

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA



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Application of Southern California Edison  
Company (U338E) for Authority to, Among  
Other Things, Increase Its Authorized Revenues  
For Santa Catalina Island Water Operations,  
And to Reflect That Increase In Rates.

Application 10-11-009  
(Filed February 1, 2011)

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

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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") Robert Barnett on September 9, 2011, the Division of Ratepayer Advocates ("DRA") hereby files its Opening Brief to Southern California Edison's ("SCE") Application ("A.") 10-11-009 for authority to increase its authorized revenues for its Santa Catalina ("Catalina") water operations and to reflect that increase in rates. In its Application SCE requests: an increase of \$3,274,000 for 2011 rates or 82.9%, but does not request attrition year increases for 2012 or 2013. With rate design, SCE proposes shifting the current allocation of revenue responsibility between residential and commercial customers and proposes to shift a portion of costs of providing water service to Catalina residents to SCE's 4.8 million electric customer accounts for a year in order to help subsidize Catalina customers. The parties in this proceeding have agreed upon a settlement on rate design.

DRA would like to first thank ALJ Barnett for his patience and efforts during this general rate case ("GRC") proceeding.

DRA's testimony in this proceeding was devoted to a limited review of SCE's Application because of its limited resources and the limited time that was available to

complete this proceeding. DRA could not address all the issues raised in this case. Its testimony focused primarily on SCE’s ten proposed capital projects and the rate design proposals.

## **II. POLICY**

DRA discusses four policy concerns in its testimony: 1) amortization of memorandum accounts; 2) phase-in rates; 3) water quality; and 4) customer complaints. DRA is in general agreement with SCE’s proposal to amortize its two memorandum accounts. Rather than increasing the rates in one year, DRA recommends the rate increases associated with this Application be phased in over three years to minimize the rate impact on SCE ratepayers. Finally, DRA also comments on the water quality and customer complaint issues based on its review of the California Department of Public Health (“CDPH”) inspection reports and historical customer complaints against SCE. *See Exhibit DRA-1, p.7-1.*

### **1. Amortization of Memorandum Accounts**

SCE requests recovering its undercollections from two memorandum accounts over a one year period and eliminating them later. The memorandum accounts are called: Purchased Power Expenses memorandum Account (“PPEMA”) and Catalina Water CARE memorandum Account (“CWCMA”). The September 30, 2010 balances are:

|       |           |
|-------|-----------|
| PPEMA | \$127,000 |
| CWCMA | \$67,000  |

The Commission allowed SCE to establish these two accounts in the last GRC. In addition, in the last GRC decision, the Commission granted the authority to recover lost revenues by advice letter or in the next GRC. DRA does not oppose this request. However, the amounts in these balancing accounts should be amortized through a surcharge consistent with the Commission’s Division of Water & Audits Standard Practice U-27. *Id.*

## **2. Phase-In Rates**

Instead of extending the amortization period to limit rate shock, SCE has proposed having its 4.8 million electric customers subsidize its Catalina water customers by contributions from their customer bills. Data request response LLK-001 question 11 suggests that the inability to recover its full revenue requirement or to recover interest on the deferred amounts have been a deterrent to phasing in rates. Nevertheless, DRA supports the use of a phase-in. It was used in the last GRC to ameliorate rate shock, and it should be applied in this case. Based upon DRA's proposed Revenue Requirement, it could be phased in 20% for 2011, 20% for 2012, and 20% for 2013. Id.

## **3. Water Quality**

The California Department of Public Health ("CDPH") is the primary state agency responsible for ensuring that water provided to the public is safe for consumption. Although the Commission does not have a role in this area, except to confirm CDPH's analysis of water quality.

DRA reviewed CDPH inspection reports and contacted CDPH representatives for information about the water SCE is providing to its customers on Catalina.

Based upon the information SCE provided and CDPH's report, it appears that SCE's water system is in compliance with the requirements established by CDPH. Water provided by SCE meets all primary drinking water standards. *See* Exhibit DRA-1, p.7-2. Thus, SCE's Catalina water customers can be confident that the water they are consuming and using is safe and will not jeopardize their well-being.

## **4. Customers Complaints**

DRA sought complaint information from the CPUC's Consumer Affairs Branch ("CAB") and received a listing of all the public and informal complaints our agency has received since 2000. The primary reason SCE's Catalina water customers contacted CAB was to voice a concern about billing or rates. There was one complaint that related to a delayed service order. Based on the information DRA reviewed, the CAB

information does not show any significant concerns regarding service quality issues at this time. Id.

