scrutinize the amount of common cost allocations they ought to receive. For example, Suburban's, parent company, Southwest, made the following statement while commenting on its growth opportunities:

As a population grows, utility connection count grows, making these assets strategic long-term growth engines. We look to consolidate in regions where our local expertise and knowledge of the region's water and wastewater issues gives us a competitive advantage when bidding for assets. We will look at outlying opportunities as long as they are in a growth market and the utility has an adequate number of connections for the economics to be sufficient.

⁸ D.10-10-019, p. 53; Rules: II, IV and VIII.

...We intend to continue to grow our contract service businesses, which includes both our O&M and MUD segments, by bidding for and winning additional service contracts. The mounting regulatory complexity and an aging and deteriorating infrastructure are increasingly becoming challenges for municipalities. Raising large amounts of funds can be difficult, especially for small and medium size cities. In order to meet their capital spending challenges, some municipalities are examining partnerships with the private sector. We have strategically grown our contract operations in small to medium size cities that are experiencing population growth. We look to expand our operations in geographic regions where we are currently operating to enhance our economies of scale, but will look at opportunities in other markets if they have the scale and economic potential to ensure we can generate industry standard margins or better. We also look to attain contract operations near our owned utilities to enable us to build a larger presence in the region.²

Thus, it is fairly certain that non-regulated affiliates, such as Suburban's Non-Utility Group will remain an intricate part of the parent company's non-regulated business activity for the near future. Hence, there is a need for the Commission to establish uniform standards and apply these standards consistently when dealing with the issues involving cost allocations toward these affiliates. Unfortunately, in the past the Commission has not remained consistent in its standards of the Four Factor Allocation Method. *See* Exhibit DRA-1, p. 8-56.

For example, while dealing with Suburban's 2003 application and the issue of the four factors application, the Commission in D.03-05-078 ordered excluding the "Number of Customers" factor. And in its D.09-03-007, where the Commission addressed the exact same issue, it allowed Suburban to use "Number of Contracts" instead.

Similarly, in D.07-10-034 the Commission decided to calculate the "Weighted Number of Customers" for one of the regulated utility's affiliates when it was addressing the similar issue regarding the use of "Number of Customers" vs. "Number of Contracts"

² Southwest's 2009 10.k Report, p. 6.

for another Class-A water company, Golden State Water Company. However, the Commission in a subsequent decision, D.08-07-010 once again reverted to using “Number of Contracts” for the regulated utility’s affiliates.

It is not in the best interests of the Commission nor ratepayers and regulated utilities alike to debate these issues anew each time a GRC application is filed. It is a waste of the Commission and its staff’s time and resources to deal with these issues during every new GRC application. Similarly, a different outcome for the same issues causes confusion amongst both the utility and the ratepayers. Thus, DRA recommends that either the Commission order an Order Instituting Ratemaking (“OIR”) regarding this issue or based on ample amount of information already in existence in prior rulings and decisions, to develop a formalized uniform set of rules concerning the applicability of its Four Factor Allocation Methodology. *Id.* at p. 8-57.

Based on DRA’s discussion regarding Suburban’s misuse of the Four Factors, DRA recommends that any such uniform rules should include that the “Number of Customer” factor should be determined in a manner of a typical customer of the regulated utility is determined. If the end-user (typical customer and not the contractual client) does not receive a “full set” of services that a typical regulated utility’s end-user receives, a value of “Weighted Number of Customer” should be calculated in accordance with D.07-10-034. In addition, in order to facilitate the assessment of “Weighted Number of Customers,” the regulated utility must be required to provide all necessary data to the Commission’s staff to evaluate the utilities’ assertions.

Similarly, the “Gross Plant” factor should include the value of plant assets of affiliates’ respective clients in accordance with D.08-07-010 as these assets truly demonstrate the level of operations that these affiliates have to maintain in order to fulfill their contractual obligations. Thus, these assets should be included in assessing the Gross Plant factor. In addition, the Commission should require regulated utilities to collect and provide this information to the Commission’s Staff or face the risk of excluding the “Gross Plant” factor for cost allocation purposes.

