Decision **PROPOSED DECISION OF ALJ BARNETT** (Mailed 4/23/2012)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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 November 15, 2010)

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DECISION GRANTING THE APPLICATION IN PART

1. Summary

Southern California Edison Company seeks an approximately 80% increase over current rates for its Catalina water subsidiary on Santa Catalina Island. The current revenue at present rates is $3,948,000; at proposed rates it increases to $7,118,000, an increase of $3,170,000. The water company rates, at present rate levels, are by far the highest in the State of California. The application was protested by the Division of Ratepayer Advocates, The Utility Reform Network, and a group of Santa Catalina Island public and private interests including the City of Avalon, Catalina Island Chamber of Commerce, Santa Catalina Island Company, Santa Catalina Island Conservancy, Guided Discoveries, Conference of Catalina Condos and Apartments, and Hamilton Cove Homeowners Association.

This decision reviews the water company's operating expenses and rate base, disallows them when appropriate, and adopts SCE's alternate rate proposal to keep level the present revenue requirement. We have disallowed approximately $0.4 million of operating expenses; approximately $7.5 million in rate base; and by adopting SCE's alternate rate proposal, shifted $7.780 million of increased costs in the water company's rate base as a one-time cost to electric rates. The result of our disallowances and adjustments makes no change in the current revenue requirement of $3.842 million.

2. Background

With a surface area of 75 square miles, Santa Catalina Island is situated approximately 30 miles southwest of Huntington Beach in southern California. The primary industry on Catalina Island is tourism. Avalon, located on the east

end of the island, is the only city and major population center on the island. Figures from the 2010 census show that Avalon had a population of 3,728, with another 200+ persons in the balance of the island. The total permanent population on Catalina Island is now estimated at over 4,000. During holidays, weekend, and the summer months, the population can swell to over 10,000. The island's summer temperature averages 75 degrees, while in winter the temperature averages 65 degrees. Catalina Island has a semi-arid climate. On average the sun shines 267 days a year and the average rainfall is 14 inches per year. As of December 31, 2010, Catalina Island had 1,934 metered service connections. Catalina Island derives its primary water supply (totaling 512 acre-feet in 2005) from a system of wells, springs, and reservoirs.

The water system on Catalina Island is not complex. It is really five separate systems, all of which are basically the same. Water is pumped from wells to a tank or tanks; then flows by gravity to the point of use. The only treatment is chlorination. The main system serves the city of Avalon and includes 95% of the connections. To serve Avalon, water from the three wells in Middle Canyon is pumped to the Wrigley Reservoir and then to the Baker Tanks. It then flows by gravity to the points of use. In this system, Pump House #2 moves water less than two miles with an approximate 400 foot rise. In terms of water systems, that is insignificant. There is a desalination plant which is monitored and maintained, primarily by changing filters. Because of the height of the Baker Tanks and the Wrigley Reservoir, pressure regulators are required. Avalon is not in danger of suddenly losing water. If the pump house went down, there is enough water in the Wrigley Reservoir and the Twin Tanks to supply Avalon for two or three weeks during the high use season.

The other four systems each consist of a well or wells, pumps, a tank or tanks and gravity feed to the point of use. They serve only 5% of the connections. One system serves a daily use campground and the small airport. One system serves one camp. One system serves two camps. The Isthmus system, the largest of the systems outside of Avalon, serves the Two Harbors area, three camps, and the University of Southern California's (USC) facility.

3. Burden of Proof

Because of the sharp conflicts in much of the testimony, and because of the large sought increase in a small water company, we restate our position on a utility's burden of proof as recently stated in a similar proceeding involving a large rate increase request by another water utility:

> Cal-Am bears the burden of proving by a preponderance of the evidence that the proposed rates are just and reasonable. We will review Cal-Am's presentation in the context of the increasingly severe water supply limitations in Cal-Am's Monterey district and the significant financial burdens imposed on residential and business customers by the substantial rate increases sought by Cal-Am in these consolidated applications. This context requires that proposed expenditures be demonstrably necessary for reliable service and provide value to customers. We understand that the cost of providing an efficient and safe water supply is rapidly increasing and we will, where necessary, approve substantial increase in expenditures, but we intend to carefully scrutinize Cal-Am's justifications for such proposals. (Decision (D.) 09-07-021 at 6-7.)