### **III. EVIDENTIARY STANDARDS & THE 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.*

SCE has not met its burden of proof in justifying its rate request related to its costs for the Catalina Island fire expenses and various other expense accounts. SCE’s justification for these costs is not persuasive and fails to meet its burden of providing “clear and convincing” evidence that the rate increases associated with the Island fire and various other expense accounts are reasonable and legitimate.

### **IV. COMPLIANCE WITH THE UNIFORM SYSTEM OF ACCOUNTS (“USOA”)**

#### **A. SCE is in compliance with the USOA**

DRA reviewed SCE’s adjustments in the 600 account series to verify compliance with USOA’s accounting practices. DRA did not perform a formal audit, which the Commission’s Water Division’s audit staff conducted in the last GRC. DRA also reviewed many spreadsheets from SCE’s Results of Operations (“R/O”) model<sup>1</sup> to verify USOA compliance. SCE is in compliance with USOA accounting practices, but SCE should have corrected its testimony, workpapers, and models to eliminate all the

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<sup>1</sup> There are 27 spreadsheets that make up the R/O model and many of those spreadsheets have additional tabular sub-spreadsheets within each spreadsheet.

misleading references to Federal Energy Regulatory Commission (“FERC”) accounts. See Exhibit DRA-1, p.1-5. For future rate cases involving Catalina’s water service, DRA recommends that the Commission require SCE to present its application in a format that is consistent with the USOA and that does not contain any references to FERC accounts.

**V. OPERATIONS & MAINTENANCE (“O&M”) EXPENSES**

**V.1. Annual Reports v. Ratemaking Adjustments**

Not Applicable.

**V.2. Account 615- Power for Pumping**

Not Applicable.

**V.3. Account 630- Employee Labor**

Not Applicable.

**V.4. Account 640- Materials**

Not Applicable.

**V.5. Account 650- Contract Work**

Not Applicable.

**V.6. Account 660- Transportation Expense**

Not Applicable.

**V.7. Account 670- Office Salaries**

**A. Only \$189,000 of SCE’s request the account under office salaries is reasonable.**

In Resolution W-4665, the Commission’s decision resolving the last GRC, the summary of earnings table did not distinguish a portion of the expense accounts in the 600 series as administrative and general services. That summary of earnings statement was limited to a listing of operating expenses. In its workpapers for this proceeding, SCE defined administrative and general expenses<sup>2</sup> to include the following accounts:

- Office salaries (670)

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<sup>2</sup> Tessler workpaper page 238.

- Management salaries (671)
- Office supplies and expenses (681)
- Professional services (682)
- General expenses (689)
- A&G allocation (erroneously labeled 920/921)
- Transfer credit (922).

SCE has proposed a cumulative total of \$674,000 for all of these expenses, whereas DRA has proposed a figure of \$189,000. DRA's adjustment is premised on its opposition to SCE's proposed new line item 920/921 for A&G. Edison proposes an "A&G allocation" that stems from applying the four factor methodology to SCE's total company A&G amounts. DRA did not have sufficient time to analyze this proposal, coordinate with other DRA staff working on the SCE electric GRC and verify that duplication of expenses did not occur. Instead, DRA included a pension and benefit estimate that is based upon an amount from the last GRC. *See* Exhibit DRA-1, p. 1-4.

Additionally, SCE created confusion in its workpapers and the Results of Operations ("R/O") model because the model incorporates the Federal Energy Regulatory Commission ("FERC") accounting nomenclature. Because SCE's R/O model and workpapers are almost as complex as what it has provided in its electric GRCs in terms of number of spreadsheets and levels of detail, SCE has the burden of demonstrating the reasonableness and validity of its new proposal. Moreover, if SCE desires unique treatment for the Catalina water system (versus other Class C water systems) it should develop a simpler R/O model, which is user-friendly and is consistent with the types of models used by other regulated water utilities. DRA recommends that the Commission require SCE to submit a better and more user-friendly R/O model for its next Catalina water GRC. *Id.* at p. 1-5.

### **V.8. Account 670- Management Salaries**

The discussion from the previous Section V.6.Account 670-Office Salaries applies to this account as well since SCE grouped up various accounts under A&G.

### **V.9. Account 674- Employee Pension & Benefits**

Not Applicable.

### **V.10. Account 676- Uncollectibles**

#### **A. SCE's uncollectible rate of 0.229% is reasonable.**

SCE developed an uncollectible factor in its 2012 electric GRC and proposes using the same factor in this water GRC. It is characterized as a percentage of total revenues and is developed from historic write-offs of unpaid bills. DRA did not oppose this uncollectible rate in the electric GRC. Here, SCE identifies the rate at 0.229% under Exhibit SCE-04 Vol 2. The currently authorized factor is 0.24%, so the updated figure assumes a decrease in unpaid bills on a percentage basis.

