Decision **PROPOSED DECISION OF ALJ KOSS** **(Mailed 11/18/2008)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Suburban Water Systems (U339W) for Authority to Increase Rates Charged for Water Service by $6,820,539 or 13.57% in 2009, $1,698,004 or 2.97% in 2010, and $1,250,644 or 2.12% in 2011.	Application 08-01-004 (Filed January 2, 2008)

(See Attachment A for List of Appearances.)

DECISION AUTHORIZING GENERAL RATE INCREASES FOR SUBURBAN WATER SYSTEMS AND APPROVING A RELATED SETTLEMENT AGREEMENT WITH THE DIVISION OF RATEPAYER ADVOCATES

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DECISION AUTHORIZING GENERAL RATE INCREASES FOR SUBURBAN WATER SYSTEMS AND APPROVING A RELATED SETTLEMENT AGREEMENT WITH THE DIVISION OF RATEPAYER ADVOCATES

Summary

This decision authorizes Suburban Water Systems to increase rates for the three-year period 2009-2011, as set forth below:

Year	% Increase	Amount Increase
2009	11.08%	$5,570,563
2010	2.70%	$1,508,585
2011	2.22%	$1,280,008

Authorized increases for the test year 2009 are shown above. The increases shown for the escalation years 2010 and 2011 are estimates as rates for these years will be determined through the Advice Letter process, reflecting current escalation data, filed prior to each year. Suburban Water Systems also shall include as an attachment to these Advice Letters (to be filed in 2009 and 2010) updates on its activities related to the implementation of the Commission's Water Action Plan policy objectives.

Today's decision also approves a related settlement agreement between Suburban Water Systems and the Commission's Division of Ratepayer Advocates, the protestant in this proceeding. The settlement resolves most, but not all, of the protested issues. As a result of the settlement, the rate increases authorized herein for test year 2009 are approximately 18% less than the increases initially requested.

Lastly, the request of Suburban Water Systems to file an Advice Letter at a later date to recover the costs of a future project to upgrade its information systems is premature and not authorized at this time.

This proceeding is closed.

1. Background

Suburban Water Systems (Suburban) is a Class A water utility[1] currently providing water service to approximately 300,000 customers in two service areas. Suburban's San Jose Hills service area is in southeast Los Angeles County and includes the cities of Covina and La Puente; and, Suburban's Whittier/La Mirada service area includes the cities of Whittier and La Mirada in Los Angeles County, and Buena Park in northeast Orange County. For ratemaking purposes, these two services areas were combined into a single district in 1996.

Suburban is a subsidiary of Southwest Water Company (Southwest). Southwest is headquartered in Los Angeles, with its operations structured into two groups: the Services Group, and the Utility Group. The Services Group consists of non-regulated contract operations that provide water and wastewater management services to cities, utility districts and other government entities in 10 states. The Utility Group is made up of regulated public utilities. These include over 100 water and wastewater systems representing more than 160,000 residential and commercial connections in six states. Suburban is the only California utility under Southwest control. Southwest is a public company (publicly traded), while Suburban is a private company (not publicly traded).

[1] Class A water utilities are those companies with more than 10,000 service connections.

Suburban filed the subject application, its triennial general rate case, pursuant to the Rate Case Plan (RCP) guidelines established in Decision (D.) 04-06-018 (RCP for Class A Water Utilities) and D.07-05-062 (Revised RCP for Class A Water Utilities). In its previous general rate case, Application (A.) 05-08-034, Suburban requested rates on a fiscal year basis (FY 2006-07 – FY 2008-09). Here, its request is based on a calendar year basis (2009-2011). Suburban complied with the RCP requirements in its application, and also addressed the general issues identified in the Commission's Water Action Plan[2] Checklist.

In addition to general rate increases, Suburban also requested authorization to file a Tier 3 Advice Letter, at a later date, for approval of its "Project Cornerstone," a future project to update its information systems for on-line billing, and to unify its system with that of Southwest.

The Commission's Division of Ratepayer Advocates (DRA) protested the application. A prehearing conference (PHC) was held to discuss the issues in dispute and to develop a procedural schedule. At the PHC, Suburban and DRA, the only parties participating in this proceeding, agreed to engage in a settlement conference in an attempt to resolve the disputed issues before any evidentiary hearing (EH) on these matters was held. The Assigned Commissioner's Ruling and Scoping Memo (Scoping Memo), issued on April 22, 2008, also confirmed that settlement discussions would be held prior to any hearings.

Suburban and DRA were able to resolve most of the disputed issues at the settlement conference, and subsequently filed a joint motion requesting that the Commission adopt the settlement agreement. As a result of the settlement,

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[2] California Public Utilities Commission Water Action Plan, adopted December 15, 2005.

Suburban reduced the level of its proposed rate increases by approximately 18%. Today, we adopt the settlement agreement (included here in Attachment B).

Generally, most of the settled issues involve Suburban, while most of the issues not settled involve the Utility Group and Southwest. Though a settlement was reached, the remaining disputed issues still resulted in differences between the rate increases requested by Suburban (11.08% for 2009), and the rate adjustments recommended by DRA (-0.14% for 2009).

The unresolved issues were the subject of an EH. The table below shows the initial rate increases sought by Suburban in its application (pre-settlement); the post-settlement rate levels recommended by DRA; and, Suburban's post-settlement adjusted rate increases.

