Decision **PROPOSED DECISION OF ALJ BUSHEY** (Mailed 4/29/2010)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company (U210W) for Authorization to Increase its Revenues for Water Service in its Monterey District by $24,718,200 or 80.30% in the year 2009; $6,503,900 or 11.72% in the year 2010; and $7,598,300 or 12.25% in the year 2011 Under the Current Rate Design and to Increase its Revenues for Water Service in the Toro Service Area of its Monterey District by $354,324 or 114.97% in the year 2009; $25,000 or 3.77% in the year 2010; and $46,500 or 6.76% in the year 2011 Under the Current Rate Design.	Application 08-01-027 (Filed January 30, 2008)
And Related Matters.	Application 08-01-024

FINAL DECISION GRANTING PETITION FOR MODIFICATION OF GENERAL OFFICE ALLOCATION

Summary

California-American Water Company's Petition for Modification of Commission Decision (D.) 09-07-021 is granted. The general office revenue requirement for the California districts is increased by $820,786 to $7,454,286.

Background

In D.09-07-021, the Commission authorized California-American Water Company (Cal-Am) to increase water rates in its Monterey District and included

an allocation of Cal-Am's parent company, American Water Works, Inc., general office costs. In that decision, the Commission found that the parent company has over 100 municipal contracts to which it allocated no costs, which had the effect of shifting these costs to utility customers. Because careful cost allocation to non-regulated operations is essential to ensure that regulated customers are not subsidizing non-regulated operations, and that regulated utilities are not engaging in unfair competition with firms that lack a monopoly customer base, the Commission adopted the Division of Ratepayer Advocate's non-regulated allocation which was calculated from data in Securities and Exchange Commission filings. The Commission, however, allowed Cal-Am another opportunity to demonstrate the cost allocation that would occur if the multiple tier allocation methodology were applied comprehensively to all non-regulated operations, and authorized Cal-Am to file a petition for modification of D.09-07-021 that fully disclosed all non-regulated operations which use any assets or employees included in revenue requirement. The Commission directed Cal-Am to specifically include in any such petition the following information:

1. Identification of all such goods and services provided to non-regulated operations,
2. Identification of all personnel positions and assets included in revenue requirement and used to provide the non-regulated goods and services,
3. Statement of revenue received for such goods and services, and
4. Demonstration that all identifiable costs are direct billed to non-regulated accounts and that all indirect costs are allocated consistent with the multiple tier methodology.

On October 7, 2009, Cal-Am filed its petition for modification of D.09-07-021. In support, Cal-Am provided testimony from the president of

American Water Works Service Company (Service Company) which is the corporate entity that provides shared services to the American Water Works companies. The testimony addressed non-regulated operations that use any assets or employees the costs of which are included in revenue requirement. The testimony revealed that American Water Works, Inc., has 47 non-regulated corporate entities[1] that receive services from Service Company and that American Water Works, Inc., uses a two-tier system to first directly bill and then allocate remaining costs to these entities. The testimony showed that American Water Works, Inc., has 135 billing contracts that were not directly billed or allocated Service Company or other corporate costs in Cal-Am's original general office filing. To comprehensively review and identify any needed corrections, the president personally initiated an in-depth and thorough review of Service Company inter-corporate billing and cost allocation policies and procedures. This review specifically included the support provided by the Customer Service Center for the 135 billing contracts which led to a reduction in California's share of Customer Service Center costs. The final result of several adjustments reduced Service Company billings to California operations by $449,000.

Cal-Am's director of rates and regulation tabulated a $309,179 resulting decrease in revenue requirement due to these adjustments. This decrease, however, was more than offset by reversing the Commission's adopted non-regulated allocation of $1,129,965, with the ultimate result of an increase in Cal-Am's 2009 general office revenue requirement of $820,786.

[1] Ten of which are inactive.

Cal-Am also presented testimony from its Manager of Business Services for the Alton, Illinois, Customer Service Center, who sponsored analysis showing that up to 1.02% of the customer telephone calls received by the center are related to non-regulated municipal service contracts.

DRA did not oppose Cal-Am's petition for modification but offered a minor correction and requested that the Commission make permanent Cal-Am's obligation to include comprehensive information on its non-regulated operations.

Discussion

In D.09-07-021, the Commission explained that accurately allocating costs between regulated and non-regulated operations was essential to ensure that regulated customers are not providing subsidies to shareholders' non-regulated businesses, and to prevent those non-regulated businesses from unfairly competing with firms that do not have regulated operations on which to shift costs. Due to the importance of rate increase applicants making a persuasive showing of thorough and accurate cost allocation, the Commission rejected Cal-Am's proposed allocation and adopted DRA's estimate of non-regulated costs based on Securities and Exchange Commission data. The Commission, however, allowed Cal-Am another opportunity to "demonstrate the cost allocation that would occur if the multiple tier allocation methodology were applied comprehensively to all non-regulated operations" and authorized Cal-Am to file a petition for modification that included the following:

1. Identification of all such goods and services provided to non-regulated operations,
2. Identification of all personnel positions and assets included in revenue requirement and used to provide the non-regulated goods and services,

3. Statement of revenue received for such goods and services, and
4. Demonstration that all identifiable costs are direct billed to non-regulated accounts and that all indirect costs are allocated consistent with the multiple tier methodology.