The increased amount of uncollectibles from the last GRC is due to the larger revenue requirement. Under SCE's proposal, uncollectibles would rise from \$10,000 to \$17,000<sup>3</sup> while DRA's uncollectible amount would rise to \$15,000 using the revised percentage for uncollectibles. DRA was unable to identify the uncollectible figure from DRA's testimony in the SCE electric general rate case because Staff at the time had not finalized the percentage by the time DRA ran the water R/O model. *See* Exhibit DRA-1, p.1-6.

Nevertheless, DRA accepts this 0.229% rate because it did not receive recorded levels to analyze and the uncollectible amount in the electric GRC was not available in time for DRA's report. *See* Exhibit DRA-1, p.3-3 – 3-4.

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<sup>3</sup> See SCE errata to the summary of earnings table I-1(b) corrected dated Feb 15, 2011.

**V.11 Account 681- Office Supplies & Expenses**

**A. \$2,000 of SCE’s request for office supplies & expenses is unreasonable.**

For Office Supplies & Expenses, DRA developed a forecast of expenses by using a different methodology from SCE. DRA’s estimate is based upon the last recorded amounts. DRA also employed this approach for labor accounts 670 and 671. With this methodology, DRA disallows \$2,000 from this account to better align the forecast methodology used to estimate labor costs with the forecast used to forecast office supply expenses. This approach is reasonable since the office supplies will be used by the same stable labor pool. DRA forecasted the leased office equipment using the “last recorded year” methodology, and the level of office supplies tends to fluctuate with the level of employees. The Commission should disallow \$2,000 from this account. *See Exhibit DRA-1, p.4-2 – 4-3.*

**V.12. Account 689- General Expenses**

The discussion from the previous sections V.6. and V.7 on office salaries and management salaries, respectively apply to this account as well.

**V.13. Account 480.2- Other Operating Revenue (“OOR”)**

Not Applicable.

**VI. ADMINISTRATIVE & GENERAL (“A&G”) EXPENSES**

See discussion under Sections V.6., V.7., and V.10.

**VII. RATEMAKING**

Not Applicable.

**VIII. CAPITAL PROJECT EXPENDITURES**

**VIII.1. 1985-2005 Capital Projects & Rate Base**

Not Applicable.

## **VIII.2. Station Office Betterment**

### **A. SCE's Station Office Betterment project is reasonable.**

SCE's main facility building was originally constructed in the 1940s and is covered by corrugated metal. Since SCE acquired the Catalina water system in 1962, the number of SCE employees working at the facility has increased from 25 to 53. Currently, some of the employees are working in adjacent trailer offices. During the site visit, DRA observed the current office space conditions did not require improvements. However, just outside of the office, the warehouse area and the workshop area does require upgrades. SCE's Electric, Gas, and Water employees share this main facility. SCE included the office betterment project in its 2012 Electric GRC testimony. SCE has proposed that its Catalina water customers pay for 25% of the total office betterment project or \$1.3 million, but these expenses do not appear in the test year revenue requirement.

The proposed work scope includes: removal of an old diesel generator, switch assembly removal, electric panel relocation, American Disabilities Act compliance, a sound attenuation wall, and building improvements. *See Exhibit DRA-1, p.5-11.*

During hearings, SCE's Mr. Hite and Intervenor's counsel, Mr. Bishton, discussed the appropriateness of removing an old generator and removing/relocating a small transformer and electric panel. (Tr.Vol. 4, Hite/SCE and Bishton/Intervenor, p.395-397) DRA observed during its site visit that the generator had not been used for decades and was in the middle of the warehouse/workshop. Removing the generator was appropriate because it posed as a tripping hazard possibly and was not in use.

It was also appropriate for safety reasons to move the transformer and electric panel since it was located in a high traffic area of the warehouse.

Based on the site visit inspections, and the presence of the facility betterment in the Electric GRC, DRA recommends approving this project and including it in rate base when appropriate.

### VIII.3. Water SCADA

#### A. SCE's Water SCADA system is reasonable.

The Water Supervisory Control and Data Acquisition (“SCADA”) system allows SCE to remotely monitor and control all of its facilities from one central location.<sup>4</sup> SCE replaced the then existing, obsolete control and monitoring equipment from the 1950’s. SCE’s Catalina water system is spread all over the Island, and some of its facilities are difficult to access if something happens. Certain locations are deep inside the Island, and due to the road conditions, it could take up to 3 to 4 hours to arrive in the bad weather. Some locations may be completely inaccessible during heavy rains. Given these conditions, and the importance of being able to protect existing infrastructure SCE’s interest in having a system that enables it to remotely control and monitor the facilities is reasonable. Moreover, SCE’s SCADA system on the Island is similar to other water systems that DRA is familiar with that have comparable equipment. *See* Exhibit DRA-1, p.5-4.