	Suburban Initial Request		**Post-Settlement**			
			DRA		**Suburban**	
Year	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**
2009	13.57%	$6,820,539	(0.14)%	$ (72,063)	11.08%	$5,570,563
2010	2.97%	$1,698,004	3.27%	$1,643,317	2.70%	$1,508,585
2011	2.12%	$1,250,644	3.12%	$1,638,615	2.22%	$1,280,008

After considering all of the issues presented at the EH, we find that the full amount of Suburban post-settlement rate increase request (11.08% for 2009) should be authorized. DRA fully and actively participated in this proceeding, and its participation assisted in the development of a fuller and more complete record. However, we find that the evidence presented by DRA was not

persuasive to the level necessary to justify authorizing a rate less than Suburban's (adjusted) request.

These issues are discussed in further detail below.

2. Procedural Matters

Suburban's application first appeared on the Commission's Daily Calendar on January 7, 2008, and DRA timely filed its protest on February 4, 2008. On January 23, 2008, Suburban timely filed proof of notice of newspaper publication of its proposed rates (pursuant to Rule 3.2(c)); and, on March 21, 2008 timely filed proof of mailing a notice of the proposed rates to its customers (pursuant to Rule 3.2(d)).[3]

The procedural history of this proceeding is outlined below:

Event	Date (all 2008)	Location
PHC	March 14	San Francisco
Scoping Memo	April 22	
Settlement Conference	June 10-13	Los Angeles
Evidentiary Hearing	June 16,17, and 30 July 7	Los Angeles San Francisco
Motion to Adopt Settlement	August 1	
Closing Briefs	August 4	
Reply Briefs/ Matter Submitted	August 18	

By mutual agreement, the parties determined that a public participation hearing (PPH) would not be necessary in this proceeding due to the lack of any

[3] Commission's Rules of Practice and Procedure (Rules).

other protests or parties participating. At the request of the parties, the procedural schedule set forth in the Scoping Memo did not include a PPH.

2.1. Motions

On March 13, 2008, the day before the PHC, DRA filed a motion to compel the production and inspection of certain data by Suburban. That motion was denied on April 15, 2008 by a ruling of the assigned Administrative Law Judge (ALJ).

On June 12, 2008, two working days before the EH commenced, DRA filed a motion to strike certain parts of the prepared testimony of Suburban; and, during the EH, both parties made various motions to strike certain testimony with respect to scope, methodologies used for review and analysis, and qualifications of witnesses. These motions were denied, in part, and granted, in part, by the ALJ on the record at the hearing.

We affirm all of the above rulings by the ALJ. Any other motions not previously addressed are denied.

3. DRA Protest

DRA expressed general concern over Suburban's relationship to its parent, Southwest, with respect to the allocation of costs between the two companies, and with the expenses and costs of the Utility Group. Specific issues identified in DRA's protest included: sales, customer service, rate design, revenue calculations, operations and maintenance expenses, administrative and general expenses, payroll expenses, plant costs, rate-base determination, water consumption, conservation, and numbers of customers.

DRA also identified other areas of concern, including: general objection to a Tier 3 Advice Letter process for Project Cornerstone being included in the scope of this proceeding; a recommendation that Suburban use a Domestic

Production Activities Deduction (DPAD) for income tax reporting purposes (also a matter related to Southwest); and, opposition to the allocation of costs and revenues of Suburban's Residential Houseline Program (RHP), an optional customer program for repairs/service on the customer's property.

4. Settlement Agreement

Suburban and DRA agreed to utilize the Commission's Alterative Dispute Resolution (ADR) program to assist in the facilitation of the settlement discussions. On June 2, 2008, the Chief ALJ assigned ALJ Victor Ryerson as the third-party neutral judge to act as the mediator in this case, and Judge Ryerson commenced a confidential settlement conference with parties in Los Angeles on June 10th. The parties also discussed settlement issues themselves, without Judge Ryerson, at various times prior to the commencement of the EH on June 16th.

4.1. Issues Settled

Suburban and DRA reached agreement on the following issues:

Revenues

Miscellaneous Services; Water Property Rents; Amortization of Deferred Revenues; and, Other Revenues

Rate Base

Deductions from Rate Base:

Depreciation Reserves; Construction Reserves; Contributions in Aid of Construction (CIAC); Unamortized Investment Tax Credits; Accumulated Deferred Taxes, Taxable Advances for Construction; Accumulated Deferred Taxes, Taxable CIAC; Accumulated Deferred Income Taxes; Unamortized Deferred Revenue, Taxable CIAC; Pension Reserve; Accumulated Deferred Income Tax Pension Reserve; and, Timing of Depreciation.

Additions to Rate Base:

Average Utility Plant in Service; Average Construction Work in Progress; and, Average Materials and Supplies.

Suburban Expenses

Employee Pension and Benefits:

Safety/Compliance Training; Other Training/Seminars; Recruiting; 401K Employer Contributions; Employee Pensions; Miscellaneous Pension Plan Charges; Term Life Insurance; Long-term Disability Insurance; Employee Contribution for Medical/Dental Benefits; Employee Welfare and Education; and, Employee Benefits Capitalized.