V. FINES

A. The Commission Should Penalize Suburban for its Inadequate Application & Uncooperative Behavior During this Proceeding

The Commission should fine Suburban for failing to comply with three Commission directives: 1) failing to fully support its Application under D.07-05-062; 2) failing to facilitate “Informal Communications” in order to create a better understanding of the position of the parties and to avoid and resolve discovery disputes and eliminate unnecessary litigation under D.07-05-062; and 3) failing to provide DRA access to its affiliates’ relevant books and records in examining the costs Suburban seeks rate recovery for under D.10-10-019, Rule VIII.B. *See* Exhibit DRA-1, p. 8-22.

DRA argues that the Commission should appropriately fine Suburban for its lack of cooperation and repeated poor quality of its workpapers so that in the future, the utility will cooperate with the Commission staff efficiently and in accordance with the Commission’s guidelines and directives under D.07-05-062.

1. Suburban’s Inadequately-Supported Application Violates D.07-05-062

The Commission should penalize Suburban for the difficulties DRA suffered during discovery when attempting to attain additional data from Suburban to substantiate its requests and because of Suburban’s generally inadequate workpapers to its Application. Suburban knew DRA’s objections to these same issues from its last GRC application in 2007.

During Suburban’s previous GRC application, DRA identified that its parent company’s estimates for Test Year 2009 were based on partial recorded year 2007 (recorded data was available till August 2007), and Suburban failed to provide supporting documentation showing how it projected the subsequent estimates for full-year 2007 and 2008. Suburban’s estimates in its workpapers were “hard-wired” and the accompanied testimony of its witness failed to tie the numbers in its workpapers to details in the testimony. *Id.* at p. 8-18-8-19.

In its current GRC application, Suburban once again repeated the same pattern of not providing support for its estimates. For example, Suburban provided electronic copies of its workpapers along with the traditional hardcopies. However, the electronic version of workpapers for its parent company's cost estimations for the base years 2010 and 2011 were all hard-wired numbers. *See* Exhibit DRA-2, Attachment-F (Excerpt of Suburban's workpapers, Excel File Titled GRC NOI.xls, Cells A3301:P3301 through A3411:P3411, plus corresponding Excel version that shows details of formulas used in calculating the values in the cells). And Mr. Raj Morey, Suburban's witness, verified that the cost estimates with linked formulas and calculations were only included in a data request response Suburban submitted rather than in its original application. (Tr.Vol.2, Morey/Suburban, p. 46)

Suburban has violated the Commission's Rules of Practice and Procedure 10.3(a)(3) & 10.4(b), respectively because under these rules, "Any party who sponsors testimony or exhibits which are based in whole, or in part, on a computer model shall provide to any party upon request among other things, "documentation sufficient for an experienced professional to understand the basic logical processes linking the input data to the output..." And "Any sponsoring party shall provide timely and reasonable access to, and explanation of, that computer model or data base..."

Mr. Morey's testimony for parent company expenses was generic and failed to tie the estimates in the workpapers to details he provided in his testimony. Mr. Morey's testimony mentioned some amounts of additional costs used in year 2010 and 2011 for forecasting purposes, but Suburban's workpapers literally did not tie back to the values shown.-Mr. Morey also verified this point during hearings. (Tr.Vol.2, Morey/Suburban, pp. 56-59)

The lack of proper formulas and linking of Suburban's electronic workpapers made it extremely difficult for DRA to follow estimation methodology and test the actual results. For example, Mr. Morey stated that the Suburban used seven months of recorded amounts through July and projected the remainder of the year using run-rates and/or other known changes to project the full year 2010. However, the accompanying workpapers

only showed hard-wired amounts. Thus, this effectively concealed the alleged “seven months of recorded amounts through July” and the details of “run-rate and/or known changes” that Suburban used to estimate its forecasts for base years 2010 and 2011. *Id.* at p. 8-19.