The processes SCE utilized in implementing the SCADA system also demonstrate its reasonableness. SCE hired Boyle Engineering (“Boyle”) in 2004 to conduct an overall water infrastructure assessment study. Boyle recommended the water SCADA system subsequent to the study.<sup>5</sup> SCE’s workpapers include the assessment report.

A contractor developed the SCADA system, and SCE selected the contractor through a competitive bidding process. SCE awarded the work to the lowest bidder (13% lower than the nearest bid.) SCE included the bid selection documents in the confidential workpapers to DRA<sup>6</sup>. SCE Engineering and Technical Support completed the software programming. *See* Exhibit DRA-1, p.5-5.

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<sup>4</sup> It could also be programmed so that SCE could monitor and control these facilities from more than one location.

<sup>5</sup> The report “*Southern California Edison Catalina Site Survey Report*” is provided in the Workpaper SCE-01 Ch. IV: Capital Projects pages 23-46. The testimony references Boyle Engineering conducted the assessment; however, the workpaper indicated Applied Technology Groups, Inc. conducted the survey.

<sup>6</sup> Confidential Workpaper SCE-01 Ch. VI: Capital Projects. Pages 3-10.

SCE provided a cost breakdown of the project in a workpaper that it submitted in its Application<sup>7</sup>. SCE provided a more detailed breakdown of the costs in response to DRA Data Request BYU-01. DRA reviewed the workpapers and the data request responses and determined the project's reasonableness. The SCADA system's capability to remotely monitor and control the functions of its water system justifies the need for this project for SCE's Catalina water system. Also, SCADA is becoming an essential element of modern water utilities. The competitive bidding process, the lowest bidder selection, and the construction cost analysis all help to demonstrate the reasonableness of the SCADA project. *See* Exhibit DRA-1, p.5-5.

DRA recommends the Commission approve \$2,186,984, for the cost of the Catalina Water SCADA system, in rate base.

#### **VIII.4. Pumphouse #2**

##### **A. SCE's Pumphouse #2 project is reasonable.**

Pump House #2 was originally constructed in 1930 before SCE acquired the water system. This is a booster pump that delivers the water from its source, through the valley and over the mountain, to the City of Avalon.

The pump house and its booster pumps had numerous issues: water hammer surge, flow rate deficiency, leaks, low system pressure, system reliability, safety issues and more. SCE constructed a new booster pump station near the previous location and demolished the old pump house. *Id.* at p.5-5 - 5-6.

SCE used contractors to build the new pump house. SCE utilized competitive bidding in selecting the contractors and supply vendors, and it awarded the work to the lowest bidder (about 30% lower than the second-lowest bidder). SCE provided DRA information regarding the competitive bidding in confidential workpapers.<sup>8</sup>

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<sup>7</sup> Workpaper SCE-01 Ch. VI: Capital Projects. Page 13-17.

<sup>8</sup> Confidential Workpaper SCE-01 Ch. IV: Capital Projects. Pages 11-18.

SCE's workpapers also included work scope and breakdowns of the cost.<sup>2</sup> SCE provided more detailed breakdowns of the cost in response to DRA's Data Request BYU-01. The pump house condition assessment presented in SCE's workpapers depict various deficiencies with the old pump house.

After reviewing the workpapers and the data request response and reviewing the bidding process SCE used for the pumphouse #2 project, DRA determined it was reasonable. The competitive bidding process, the lowest bidder selection, and construction cost analysis all demonstrate the reasonableness of this project. *See* Exhibit DRA-1, p.5-6.

Any cost increases in this project were due to change orders/scope changes that were demonstrated to DRA by SCE. These changes included constructing the Fire Department Connection ("FDC"), diverting the existing stream that flows in front of the old pump house to preserve the environment, and installing special fences to prevent the Island wildlife from entering the facility. SCE explained to DRA that the Los Angeles County Fire department requested the FDC and the Island Conservancy requested diverting the stream and fence. These were all special provisions that are not typical of a water utility's plant construction projects.

Lastly, the pumphouse is similar to other facilities DRA has observed with other Class A water utilities.

DRA recommends the Commission include the cost of the Pump House #2 Replacement in rate base.