Administrative/General

Office Supplies and Other Expenses; Property Insurance; Insurance - Injuries and Damages; Regulatory Agency Expenses; CPUC Reimbursement Fee; Outside Services Employed; Miscellaneous General; General Plant Maintenance; Rents; General Overhead; Transportation – Clearing; Tools and Work Equipment; Depreciation; Taxes Other than Income; California Corporation Franchise Tax; and, Federal Income Tax.

Operation and Maintenance

Pumped Water Assessments – Main Basin and Central Basin; Purchased Water; Cooperating Respondent Reimbursement; Maintenance – Well Repairs; Purchased Power; Field Supplies; Building/Plant Supplies; Maintenance of Pumping Equipment; Operation Labor and Expenses; Miscellaneous Expenses; Chemical and Filtering Materials; Maintenance of Water Treatment Equipment; Storage Facilities; Meter Expense; Maintenance of Reservoirs and Tanks; Maintenance of Transmission and Distribution Mains; Maintenance of Services; Maintenance of Meters; Maintenance of Hydrants; Postage; Meter Reading; Customer Records and Collections; Uncollectable Accounts; Water Conservation; and, Capacity Reservation Charges.

Utility Group Expenses

Payroll and Benefits

Regular payroll; Payroll Taxes; Health Insurance; Employee Welfare; Unused Sick-leave; Worker's Compensation; Miscellaneous Pension Plan Charges; 410K Employer Contribution; and, Bonus Accrual.

Administrative/General

Subscriptions; Office Supplies; Printing, Communication, and Telecommunication; Building Utilities; Janitorial Services and Supplies; Machine Rental and Repairs; Rent; Car/Truck Service; Car/Truck Fuel; Car Allowance;

Audit and Accounting; Director and Officer Travel and Accident Insurance; and, Miscellaneous Expenses.

Other Expenses
Training and Seminars; Insurance; Deductible Travel and Entertainment; Professional Dues, and, Other Professional Services

Parent Company (Southwest) Expenses
Payroll and Benefits
Health Insurance; Public Company Expenses; Sarbannes/Oxley Act,[4] Section 404 Compliance - Testing and Revisions; Director's Fees; Transfer Agent Fees; and, Financial Public Relations

Office Rent and Expenses
Subscriptions; Office Supplies; Telephone, Fax and Voice-mail; Postage; Maintenance and Repairs; and, Relocation Expenses

Administrative and General
Training and Seminars; Executive Conferences; Professional Dues; Other Expenses; Depreciation – General; Bank Charges; Interest – Deferred Compensation; Franchise Taxes; Miscellaneous Expenses.

4.2. Reasonable, Consistent with the Law, and in the Public Interest

We commend the parties for engaging in a worthwhile and meaningful settlement discussion. The many hours spent in analysis, negotiation, and compromise resulted in most of the contentious issues being resolved, and also better identified and clarified the remaining issues subject to hearing.

All settlements must comply with Article 12 of the Rules. Rule 12.1(d) further states that the Commission will not approve any settlement unless it is

[4] Sarbanes-Oxley Act of 2002, PL 107-204, 116 Stats. 745.

reasonable in light of the whole record, consistent with the law, and in the public interest.

We find that the settlement is reasonable as it allows Suburban to recover a reasonable amount of increased costs; promotes operational efficiency, infrastructure development, and investment; and, keeps the burden on ratepayers as low as reasonably possible.

We also find that the settlement is consistent with the law. Both parties engaged in settlement discussions voluntarily, and both were represented by counsel. At the parties' request, approval of the settlement will not be construed as an admission or concession of either party regarding any fact or matter of law, or as any statement of precedent or policy for any purpose against Suburban in any other current or future proceedings. Also, as the parties note, the settlement is an integrated agreement, meaning that if we had rejected any part of the agreement, either party would have the right to withdraw from the settlement. Here, we approve the settlement agreement in its entirety.

Lastly, we find that the settlement is in the public interest. The settlement will result in a reduction of Suburban's initial rate increase request, provides for reasonable expenses (in those categories identified in the agreement), and allows Suburban to complete needed capital projects.

In conclusion, we approve the August 1, 2008 settlement agreement between Suburban and DRA (included in Attachment B), and find that it complies with all of the provisions of Article 12, including Rule 12.1(d).

5. Disputed Issues

DRA prepared two written reports on the results of its analysis of Suburban's application (both reports were received as exhibits at the EH). The first, the "Report on the Results of Operations of Suburban Water Systems"

(Suburban Report), focused on Suburban; and, the second, the "Report on the Southwest Water Company/Utility Group Costs of Suburban Water Systems" (Southwest Report), focused on the parent company Southwest. Most of the settled issues were included in the Suburban Report, while most of the unsettled issues were included in Southwest Report. The disputed issues (those not settled) of both reports are outlined below:

Affiliate Transaction Rules
DRA recommends Affiliate Transaction Rules be adopted for Suburban.

Utility Group and Parent Company Allocations
Four-Factor Allocation Methodology

Taxes: Domestic Production Activities Deduction

Project Cornerstone
DRA objects to use of a Tier-3 Advice Letter for approval.