By not providing proper workpapers, Suburban created a lengthier and more complex discovery that shifted its burden of proof to DRA. DRA was forced to use its limited time not only to review the filing, but to conduct extensive discovery to attain supporting documentation and explanations for Suburban’s various cost estimations and forecasts, which were produced after the fact rather than upfront along with its filed Application. Mr. Morey again verified that Suburban supported most of Suburban’s parent company estimates later after responding to DRA data requests. (Tr.Vol.2, Morey/Suburban, pp. 62-65)

The Commission’s D.07-05-062 (New Rate Case Plan Decision), Appendix-A, Section: Contents of Proposed Application and Supporting Prepared Testimony (Page A-6), states the utility bears the burden of proving that its proposed rate increase is justified and must include in the proposed application and supporting testimony, all information and analysis necessary to meet this burden. Thus, Suburban has failed to meet its burden of proof in making its rate increase request.

For example, for “Incentive Expenses,” Suburban provided a redacted version of supporting calculations in a PDF file format that restricted DRA’s ability to evaluate the reasonableness of these expenses. Subsequently, it took DRA approximately one-month (April 26 through May 23)¹⁰ to get bits and pieces of information from Suburban regarding the support for these incentive expenses. (Tr.Vol.2 Aslam/DRA, p. 85) At the end, there were still a few details that remained unanswered and DRA was unable to complete its review of the reasonableness of these increases for rate recovery. *See* Exhibit DRA-1 8-58-8-61 & DRA-2c, Attachment –L.

¹⁰ The original DRA’s data request, AMX-06 was sent to Suburban on April 26)

Mr. Kelly, during hearings admitted that the initial information Suburban provided to DRA was omitted, but stated that the information was not redacted and instead was simply not there. (Tr.Vol.2, Kelly/Suburban, p. 85.) Please note that DRA, through its initial data request, AMX-06, had requested that Suburban provide support: “...*Explain what “Incentive Expense” is and how it is calculated. Discuss all assumptions made in calculating the amount of \$35,435 in cell G3501 and provide all supporting documentation. Provide a breakdown of the amount in year 2011 for the employees discussed in item-6 above.*”

Thus, Suburban’s response to DRA’s inquiry, that contained omitted numerical data, redacted or not, demonstrates Suburban’s lack of preparation and inadequate methods of responding to DRA’s data requests. Additionally, pursuant to D.07-05-062, this supporting information should have been included along with Suburban’s filed application originally.

During hearings Mr. Kelly also stated that even though the information was omitted it would not have made a difference for one’s understanding of the calculations for the incentive expenses even if the omitted information was provided in a PDF file or in Excel file format (Tr.Vol.2, Kelly/Suburban, p.85-87.) Unfortunately, the numerical data and complex calculations cannot be analyzed with a PDF file since a PDF file format does not reveal the details of embedded formulas used for the calculations. A properly linked Excel file is required to understand the complexities of the calculations.

DRA also notes that during its discovery efforts in other GRCs, DRA addresses similar issues with other Class-A utilities on a regular basis. All other Class-A utilities have generated comparatively more complex quantitative data in the requested Excel file format.

Even though Suburban eventually provided the redacted/omitted information, DRA never had its request to have the calculations presented in an Excel file format honored. Instead, Suburban continued to refuse to provide an Excel file stating that the information was not available in Excel. And even after Suburban offered explanations regarding the mathematics involved behind the calculations, DRA still had additional

questions and was unable to determine the reasonableness of the proposed incentive expenses. *See* Exhibit DRA-1, p. 8-58-8-61.

**2. Lack of adherence to “informal discussions”
violates D.07-05-062**

Suburban’s lack of cooperation and non-responses to DRA’s discovery request harms the regulatory process and the Commission should discourage this behavior in future rate cases. Suburban has violated several of the Commission’s directives under D.07-05-062 (Revised Rate Case Plan), such as its failure to engage in informal discussions with the Commission’s staff to facilitate the understanding of issues and to avoid unnecessary litigation, and its failure to provide its work papers and related supporting documentation in the desired electronic spreadsheet format.