## **VIII.5. Pebble Beach Water Line Replacement**

### **A. SCE's Pebble Beach Water Line Replacement**

In 2001, SCE discovered the upper portion of the Pebble Beach Village community had insufficient water pressure for the newly-installed residential fire sprinkler system. The City of Avalon Fire Department ordered the Santa Catalina Island

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<sup>2</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 47-94.

Company<sup>10</sup> (“Island Company”) to provide a sufficient fire water line. SCE proposed a project to share the cost of this upgrade with the Island Company. SCE did not explain why SCE first proposed this project when the fire department’s order was directed at the Island Company. *See* Exhibit DRA-1, p.5-6.

According to information in the workpapers, the Island Company was planning to install an eight inch PVC main pipeline along the Pebbly Beach Road, which is the main access to the Pebbly Beach Village. For reasons unknown to DRA, the Island Company stopped pursuing the project and failed to comply with the fire department’s order. DRA also learned that it was SCE felt “compelled” to construct the project on its own in order to continue to fulfill its service obligation. This project would allow SCE to resolve the pressure deficiency at the location by installing a 3-inch water main from the existing 10-inch main line.

Consistent with the earlier finding by the City of Avalon’s Fire Department that the Island Company should bear the ultimate responsibility for the fire sprinkler deficiencies, SCE’s ratepayers should not be responsible for these expenses. The fire sprinkler deficiency the Fire department cited was directed at the Island Company and therefore, the Island Company should be the one to correct the deficiency and bear the cost. DRA recommends disallowing the cost of this project and SCE should instead recoup the cost of this project from the Island Company. *Id.* at p.5-7.

#### **VIII.6. West End Pipeline Replacement Project**

##### **A. SCE’s West End Pipeline replacement project is reasonable.**

The potable water distribution pipeline from Isthmus/Two Harbors to Howland’s Landing (“West End”) is about 2 miles and mostly galvanized pipes. The pipeline is approximately 60 years old. Some portion of the existing lines had broken away from their anchor points and either slid down the hill or were hanging in mid-air. SCE replaced the entire line. *Id.* at p.5-8.

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<sup>10</sup> Santa Catalina Island Company is the land owner of almost the entire Island.

SCE sent the project out for competitive bidding, and SCE awarded the work to the lowest bidder (19% lower than the nearest bid). SCE provided DRA the bid information and the results of the bid selection in confidential workpapers.<sup>11</sup>

SCE also provided DRA the work description and the cost breakdown in workpapers.<sup>12</sup> DRA reviewed the workpapers and the inspection records listing consecutive water loss due to pipeline breakage and the before-and-after photos showing the conditions of the pipeline anchors to determine the reasonableness of this project. The competitive bidding process, the lowest bidder selection, and the construction cost analysis also demonstrate the reasonableness of the project. *See* Exhibit DRA-1, p.5-9.

DRA recommends the Commission include the cost of this project in the rate base.

#### **VIII.7. Isthmus Area Water Supply & SCADA**

##### **A. SCE's Isthmus Area water supply & SCADA project is reasonable.**

The Million Gallon Tank at Isthmus Area required interior and exterior repairs. SCE sandblasted the tank and repainted it. Additionally, SCE installed ladders, railings, new valves, and connected it to the SCADA.

A contractor completed the construction, and SCE awarded the job directly to the contractor already working on the Pump House #2 Project. SCE awarded the SCADA installation portion of the project to the contractor, who was already working on the entire SCADA system. DRA determined it was reasonable for SCE to reduce project costs by selecting these two contractors who were already working on other projects. The contractors used the same equipment and crew that they already brought onto the Island. SCE provided the contractor selection information in confidential workpapers.<sup>13</sup> Id.

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<sup>11</sup> Confidential Workpaper SCE-01 Ch. IV: Capital Projects. Pages 27-30.

<sup>12</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 414-417.

<sup>13</sup> Confidential Workpaper SCE-01 Ch. IV: Capital Projects. Pages 31-40.

SCE also provided DRA the project description, work details, and the breakdown of the cost of this project in workpapers.<sup>14</sup> After reviewing workpapers, the reservoir condition assessment report, and construction cost analysis DRA determined the project is reasonable.

DRA recommends the Commission include the cost of this project in rate base.