Suburban Expenses
New positions (4); Payroll; and, Medical and Dental Insurance

Suburban Revenues
The RHP; and, Water Service Revenue

Rate Base
Working Cash

Utility Group Expenses
Computer Costs

Southwest Expenses
<u>Payroll and Benefits</u>
Regular Payroll; Payroll Taxes; Employee Welfare; Worker's Compensation; Pension Expenses; Financial Accounting Standards No. 123 - Compensation Expenses; and, Employee Stock Purchase Plan - Compensation Expenses.

Public Company Costs
Legal Fees; Audit/Accounting Expenses; Annual Report; Annual Meeting - 10-K Filings; Shareholder Relations; and, Financial Public Relations

Office Rent and Expenses
Computer and Information Technology Services Fees; Machine Rental; Rent; and, Property Taxes

General/Administrative Expenses
Insurance; Broker's Fees; Tax Deductible Travel and Entertainment; Outside Services; and, Recruiting

Other Expenses
Line of Credit Fees

6. Evidentiary Hearing

Four days of hearings were held between June 16, and July 7, 2008. All of DRA's 17 exhibits and 20 of 22 of Suburban's exhibits were received into evidence at the hearing (as previously noted, certain testimony from both parties was stricken from the record).

Suburban served the written prepared testimony of eight witnesses. Four of those witnesses testified at the hearing (three on the first day, and Robert Kelly, Vice-President for Regulatory Affairs for the Southwest Utility Group and Suburban's primary witness, on final three days).

DRA also served written prepared testimony and identified eight potential witnesses: seven related to the Suburban Report, and one related to the Southwest Report. At the hearing, DRA offered the testimony of only one of its witness regarding the Suburban Report, regarding the DPAD issue on the second day of hearing, due to the many issues settled in that report; and, the testimony of its one witness related to the Southwest Report, on the final day of hearing.

7. Discussion

The issues argued in the hearing involved two primary areas: Suburban's relationship and cost allocations associated with its parent company, Southwest; and, the differences between DRA and Suburban for projected expenses and costs (for Southwest and Suburban).

Below is a discussion of key Southwest-related issues, followed by a discussion of Suburban-related issues. Included are discussions of the issues in dispute with respect to the calculations of expenses and costs. We do not discuss all issues related to expenses, as we generally find that DRA's arguments are not persuasive to the extent necessary to disallow any of Suburban's projected expense or cost data, and that most of the data presented by DRA was unsubstantial, and not fully analyzed with respect to Suburban's positions on the specific issues.

Moreover, in our view both parties spent an excessive amount of time and effort in their pleadings and briefs alleging unsubstantiated errors and attempting to discredit the other party's witnesses. In future proceedings, the parties are advised to limit these types of activities, and focus more time and effort on meaningful settlement discussion and a more objective argument of the facts.

7.1. Southwest (Parent Company) Issues

In its application, Suburban showed all relevant transactions with Southwest (and the Utility Group), and to the best extent possible made these transactions open and transparent.

Unlike the rules for electric utilities, however, the Commission currently does not have any general rules in place governing affiliate transactions with respect to water utilities. Many of DRA's objections in this proceeding are based

on Suburban's relationship with Southwest, but also on scenarios, suppositions and implications of that relationship that may or may not actually exist.

We understand DRA's concerns. However, without specific rules in place we find it difficult to accept DRA's recommendations or arguments on these matters.

7.1.1. Affiliate Transaction Rules

In 1975, Southwest requested Commission authority to purchase Suburban, and consolidate its California operations with Southwest as the holding company and Suburban as the regulated utility (Application 55655). The Commission approved this transaction in Decision (D.) 84466 (1976).

In view of the parent/subsidiary relationship between Southwest and Suburban, DRA now recommends that the Commission direct Suburban to file an application for authority to establish a holding company, and consolidation of its California utilities, and further to institute affiliate transaction rules for Suburban. DRA cites other cases where similar rules have been required of other water companies.[5]

Suburban argues that the Southwest/Suburban transaction was approved over 30 years ago; that Suburban since has filed many formal requests for rate increases and other matters; and, that its parent/subsidiary relationship with Southwest has been transparent and known during this entire time. Suburban also argues that all of the similar affiliate cases involving water companies cited by DRA were the result of settlements; and, pursuant to Rule 12.5, that adoption

[5] D.97-12-001, California Water Service Company; D.98-06-068, Southern California Water Company; and, D.02-12-068, California-American Water Company.

of a settlement does not constitute approval or precedent in any future proceeding.

Lastly, Suburban argues that any effort to establish affiliate transaction rules for water utilities, other that case-specific settlements, should be the result of a rulemaking opened for that purpose.

In this regard, we also must consider the directives in D.04-06-018 (RCP for Class A Water Companies) below, regarding transactions with corporate affiliates, and also note that Suburban complied with these directives in its application.

> Transactions with Corporate Affiliates
> Identify and explain all transactions with corporate affiliates involving utility employees or assets, or resulting in costs to be included in revenue requirement. Include all documentation, including a list of all such contracts, and accounting detail necessary to demonstrate that any services provided by utility officers or employees to corporate affiliates are reimbursed at fully allocated costs.
>
> Unregulated Transactions
>
> To the extent the utility uses assets or employees included in revenue requirement for unregulated activities, the utility shall identify, document, and account for all such activities, including all costs and resulting revenue, and provide a list of all contracts.

Considering the above issues, we find it unreasonable now to direct Suburban to institute any affiliate rules.