Additionally, Suburban utilized the ALJ’s procedure for data request responses to its advantage. For example, Suburban took the allotted 10-days to respond to one of DRA’s inquiries (Data Request, AMX-02SWS, Question-20) regarding audited financial statements of its various non-regulated affiliates, by simply stating that audited financial statements do not exist. Suburban could have informed DRA within few days after receiving DRA’s data request that such audited financial statements do not exist, but instead waited 10-days to provide this simple response. *Id.* at p. 8-20.

Further exacerbating its abuse of the discovery process, DRA became aware after discussing this issue with Suburban’s VP of Regulatory Affairs, Mr. Kelly, that instead of audited financial statements, un-audited financial statements or monthly operating reports do exist for these affiliates, and DRA sent a follow up data request (Data Request AMX-02 SWS Follow Up, Question 1(v)) to obtain un-audited financial statements and monthly reports. This time around Suburban took another 10-day time period to object to DRA’s request on the grounds that the request was not relevant to this general rate case proceeding. Suburban could have easily informed DRA that it objects to its request to provide un-audited financial statements and monthly reports when Suburban’s VP of Regulatory Affairs was discussing this issue with DRA over the telephone. However, Suburban took the additional allotted 10-days to express its disagreement. Mr. Kelly

during hearings verified the time it took Suburban to respond to the various stages of responses Suburban created for these data requests. (Tr.Vol.2, Kelly/Suburban, pp. 73-78)

Later, DRA raised this issue with the ALJ and received some redacted information for Suburban's non-regulated affiliates. In the end, a simple discovery inquiry, which started on March 1, 2011 with DRA's initial data request required Suburban to take two months to respond on May 5, 2011---and then only with the ALJ's intervention. *See* DRA-2, Attachment-G.

Despite Suburban's efforts during hearings to show it had tried to conduct "informal discussions" with DRA regarding discovery issues, Mr. Kelly did not deny that Suburban did take significant amounts of time to provide fairly simple responses. (Tr.Vol.2, Aslam/DRA, p. 163-165 & Kelly/Suburban, pp. 73-78.)

3. Denial of access to Affiliate Information Violates D.10-10-019

DRA asserts the Commission's recently adopted Affiliate Transaction Rules pursuant to D.10-10-019 govern the issues involving Suburban's parent company costs and its subsequent allocations to Suburban. DRA acknowledges that portions of the ATRs are not effective yet, but the issues DRA cites in this proceeding are already effective. While the Commission generally allows such business transactions, it also stresses a great deal of openness and reporting obligations by the regulated utility. For example, while discussing the issue of Shared Corporate Support provided by the regulated utility's parent or other affiliates, the Commission stated:

DRA recommends retaining the Staff Proposed Rule V. However, DRA's position relies on ensuring that the affiliate transaction rules overall include safeguard to ensure protection of ratepayers and the public interest. For example, DRA urges that a strict and efficient cost allocation procedure is needed for shared services (based on cost causation principles), as well as thorough reporting requirement and full access to the accounting records and officers of the utility and relevant affiliates.

DRA's concerns are valid, and have been addressed in other parts of the adopted rules. Specifically, Rule IV addresses cost allocations and Rule VIII addresses access to affiliates records and officers. p. 53.

Suburban did not meet its obligations in cooperating with DRA under the Commission's multiple directives. Instead, Suburban consistently refused to provide requested information regarding its affiliates regarding shared services and associated costs in which Suburban requests recovery in rates. This lack of cooperation has forced DRA to seek guidance from the ALJ many times while losing valuable time during discovery. Suburban often delayed its responses so that DRA could not conclude its review of shared services and associated costs timely. Suburban's actions have considerably delayed, and in few instances impaired DRA's efforts to perform a thorough review of its requested shared services costs and associated allocations. *Id.* at p. 8-21-8-22.