### **VIII.8. Thompson Reservoir Siphon**

#### **B. SCE's Thompson Reservoir Siphon project is reasonable.**

During a routine inspection in 2004, the California Department of Water Resources Division of Safety of Dams ("DSOD") questioned the operability of the 10-inch emergency drain at the Thompson Reservoir. DSOD tested the drain and it did not meet DSOD requirements due to plugging. SCE needed to find mitigation measures to comply with DSOD requirements. SCE cleared the line, but it quickly became partially plugged again. After several attempts with alternatives, SCE chose an 18-inch siphon over the dam.<sup>15</sup>

Because of the design, testing, and approval process that DSOD requires to remedy problems with an existing dam, SCE had also gone through numerous revisions for the siphon installation project.<sup>16</sup> DSOD inspections subsequent to 2004 inspection note that SCE was conducting underwater inspections (2005 inspection report)<sup>17</sup>, working closely to develop an acceptable method of draining the Thompson Reservoir (2006 inspection report),<sup>18</sup> and conducted testing (2007 inspection report).<sup>19</sup>

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<sup>14</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 477-482.

<sup>15</sup> SCE actually hired an outside contractor, Parsons Engineering, to design a proper drain system. Workpaper SCE-01 Ch. IV: Capital Projects. Pages 661-700.

<sup>16</sup> Department of Water Resources Division of Safety of Dams required the following: "In any case, if a second outlet conduit is deemed necessary to provide the needed emergency drawdown capacity, an alteration application must be filed, and all dam safety related issues must be resolved prior to granting approval and beginning of construction." Workpaper SCE-01 Ch. IV: Capital Projects. Page 587.

<sup>17</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 612-613.

<sup>18</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 628-629.

<sup>19</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 644-645.

SCE sent the project out for competitive bid, and it awarded the work to the second lowest bidder (1.3% higher than the lowest bid). However, this was the only bidder who submitted the required information DSOD requested. SCE provided DRA the bid information and the bid selection results in confidential workpapers.<sup>20</sup>

SCE also provided DRA with the project description, work details, and the breakdown of the cost of this project in workpapers.<sup>21</sup> And SCE provided a more detailed cost breakdown in response to DRA Data Request BYU-01. DRA reviewed the workpapers and data request response to help determine its reasonableness.

Additionally, the inspection findings and the chronology of subsequent submittals to DSOD in search of proper mitigation measures and the chronology of design changes to meet DSOD requirements presented in workpapers demonstrate why the design change was the driving force for the project cost increases. The construction cost analysis SCE presented in the data request demonstrates the reasonableness of the project as well, but it is clear the project was necessary to comply with DSOD and its requirements. *See* Exhibit DRA-1, p.5-10.

Considering all these issues, DRA recommends the Commission include the cost of this project in rate base.

### **VIII.9. Catalina Island Fire- Watershed & Above Ground System Restoration**

#### **A. SCE's Catalina Island Fire projects are unreasonable for customers to fund.**

The 2007 fire on the Island inflicted substantial damage to the water system, but especially to the Baker Tanks. Thus, investments had to be made to repair and restore operations. In addition, other projects and construction were required as a result of the fire. For instance, the debris walls project and Baker Dam maintenance road project had to be constructed to improve the reliability of the facilities to prevent similar destruction from a future fire disaster. Access to the facilities also had to be improved. Considering

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<sup>20</sup> Confidential Workpaper SCE-01 Ch. IV: Capital Projects. Pages 41-48.

<sup>21</sup> Workpaper SCE-01 Ch. IV: Capital Projects. Pages 583-585.

all of these issues, DRA has determined that SCE's expenditures for the Old Baker Dam Maintenance (\$654,609) and the Debris Wall Project (\$265,272) are reasonable.

Regarding the remaining dollars for the Baker Tank replacement and the plastic pipe replacement project, DRA recommends disallowing rate recovery in this GRC. Originally, the reason for DRA's disallowance is based on its review of SCE's insurance policy. The following quote from the insurance policy states in Part 1. Property Covered. (g) "the full cost of repair or reconstruction of both damaged and demolished portions of such property insured ...." This statement led DRA to believe that SCE should recover the \$2.284 million from its insurance policy. See Exhibit DRA-1, p.5-2.

While SCE points out that the facilities and system restored under this project are exempted property, DRA still could not understand why funds had not been recovered when it appears the the clear language of the insurance policy covers the restored facilities and system. A significant portion of the \$2.195 million spent on the Baker Tank Replacement should be covered under SCE's insurance policy<sup>22</sup>

During hearings, however, Mr. Hite changed SCE's position and explained SCE could not recover the costs because the deductible for the insurance policy is \$5million, which is more than the costs here and therefore not eligible for recovery. SCE's insurance policy is for all of its operations including gas, electric, and water. It is wrong to have this inappropriate insurance policy force ratepayers to pay for these costs when it was a management decision that created this liability for ratepayers. Other utilities have a much more reasonable deductible amount. See Exhibit A, DRA's Supplemental Testimony Regarding Fire Insurance.