7.1.2. Four Factor Method

The Commission established the "Four Factor Method" (FFM) in 1956 for the purpose of setting forth procedures to determine the allocation of expenses

and common utility plant among "departments, districts and states."[6] The four factors are: Direct Operating Expenses; Gross Plant; Number of Employees; and, Number of Customers.

Suburban used the FFM in determining the expense allocations not only for Suburban, itself, but also for Southwest and the Utility Group. DRA argues that the language of the 1956 memo limits use of the FFM only to Suburban, and therefore that Suburban improperly calculated its expense allocations by also using the FFM for Southwest. By using the FFM for Southwest, DRA asserts that Suburban misapplied two of the four factors, the Number of Customers and Gross Plant, and as a result Suburban's actual expenses were misstated.

Suburban argues that it followed the Commission's precedent and guidelines regarding the FFM by using all four of the expense elements, and as a result the data shown in its application related to the number of employees and number of customers reflects the actual numbers for each element for both Suburban and Southwest. Suburban further argues that the applicability of the FFM to "departments, districts and states" should be construed as including parent and affiliate companies.

We agree with Suburban in this regard. Absent specific rules, we find that Suburban correctly applied the FFM, and further that DRA did not demonstrate why the entire FFM should not be used in this case.

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[6] Subject Reference Memorandum H 32, Allocation of Administrative and General Expenses and Common Utility Plant, issued July 26, 1956.

7.1.3. Domestic Production Activities Deduction

The DPAD is part of the American Jobs Creation Act of 2004,[7] which amended the Internal Revenue Code to allow certain tax deductions for income attributable to domestic production activities. It includes income from sales of potable water. However, the DPAD cannot be taken if the company experiences a loss for tax purposes.

Suburban files a consolidated joint tax return with Southwest. They have not claimed a DPAD as they have shown an overall loss on their recent returns. DRA argues that if Suburban were a stand-alone company it would realize a profit, and therefore be eligible for a DPAD; and, that any benefits from a DPAD could be passed along to customers.

In D.84-05-036, the Commission determined certain policies with respect to the impacts on ratemaking of the income tax expenses of affiliated entities. DRA argues the Commission concluded in that decision that using a stand-alone method is appropriate. Suburban argues that DRA misinterprets D.84-05-036 in this regard as the decision states:

> The consolidated tax return of the utility and its affiliates is measured by the algebraic sum of the taxable income that each member contributes to the consolidated return. If any member has negative taxable income, the taxes paid by the consolidate group will result in an effective tax rate less than the statutory rate.

Suburban concludes that in determining the stand-alone taxable income for a utility (such a Suburban), the Commission should not consider any deductions or income from which the parent company can never benefit. Here,

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[7] H.R 4520 (2004), Section 102.

we agree with Suburban and find it is unnecessary to direct the imputation of a supposed, non-existent deduction. However, we also note here that the policies the Commission established in 1984 (20 years prior to the DPAD) are not entirely clear in this regard, and that updating and clarifying these issues may be necessary.

7.1.4. Southwest and Utility Group Expenses

DRA and Suburban argue over various issues with respect to the expenses of Southwest and of the Utility Group.

The only Utility Group issue is computer costs. Suburban argues that DRA failed to account for a Microsoft licensing agreement that began in May, 2007. We agree with Suburban in this regard and find the expense reasonable.

The parties disagree on several issues with respect to Southwest expenses. Suburban asserts these differences generally are the result of it switching its RCP from a fiscal-year to a calendar-year basis, and that many of its forecasts were based on actual expenses through July 2007, and estimates for the remainder of the year.

One of these expense matters is the allocation of costs of performing audits required by the Sarbanes-Oxley Act (SOX), the Public Company Accounting Reform and Investor Protection Act of 2002 enacted in response to the collapse of Enron and other public companies. SOX established standards and reporting requirements for all public companies. It does not apply to privately held companies. The parties argue over the allocation of expenses related to SOX compliance, particularly since Suburban is a private company and Southwest is public. DRA asserts that SOX compliance costs should be disallowed for Suburban. Suburban argues that SOX compliance benefits the utility and its

customers, as well as the parent company. We agree with Suburban and will allow the expenses attributable to SOX compliance.

7.2. Suburban Issues

The following issues pertain to Suburban (wholly, or for the most part).

7.2.1. Project Cornerstone

Project Cornerstone is a future project that will unify the information systems of Suburban and Southwest, and also allow Suburban to institute an on-line customer billing process. Southwest is coordinating the project, but both entities, and Suburban's customers, will realize benefits.

Suburban estimates the project will be in place within the next two years, before its next general rate case is filed in 2011. Currently, design and costs estimates for the project are still being developed and Suburban has no useful data to include in this proceeding. Here, Suburban is requesting authorization to track the costs related to the project in a memorandum account, then file a Tier-3 Advice Letter at a later date for recovery of the costs.

DRA objects to the Advice Letter process for the project alleging that Suburban: has not established the need for the project; may be unwilling to allow the necessary level of discovery in an Advice Letter process; already has included project related costs in the subject proceeding; and, made no witnesses on the subject available for cross-examination at the EH held in this matter. DRA instead recommends that Suburban be required to file a new formal application at the time all the details and data have been developed, allowing for a more thorough review of the matter as compared to an abbreviated review associated with an Advice Letter.