4. Evaluating the Appropriate Fine Amount

This non-cooperative behavior unnecessarily frustrated DRA's review of the rate case and provides the Commission an inferior evidentiary record upon which to make informed decisions. If the Commission imposes a penalty on Suburban it will send a strong message to improve the level of its workpapers, access to information, and cooperation with staff regarding general cost allocations from its parent company and to its affiliates. *Id.* at p. 8-65.

The Public Utility Code, Section 702 states that:

Every public utility shall obey and comply with every order, decision, or rule made or prescribed by the commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as public utility, and shall do everything necessary or proper to secure compliance therewith by all of its officers, agents, and employees.

And the Public Utility Code, Section 2107 states that:

Any public utility which violates or fails to comply with any provision of the Constitution of this state or of this part, or

which fails or neglects to comply with any part or provision of any order, decision, rule, direction, demand, or requirement of the commission, in a case in which a penalty has not otherwise been provided, is subject to penalty of not less than five hundred dollars (\$500), nor more than twenty thousand dollars (\$20,000) for each offense.

Based on these codes and DRA's arguments above, they show how Suburban's repeated conduct regarding its parent company and affiliate issues, violates various directives under, D.07-05-062 and warrants the Commission fining Suburban \$30,750 for its three non-compliance practices¹¹:

1. Suburban is in violation of the Commission's directives under D.07-05-062 since it failed to engage in informal discussions with the Commission's staff to facilitate the understanding of issues and to avoid unnecessary litigation,
2. Suburban is in violation of the Commission's directives under D.07-05-062 since it failed to provide its workpapers and related supporting documentation in the desired electronic spreadsheet format;
3. Suburban is in violation of the Commission's directives under D.07-05-062 since it failed to properly meet its burden of proof for its proposed rate increase by not including within its filed application all information and analyses necessary to meet this burden.

In D.07-10-034, the Commission fined Golden State Water Company ("Golden State"), because of its lack of cooperation with DRA and poor documentation of its Application regarding its expenses and support for Golden State's General Office requests. DRA raised significant issues dealing with Golden State's allocations of costs to the parent company's affiliates and its regulated operations. Regarding the fine on Golden State, the Commission stated:

By levying a fine against GSWC, we send a strong message to GSWC and other utilities that direct testimony is the time to address and justify its case. In particular, when there is a

¹¹ DRA calculated the level of the penalty based on the mid-range of \$500 to \$20,000 per violation times three (\$10,250x3=\$30,750).

proposed rate change, new policy proposals or ideas, business changes that could or should influence the treatment of historic data, dramatic regulatory or environmental events and/or significant additions to the employee base or the capital budget, the burden is particularly obvious. Furthermore, as general office expenses are routinely contentious in water cases, it is not unreasonable to expect utilities to be forthcoming in their justifications of these expenses. The integrity of our regulatory process is best served when a utility justifies and addresses the issues in its application in direct testimony. (D.07-10-034, p. 122) [Emphasis Added]

Despite Suburban's arguments to the contrary, DRA only cites the Golden State decision to help the Commission assess what penalty amount is appropriate- not because the fact scenarios are identical.

DRA asserts the Commission impose a penalty of \$30,750 on Suburban due to its conduct in this rate case for its lack of cooperation, poor work papers, and the difficulty it imposed on DRA in accessing information, which impaired DRA's ability to perform a thorough review of Suburban's parent company's costs and allocations to its affiliates. DRA also recommends that the Commission should order formal audit regarding Suburban's parent company, Southwest's allocable costs and Suburban's affiliate, Non-Utility's four factor values, especially its number of customers served under each contract and gross plant value of its clients.

VI. AUDIT

The Commission should order audits of: 1) Suburban's parent company's allocable costs; 2) the Non-Utility Group's four factor values, specifically the number of customers served under each contract and gross plant value of its clients; and 3) Suburban's Non-Tariff Product Services for all the various problems DRA has cited in this brief and proceeding.

VII. CONCLUSION

The Commission should adopt DRA's recommendations regarding: 1) taxes; 2) regulatory expenses; 3) the four factor allocation; 4) fining Suburban for its misconduct; and 5) conducting audits.

Respectfully submitted,

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