During the site visit, DRA compared the new Baker Tanks with other utilities' storage tanks it has observed. Other than being a new facility, there was no indication of excess costs or it being an imprudent investment.

As for the reasonableness of the debris wall, DRA agrees the facility is justified. After the 2007 fire, the first rainy season produced land slides. The landslide clogged the

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<sup>22</sup> Because the insurance policy is privileged, DRA is trying to maintain that confidence by using general terms. The policy was presented to DRA as DR LLK003 question 12 under section 581.

watershed and almost destroyed some of the critical facilities, such as pressure reducing valve stations, a well, and a pump house. Some of this damage to the sites was still visible at the valve stations. With the addition of the debris wall, the existing facilities are better protected from future landslides. The valve stations are important facilities because the water from the source needs to be pumped over the mountain to be delivered to the city of Avalon. Pump house #2 is the only pump station in the system that can deliver water from the source. The water pumped from the pump house is then collected in the Wrigley reservoir at the top of the mountain and is fed through the pipeline to the Baker Tanks, which serves the City of Avalon. The large elevation differences between the reservoir and the tank are regulated by the pressure reducing valves. Essentially, the valves safeguard the system and ensure the reliability of water delivery, and thus it is reasonable to add protection to these facilities. *See Exhibit DRA-1, p.5-3.*

Additionally, the City of Avalon had concerns with the Old Baker Dam<sup>23</sup> as a result of the post-fire landslides. The City perceived a threat to city facilities built adjacent to the defunct concrete dam<sup>24</sup> because another landslide would harm city property and potentially private businesses. The Catalina Island Company constructed a debris wall just upstream of the dam to protect the dam from future landslides. Before the wall was constructed, SCE dredged and cleared the debris and mud from the watershed and the dam. SCE recovered the cost for debris and mud clean up through O&M expenses. Upon seeing the terrain and circumstance, DRA determined it was a reasonable action. These are also costs that SCE is not seeking recovery from in this proceeding.

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<sup>23</sup> Old Baker Dam used to be the primary water storage for the City of Avalon until the 1960's. It does not function as water storage due to the California Department of Health requirements and its function is being replaced by Baker Tanks. Old Baker Dam exists today as a concrete wall at the end of the watershed.

<sup>24</sup> The post-fire landslide forced debris and mud into the watershed and filled the dam. The landslide also destroyed the access road to the dam. There are two city facilities just downstream of the dam and some other private businesses further down.

Fire-related landslides essentially destroyed the Old Baker Dam maintenance access road. Moreover, after the 2007 fire, the landslides changed the landscape of the Old Baker Dam location and SCE had to reconstruct a new access road to the Old Baker Dam. This road was also used to construct the debris wall upstream of the Old Baker Dam. The new road will be used to maintain the Old Baker Dam and the debris wall. For all these reasons, it is a reasonable project. *See Exhibit DRA-1, p.5-4.*

## **IX. POTENTIAL SALE OF THE WATER UTILITY**

Not Applicable.

## **X. DEPRECIATION**

### **A. The differences in depreciation are due to plant addition differences between DRA and SCE.**

SCE proposes updating the depreciation parameters to reflect those of other water utilities. DRA does not object to the update rates. The only differences in SCE's request and DRA's recommendation are from differences in plant additions. *See Exhibit DRA-1, p.5-11.*

## **XI. RATE DESIGN**

### **A. The parties have settled rate design.**

The parties in this proceeding will be presenting a settlement on this issue soon. The only unsettled issue is whether SCE employees should continue to receive discounts on their utilities. DRA defers to the electric GRC proceeding on this matter. If the Commission changes this employee policy in that proceeding, it should flow through to the water rates as well.

## **XII. TAXES**

### **A. SCE's tax estimates are reasonable.**

Because tax law changes impacted the revenue requirement substantially, DRA wanted to recognize the tax law change that occurred in January in the hopes that it would lower SCE's tax responsibility and rate base due to the potential increase in deferred income taxes. With this proceeding, because of a decline in plant in service

revenues for 2011, taxes have declined by \$93,000. Despite expectations of further downward tax adjustments, SCE has demonstrated that the capital projects in 2010 and 2011 are ineligible for the accelerated depreciation and tax benefits from the new January law. If the 2010 and 2011 plant additions are actually eligible for accelerated depreciation, DRA asks that the rates be subject to refund to allow for the corrected figure.