DRA also states this issue is outside the scope of this proceeding. The Scoping Memo indicates the issue is within the proceeding scope.

Commission General Order (GO) 96-B governs the filing of Advice Letters. Section 3.1 of the GO defines an Advice Letter as "… an informal request by a utility for Commission approval, authorization, or other relief, including an informal request for approval to furnish service under rates, charges, terms or conditions other than those contained in the utility's tariffs then in effect…" Section 3.7 further defines an informal matter as "…either an uncontested matter or a matter for which a hearing is not required in order to resolve the contested issues."

Though we do not agree necessarily with all of DRA's contentions regarding the use of an Advice Letter in this case, it is clear the matter is not "uncontested." Further, because no meaningful data for the project is yet available, it is difficult to determine whether a hearing will be required to approve the project for ratemaking purposes.

Suburban is authorized here to track Project Cornerstone costs in a memorandum account. However, we find that the matter premature, and will not authorize Suburban to utilize the Advice Letter process at this time to recover those costs. Instead, Suburban and DRA are directed to meet and confer informally on this issue prior to the filing of any request to recover these costs. The parties may meet/confer themselves, or request a mediation conference through the Commission's ADR program. If the parties agree, Suburban may file a request to recover these costs through an Advice Letter. If no agreement is reached, Suburban shall file a formal application for that purpose.

7.2.2. New Positions

Suburban is requesting authorization in this proceeding to add four new positions (named below) to its payroll. DRA argues that all four positions are unwarranted. After considering Suburban's request and DRA's opposition, we

find that all four positions are necessary, for the reasons discussed below, and authorize Suburban to add these positions to its payroll.

Water Quality Conservation Coordinator.

Suburban requests this position for the following reasons:

- One of the primary objectives of the Water Action Plan is to strengthen water conservation programs. This position, in part, will assist Suburban in achieving its objectives.
- Order Instituting Investigation (OII) 07-01-022 was opened to consider policies designed to achieve conservation objectives for Class A water utilities. In Phase 1 of that proceeding, Suburban and DRA developed a complex rate design to encourage water conservation, which the Commission approved in D.08-02-036. The ongoing second phase of this proceeding will address non-rate design conservation measures. The conservation coordinator will allow Suburban to continue work in this area at the necessary levels.
- The Commission urges all Class A water companies to become members of the California Urban Water Conservation Council (CUWCC) – and to comply with the council's "Best Management Practices" (BMP), and the BMP directs that each utility designate a Water Conservation Coordinator.
- In Executive Order S-06-08, the Governor declared a statewide drought, and further encouraged water agencies and districts to work cooperatively at the regional and state level to take immediate action to reduce water consumption in 2008 and 2009. Suburban states the coordinator position is necessary in order to respond to current and possible future drought conditions.

DRA argues that some of this work can be performed by outside sources. However, we agree with Suburban for the reasons stated above and authorize this position.

Supplier Diversity Coordinator

In 2004, Suburban and other water utilities signed a Memorandum of Intent to voluntarily commit to improving supplier diversity. In its 2006 report to the legislature on supplier diversity, the Commission noted that by statute, water utilities are not required to participate in a supplier diversity program, but nonetheless commended the voluntary efforts of the water utilities and urged those utilities to increase their efforts in this regard. Suburban states the coordinator position is necessary to continue this work.

DRA argues that Suburban should make use of the Commission's Diversity Clearinghouse[8] to assist in these functions. Suburban argues that the primary purpose of the clearinghouse is to verify that potential suppliers actually qualify as Women Minority Disabled Veteran Business Enterprises, and not to assist utilities contracting vendors. We agree with Suburban, and authorize this position.

Information Technology (IT) Support Technician II

Suburban requests this position for the following reasons:

- Necessary support for personal computers.
- Support for Suburban's new automatic reading and updated mapping systems.
- Database maintenance of Suburban's geographical information system (GIS) and financial software systems, integration of the GIS with its customer information system, and other facilities maintenance.

Generally, the number of users of Suburban's system has increased only slightly. Suburban's justification of this position is not based on the number of

[8] As defined in GO 156, Section 3, The Women Minority Disabled Veteran Business Enterprise (WMDVBE) Clearinghouse.

additional users, but instead on the type and complexity of uses of the system. We agree with Suburban and authorize this position.

Benefits Analyst

Here, Suburban's request is not to add a new position, but to reassign a full-time position from Southwest to a three-quarter time position at Suburban. Suburban currently has no benefits analyst, or similar type position, on-site. Transferring this position will allow Suburban employees to have face-to-face contact for benefit related matters. We also note that, for ratemaking purposes, Suburban will not be responsible for any of the costs that Southwest will incur to outsource this function at the parent company. We agree with Suburban and authorize this position.

7.2.3. Residential Houseline Program

The RHP is an optional maintenance program for service and repairs on the customer property-side of Suburban's water meter. The customer typically owns the line, and the service includes monthly houseline inspections by meter-readers. Suburban now charges approximately $5/month for this service, and estimates the program will generate approximately $356,000/year, with 10%, or $35,600, being allocated to customers.