Further, we may find that Southern California Edison Company (SCE) has not met its burden of proof even where no adverse party served testimony on the issue in question, and deny cost recovery as a result.[1]

In Apple Valley Ranchos Water Company (Apple Valley) for authority to increase rates, D.05-12-020, we held:

> There is a natural litigation advantage enjoyed by utilities in that we must rely in significant part on their evidence and experts; this advantage reinforces the importance of placing the burden of proof in ratemaking applications on the applicant utilities. Apple Valley has the sole obligation to provide a convincing and sufficient showing to meet the burden of proof, and any active participation of other parties can never change that obligation. (D.05-12-020 at 5.)

4. Compliance With Uniform System of Accounts

DRA, TURN, and a group of Catalina public and private interests including the City of Avalon, Catalina Island Chamber of Commerce, Santa Catalina Island Company, Santa Catalina Island Conservancy, Guided Discoveries, Conference of Catalina Condos and Apartments, and Hamilton Cove Homeowners Association (Protestants) complain that SCE has ignored Resolution No. 4665, dated November 1, 2007, SCE's Catalina Water Company's last rate increase, in which SCE was ordered to use Uniform System of Accounts

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[1] D.96-01-011 (SCE 1995 GRC), 1996 Cal. PUC LEXIS 23, *81-85. The Commission denied cost recovery of SCE's share of the abandoned California-Oregon Transmission project because the utility failed to meet its burden of proof. No party presented testimony opposing SCE's request, but The Utility Reform Network (TURN) and the Division of Ratepayer Advocates (DRA) raised issues regarding the insufficiency of the utility's showing in support of that request. The Commission agreed with TURN and DRA, and denied cost recovery.

(USOA) accounting.[2] For example, Protestants state that SCE has never complied with the requirements applicable to reporting operating revenue; never reported the revenue it receives for fire protection; never complied with the requirement that it report its metered revenue according to five subcategories (single-family residential, commercial and multi-residential, large water users, safe drinking water bond surcharge, and other meter revenue); and never complied with the requirement that it report its other water revenue. Further, where it did follow the USOA and recorded the totals in its annual reports, frequently it did not rely on those recorded numbers in presenting its rate case.

DRA reviewed SCE's adjustments in the 600 account series to verify compliance with USOA's accounting practices, but did not perform a formal audit. DRA reviewed many spreadsheets from SCE's Results of Operations (R/O) model and concluded that SCE is in compliance with USOA accounting practices, but SCE should have corrected its testimony, workpapers, and models to eliminate all misleading references to Federal Energy Regulatory Commission (FERC) accounts. For future rate cases involving Catalina's water service, DRA recommends that the Commission again 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.

Requiring a utility to follow the USOA is not exalting form over substance; it permits a reviewing body, and interested persons, to track revenues and expenses year by year with a measure of consistency. This proceeding is a prime

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[2] Ordering Paragraph 14. "Southern California Edison Company, Catalina Island Water System, shall follow the USOA in its annual reports submitted to the Commission."

example of the problems caused by failure to follow standard regulatory practices. This is particularly true when failure to follow the USOA causes confusion in analyzing a utility's annual reports.

5. Annual Reports v. Ratemaking Adjustments

SCE states:

> SCE acknowledges that the use of "FERC accounts" throughout our testimony and workpapers added to the confusion that even DRA had when evaluating our O&M showing, and should be replaced and corrected to read "accounts" instead. However, if Protestants truly wanted to understand SCE's case (instead of just re-stating old arguments about SCE's operations), they could have consulted with SCE staff, as did DRA's analyst, regarding SCE's accounting and naming conventions. In fact, DRA concluded that SCE is compliant with USOA.[3]

It is not Protestants' responsibility to prove or disprove SCE's case. The Commission has noted the advantage a utility has and we have instructed that the utility has the sole obligation to provide a convincing and sufficient showing to meet the burden of proof. (D.05-12-020 at 5.)

Even though DRA recommended that SCE "correct its testimony, workpapers and models,"[4] SCE declined to do so. SCE continues to attempt to meet its burden of proof with testimony it admits is, at best, confusing. Throughout SCE's testimony it uses historical data going back to 2005 to justify the amount SCE seeks in its proposed revenue requirement. Unfortunately, SCE's testimonial historical data and the historical data contained in SCE's annual reports substantially differ. And that difference raises serious concerns.

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[3] Exhibit SCE-04 at 7, II. 9-14.

[4] Exhibit DRA-1 at 1-6, II. 1-2.