Taxes are a significant expense in this GRC. They are comprised of taxes on income (\$889,000), payroll and other taxes (\$70,000), and ad valorem taxes (\$212,000). Taxes comprise 16.2% of the total revenue requirement. Although recorded 2009 amounts were \$208,000, the projected tax amount jumps 463% to \$1,171,000<sup>25</sup>. Taxes, along with the revenue requirement associated with the capital projects, produce substantial increases.

The largest tax increase comes from the substantial increases expected for federal and California income taxes (a combined increase of \$873,000). In recorded 2009, Catalina Island had negative federal taxable income and negative federal income tax of \$174,000.<sup>26</sup> This compares with a 2011 Catalina Island taxable income of \$1,486,000 to result in a federal income tax of \$520,000. Similarly, Catalina Island's California corporate franchise tax went from \$1,000 in 2009 to a projected \$180,000 in 2011. This is because its California taxable income went from \$8,000 to a projected amount of \$2,111,000 for 2011. *See Exhibit DRA-1, p.6-1.*

Because these are significant increases for the ratepayers to bear, DRA looked to federal laws that might provide relief for this increase. After SCE's Catalina Island filing, President Obama signed the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act Of 2010 ("New Tax Law"). This was signed into law a month after SCE filed this GRC. Among the many provisions of the new tax law, it

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<sup>25</sup> See Pasaporte Chapter VIII workpaper on page 53 of SCE-01 workpapers.

<sup>26</sup> See Pasaporte Chapter VIII workpaper on page 55 of SCE-01 workpapers.

provides for 50%-100% accelerated bonus depreciation on certain business property put into service after September 8, 2010. *Id.*

SCE representatives recently stated in an all party meeting held by Commissioners Sandoval and Ferron in regards to the Commission draft Resolution ALJ-411, that it was going to update its electric GRC filing to reflect the effects of the new tax law. DRA hoped that SCE would incorporate the spirit of the law into this GRC as well to help alleviate some of the rate shock.

DRA followed up with SCE and requested that the Company help craft best estimates for this tax law change. SCE's response to DRA suggests that it cannot make a downward adjustment to Catalina Island's deferred income tax balances in rate base because of the qualifications required to receive that benefit. SCE has explained that no capital additions in 2010 or 2011 will qualify for the tax benefits because there are too many dollars recorded in prior years towards the project. According to SCE, there are percentage limitations on how much of the construction could have occurred in the past. SCE demonstrated to DRA with spreadsheets that not one dollar qualifies. If given more time, DRA might have been able to explore this more fully. For now, DRA accepts SCE's interpretation of the new law, but proposes that rates should be subject to true-up<sup>27</sup>, if the circumstances for the deduction changes. *Id.* at p.6-2.

### **XIII. RATE OF RETURN ("ROR")**

#### **A. SCE's ROR is reasonable.**

SCE utilizes its company-wide ROR on rate base of 8.75%. Other class C water utilities are allowed to use a much higher percentage<sup>28</sup> to compute an ROR on capital investments. SCE's ROR directly benefits Catalina customers by lowering the revenue requirement, when compared to the higher ROR the Commission has granted to Class C and D water utilities. Thus, Catalina customers have been benefiting from these savings since SCE has owned the water operations. See Exhibit DRA-1, p.1-3.

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<sup>27</sup> See Resolution W-4867.

<sup>28</sup> See <http://docs.cpuc.ca.gov/PUBLISHED/GRAPHICS/131464.PDF> (the latest memo suggests a return between 11.25% and 12.25% for a class C water utility).

#### **XIV. CONCLUSION**

DRA reviewed testimony, workpapers, and data request responses, spoke with the Department of Public Health, consulted with the Commission's Consumer Affairs Branch, reviewed the GRCs of other CPUC regulated class C utilities, and visited the Island. DRA typically reviews the rates and operations of the nine Class A water utilities. The unique attributes of a small Island system for fewer than 2000 customers are challenging, and DRA did its best to balance the need for a safe and reliable system against the burden of rate shock.

Respectfully submitted,

/s/ SELINA SHEK

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## ATTACHMENT A

DRA was able to obtain the property insurance deductible information from 8 Class A water utilities.

In order to preserve the confidentiality of each company, DRA is presenting generalized information that shows a given deductible amount and the magnitude of rate base that a company would have.

| Rate Base levels     | Deductible |
|----------------------|------------|
| \$450 to 600 million | \$100,000  |
| \$80 to 90 million   | \$50,000   |
| \$300 to 800 million | \$25,000   |
| \$45 to 50 million   | \$10,000   |
| \$28 to 38 million   | \$5,000    |