In D.00-07-018, the Commission determined that water utilities may use excess capacity for non-tariffed services, and split the revenues generated from "active" services 90-10 between the shareholders and the ratepayers. As defined in the decision, "active" projects include "customer facility related services, including maintenance contracts." Suburban argues the 90/10% split is appropriate here as the RHP is an "active" non-tariffed service.

DRA argues that all of the RHP revenues should be allocated to the ratepayers as the RHP does not qualify as a "non-tariffed" service. DRA also has

concerns with Suburban's cost-sharing methodology, and reporting of annual and incremental costs associated with the RHP, but the primary issue here is whether the RHP qualifies as an "active" project, as defined in D.00-07-018.

DRA asserts the RHP is more of an "insurance" service than a maintenance contract, as Suburban's customers are paying the monthly charge to insure against breakage, leaks, etc. Suburban argues that "maintenance" involves actions to prevent damage, while "insurance" involves payment for damage. D.00-07-018 defined maintenance contracts as a non-tariffed service; and, D.07-12-055 further defined "maintenance" as "the upkeep, repair, and preservation of existing facilities." In administering the RHP, Suburban performs an initial analysis of the line; performs upkeep, repair and preservation of the line; repairs any breaks in the line; and, conducts a monthly status check. We agree with Suburban that the RHP clearly is a maintenance program and not an insurance program.

DRA also argues that D.07-12-055 applies here. In that decision, the Commission found that the Extended Service Protection (ESP) program administered by a non-regulated affiliate of California Water Service Company (Cal Water) did not qualify as a utility non-tariffed service. Suburban argues that D.07-12-055 should not apply here for two reasons: first, that the Commission limited the applicability of the Cal Water decision by stating "based on the record evidence in this proceeding, we are doubtful that an ESP-type service could ever satisfy the requirements of the excess-capacity rules"; and, second, that Suburban's RHP is much different than Cal Water's ESP in that Cal Water was offering its ESP through contracts with its parent company, an un-regulated affiliate, and that the parent company was administering the program. We agree with Suburban that D.07-12-055 should not apply here in this respect.

For the reasons above, we find that Suburban's RHP is an "active" non-tariffed service, as defined in D.00-07-018, and that Suburban may continue to administer the program as such.

7.2.4. Rate Base—Working Cash

Suburban and DRA settled most rate-base issues. Working Cash is the only issue remaining. Suburban's estimate for 2009 is $1.64 million, and DRA's estimate is $1.37 million. Though DRA adopted Suburban's calculation methodology in the settlement, the difference here is based on the other ancillary issues, such as Payroll, that have an impact on Working Cash. Since we agree with Suburban regarding the ancillary issues (previously discussed), we likewise agree with Suburban's estimates on Working Cash.

8. Water Action Plan Checklist

The Commissions' Water Action Plan established certain goals and objectives to ensure that safe, high quality water, and reliable supplies are available from regulated water utilities operating in California. To further these goals, all Class A water utilities were directed to address the four issues listed below in any general rate case.

8.1. Activities Reported in Application

Suburban addressed these four issues in its application, primarily reporting on steps it took in 2007 and earlier to implement the plan, as discussed below:

8.1.1. Water Quality

Suburban detailed in its written prepared testimony the many activities and steps it has taken with respect to water quality issues, including compliance with and implementation of all related federal, state and local environmental,

safety and security issues. Suburban also provided in its application the Minimum Data Requirement Water Quality Responses required by the Water Action Plan. Suburban also is adding four additional Water Quality Assurance Technicians to its Quality Assurance Department to better ensure high quality water for its customers.

8.1.2. Water Conservation

As discussed above, Suburban is adding a new Water Quality Conservation Coordinator to its staff. Suburban also addressed the following conservation issues in its application.

- Metered Service – all Suburban customers are metered.
- Membership in the California Urban Water Conservation Council (CUWCC) – and compliance with the council's "Best Management Practices" (BMP). Suburban recently joined CUWCC, in June 2007, and intends to comply with the BMP.
- Increasing Block Rates; Decoupling Sales from Revenues; and, Financial Incentives.
  Suburban addressed these issues in OII 07-01-022, the water conservation OII. D.08-02-036 in that proceeding authorized Suburban to institute a two-tier increasing block rate structure, an adjustment mechanism for decoupling sales, and financial incentives for conservation.
- 10% Energy Reduction by 2009-2010.

Suburban states it continues to efficiently manage its energy use, but provides no further details on this issue.

- Amount of Unaccounted Water
  Suburban reports the amount of unaccounted water is less than 7%.
- Leak Detection Program / Leak Repair Time.
  Suburban has an active detection program that will be enhanced by the

addition of the two new three-person leak crews requested in this application. Leak repair time also will be enhanced by the addition of these crews.

8.1.3. Infrastructure Investment

Suburban notes the most recent Department of Water Resources Water Management Plan and the Distribution Improvement Charge in it application and work-papers. Suburban also discussed its Security Plan, compliance with the Environmental Protection Agency's Vulnerability Assessment, and the State Office of Emergency Services' Response Plan in its prepared written testimony.

8.1.4. Low-Income Ratepayer Assistance

Similar to other Water Action Plan issues discussed above (block rates, etc.), Suburban's low-income ratepayer assistance program was adopted in D.08-02-036.