In its petition, Cal-Am presented detailed information about the results of the management investigation of Service Company cost allocation and billing process.[2] Cal-Am stated that its investigation included: identifying and verifying all non-regulated companies and business activities, including operations and maintenance contract revenues recorded by regulated entities, tracing customer counts, especially the change in California numbers, and understanding how support costs are billed and revenue recorded. The testimony from the Service Company President stated that the results of the "in-depth and thorough" investigation were "subject to close examination and confirmation" and that Cal-Am's new management played a "strong role" in "pressing the Service Company for a thorough review of the charges and an accurate application of the allocation methodology to California."

As noted above, the result of the investigation was a series of relatively minor corrections to the cost allocation study, which Cal-Am concludes verifies that its original allocation proposal was "accurate and proper." Based on its presentation, Cal-Am requests that the adopted non-regulated services cost allocation be reversed, with an increase in Service Company allocations to California of $820,789.

[2] Much of personnel and cost data contained in the testimony supporting the petition for modification had previously been provided to the Commission in this docket.

We have reviewed Cal-Am's application and find that it meets the requirements set out in D.09-07-021. Cal-Am's investigation and documentation shows that it has identified non-regulated operations and segregated costs of serving these operations from its regulated revenue requirement. We will, therefore, modify D.09-07-021 to reverse the non-regulated adjustment based on DRA's Securities and Exchange Commission data, and instead adopt the non-regulated operations corrections presented by Cal-Am in its petition for modification. The end result of these changes is to increase Cal-Am's general office allocation to California by $820,786. The revenue requirement increase for the Monterey water district is $131,300 and for the Monterey wastewater district is $11,100.

We reiterate our commitment to imposing the highest cost accounting and disclosure requirements on public utilities that choose to use employees and assets included in regulated revenue requirement for non-regulated operations. Therefore, we grant DRA's request to impose explicitly these duties on Cal-Am.

Comments on Proposed Decision

The proposed decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. No comments were received.

Assignment of Proceeding

John Bohn is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in these proceedings.

Findings of Fact

1. In D.09-07-021, the Commission adopted an estimate to allocate general office costs to non-regulated operations but authorized Cal-Am to file a petition for modification to replace the estimate with the results of Cal-Am's multiple tier allocation methodology if Cal-Am provided the following:

   a. Identification of all general office goods and services provided to non-regulated operations,
   b. Identification of all personnel positions and assets included in revenue requirement and used to provide the non-regulated goods and services,
   c. Statement of revenue received for such goods and services, and
   d. Demonstration that all identifiable costs are direct billed to non-regulated accounts and that all indirect costs are allocated consistent with the multiple tier methodology.

2. On October 7, 2009, Cal-Am filed its Petition to Modify D.09-07-021 with three volumes of supporting testimony. The President of the American Water Works Service Company detailed the investigation and resulting corrections to non-regulated operations cost allocation. The Manager of Business Services for the Customer Service Center analyzed the share of time calls to the customer service center related to non-regulated contracts, and the Rate and Revenue Requirements Manager tabulated the changes to D.09-07-021 to implement the corrections and reverse the Commission's adopted estimate.

3. Cal-Am has demonstrated that replacing the Commission's adopted estimate for non-regulated general office cost allocation with the results of Cal-Am's multiple tier allocation methodology will increase the general office revenue requirement allocated to California by $820,786, and to the Monterey water district by $131,300 and the Monterey wastewater district by $11,100.

Conclusions of Law

1. Cal-Am has presented data and analysis showing that its multiple tier allocation methodology adequately allocates general office costs to non-regulated operations.

2. As provided in D.09-07-021, the Commission should authorize modifications to the revenue requirement adopted in that decision based on Cal-Am's presentation.

3. Cal-Am has justified revenue requirement increases to its Monterey water and wastewater districts, and the rate tables and tariff sheets attached to today's decision incorporate the increase.

4. Cal-Am's petition to modify should be granted.

5. Cal-Am should be authorized to file in accordance with General Order 96, and to make effective on not less than five days' notice, a Tier 1 advice letter with the revised tariff schedules for Monterey water and wastewater districts that are attached as appendices to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

O R D E R

IT IS ORDERED that:

1. The Petition for Modification of Commission Decision 09-07-021 is granted.

2. California American Water Company is authorized to file a Tier 1 advice letter in accordance with General Order 96, and to make effective on not less than five days' notice, the revised tariff schedules for Monterey water and wastewater districts that are attached as appendices to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

3. In all future general office applications, California American Water Company shall include a comprehensive and detailed showing of non-regulated operations that in any way use assets or employees included in regulated revenue requirement. All contracts and accounting records related to such non-regulated operations are subject to discovery by the Division of Ratepayer Advocates and California American Water Company and its corporate affiliates using such assets or employees shall promptly produce all such documents upon request.

This order is effective today.

Dated _____, at San Francisco, California.

Bushey Appendices