8.2. Report on 2008 and 2009 Activities

As noted, Suburban reported on its past activities, primarily those undertaken in 2007. The reported results were encouraging, but we find that not all activities, and the description of those activities, were fully addressed to the level necessary to allow for a meaningful and full review of Suburban's efforts. In this regard, we direct Suburban to prepare an annual report documenting its progress and the activities undertaken in 2008 and 2009 with respect to its continuing implementation of the Water Action Plan policy objectives. A report on 2008 activities shall be included as an attachment to Suburban's Advice Letter requesting rate increases for the escalation year 2010 (to be filed in 2009); and, a report for 2009 activities shall be attached to its Advice Letter for rates for the escalation year 2011 (to be filed in 2010).

9. Conclusion / Authorized Rates

In consideration of all of the issues discussed herein, we conclude that the rates increases requested by Suburban are reasonable and we therefore authorize Suburban to increase rates for the three-year period 2009-2011 as set forth in the table below.

Year	% Increase	Amount Increase
2009	11.08%	$5,570,563
2010	2.70%	$1,508,585
2011	2.22%	$1,280,008

The increases shown for the escalation years 2010 and 2011 are estimates as rates for these years will be determined through the Advice Letter[9] process, reflecting current escalation data, filed prior to each year.

The Commission's Water and Audits Division has prepared a series of "Rate Tables" detailing all of the actual adopted rates and charges. These Rate Tables are included in Attachment C of this decision.

10. Categorization

In Resolution ALJ-3206, issued January 10, 2008, we preliminarily determined this proceeding should be categorized as ratesetting, and that an evidentiary hearing would be necessary. No party objected to the categorization or need for hearing, and we find here that the proceeding is properly categorized and that a hearing was necessary.

[9] Filed pursuant to GO 96-B.

11. Comments on Proposed Decision

The proposed decision of the 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. Comments were filed on _____, and reply comments were filed on _____ by _____.

12. Assignment of Proceeding

John A. Bohn is the assigned Commissioner and Kenneth L. Koss is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The parties resolved most, but not all, of the disputed issues in the settlement conference and subsequent settlement agreement.

2. The settlement is reasonable in light of the whole record, consistent with the law, and in the public interest, and the agreement complies with Commission rules regarding settlements.

3. As a result of the settlement, Suburban reduced the amount of its requested rate increase by approximately 18%.

4. An evidentiary hearing was necessary with respect to the unresolved issues.

5. Suburban correctly applied the FFM in allocating its expenses.

6. Suburban's projections for Working Cash are reasonable as DRA and Suburban agree on the calculation methodology, and related ancillary issues were otherwise determined.

7. Southwest's projected expenses are reasonable in light of its software licensing agreement, switching to a calendar year reporting basis, and in order to comply with federal reporting requirements.

8. It is unreasonable to direct Suburban to institute affiliate transaction rules as Suburban complied with existing rules in this regard.

9. It is unreasonable to direct Suburban to compute a DPAD as this deduction is non-existent.

10. DRA's arguments are not persuasive to the level necessary to justify a rate increase less than that requested by Suburban.

11. It is premature to make any determinations regarding Project Cornerstone as all of the necessary data is not yet available.

12. The following four new positions requested by Suburban are necessary in order to more efficiently carry out its responsibilities with respect to water quality, supplier diversity, and other administrative functions: Water Quality Conservation Coordinator; Supplier Diversity Coordinator; IT Support Tech; and, Benefits Analyst.

13. Suburban's RHP is an active non-tariffed service, as defined in D.00-07-018, and Suburban may continue to administer the RHP as such program.

14. The Commission's Water Action Plan established certain goals and activities for Class A water companies, and as required Suburban reported on its activities in the subject application, its general rate case.

15. Suburban's descriptions of its activities do not fully address all of the issues required by the RCP and the Water Action Plan, and it is necessary to direct Suburban to submit updated annual reports on its activities undertaken in 2008 and 2009.

16. Suburban's post-settlement adjusted rate increase request is reasonable, as it allows Suburban to recover a reasonable amount of increased costs; promotes

operational efficiency, infrastructure development, and investment; and, keeps the burden on ratepayers as low as reasonably possible.

Conclusions of Law

1. The settlement between Suburban and DRA should be approved.

2. The full amount of Suburban's post-settlement adjusted rate increase should be authorized, as described herein.

3. Suburban should be required to report in future Advice Letters the activities it undertook in 2008 and 2009 with respect to the Commission's Water Action Plan requirements.

4. Suburban should not be authorized now to recover costs associated with Project Cornerstone through an Advice Letter, though Suburban may revisit this issue at a later date.

O R D E R

IT IS ORDERED that:

1. The settlement agreement between Suburban Water Systems (Suburban) and the Commission's Division of Ratepayer Advocates is approved.

2. Suburban is authorized to increase rates for the years 2009-2011 to the levels it requested as a result of the settlement agreement, as described herein.

3. Suburban shall report in future Advice Letters, as described herein, the activities it undertakes in 2008 and 2009 related to the requirements of the Commission's Water Action Plan.

4. At this time we decline to approve Suburban's request to recover future costs associated with its Project Cornerstone through an Advice Letter process; however, Suburban may revisit this issue at a later date.

5. Application 08-01-004 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

********** ATTACHMENT D—SERVICE LIST **********
Last Updated on 14-NOV-2008 by: JVG
A0801004 LIST

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(END OF ATTACHMENT D)