Every annual report filed with the Commission must be on a form provided by the Commission, with the appropriate USOA accounts, and a declaration under penalty of perjury by an officer of the company that the information provided is complete and correct. We have the annual reports from 2005 through 2010. They markedly differ from each other and from the testimony offered by SCE; especially the difference between the 2010 Annual Report and the testimony of SCE's witness regarding the 2010 actual number. We will discuss this in detail below, when reviewing SCE's individual accounts. Protestants contend that the historical data used by SCE to justify the expenses it seeks to include in its revenue requirement are totally at odds with the data it has provided the Commission in its annual reports, and, as a consequence, do not form any basis for meeting SCE's burden of proof. Protestants raise a valid point.

When there is a discrepancy between the amounts shown in the annual reports and the amounts testified to by the expert at the hearing, that in itself raises a conflict in the evidence, causes confusion, and goes to the essence of SCE's meeting its burden of proof. Such a discrepancy raises two questions: 1) whether this is a result of shoddy record keeping, or 2) whether there are merely two ways to consider raw data to reach a conclusion? In either case, it reflects poorly on SCE and ineluctably affects our findings.

6. Current Economic Condition

SCE has been the primary provider of utility service (including water distribution and commercial customers) since 1962.[5] Over this 50-year period, SCE has been authorized to increase its water base distribution rates only two times, once in 1985, and subsequently in 2007.

An important economic driver of water consumption is the number of visitors to Catalina. SCE finds that the number of cross-channel and cruise ship passengers (a proxy for the number of visitors) is statistically significant in explaining variations in historical water consumption. Visitors to Catalina have been steadily declining for a number of years. For example, between 2006 and 2009 the number of cross-channel and cruise ship passengers fell by 20%. For 2010, SCE is forecasting 698,056 visitors. The visitor forecast for 2011 reflects the expectation of a modest improvement in personal income levels, which in turn is predicted to result in somewhat higher recreational spending and higher visitation rates.

An indicator of the recession's impact on Catalina Island is the "idle meter rate" (defined as the number of idle meters divided by the number of installed meters). The idle meter rate serves as a proxy for business conditions on Catalina as it indicates the number of households and businesses that are unoccupied or no longer in business. Between year-end 2008 and 2009, the residential idle meter percentage jumped from 1.3% to 2.1% and the non-residential idle meter rate increased from 2.2% to 2.7%. Present data suggest that the residential idle meter rate is starting to slowly decline, with the likelihood of

[5] D.64420 authorized SCE to purchase all the water, gas, and electric service facilities in Catalina.

lower household foreclosure rates and business failures as the economy improves.

SCE is forecasting a decline in Catalina water sales in 2010 compared to 2009, but a modest recovery in water sales in 2011 in line with predicted increases in tourism and an improving economy. Sales in 2012 are still estimated to be 13.8% below the 2008 sales level.

7. Expenses

7.1. Account 615 Power for Pumping

SCE[6] based its request for test year 2011 on its estimate that it would spend $291,000 in 2010, seeking the same amount for the test year. Subsequent to filing its application, SCE filed its Annual Report for 2010, representing that it spent only $19,321 for Power for Pumping. Protestants' expert[7] testified that because SCE seeks the same amount for test year 2011 as it spent in 2010, $19, 321 should be included for test year 2011.

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[6] SCE's principal expert witness, Roland Hite, is SCE's District Manager for SCE's Catalina Island Utilities. His resume includes: Senior Project Manager; Edison's Regional Manager for the Asia/Pacific region; Project Manager for Guam Power Authority; started at SCE in 1988.

[7] Protestants expert witness, Brian J. Brady, is a consultant specializing in water utilities. He is a registered civil engineer in California. His resumé includes: General Manager – Imperial Irrigation District; General Manager – Rancho California Water District; Chairman, CEO – Dominguez Services Corporation; 12 years in various capacities as an engineer for SCE

ACCOUNT 615 POWER FOR PUMPING			
Year	**HITE, SCE-01, p. 16**	**Annual Reports**	
2005	$387,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$370,000	$330,622[8]	2007 Annual Report, Work Papers, p. 187
2007	$306,000	$262,594	2007 Annual Report, Work Papers, p. 187
2008	$312,000	$309,002	2008 Annual Report, Work Papers, p. 226
2009	$256,000	$265,283	2009 Annual Report, Work Papers, p. 264
2010	$291,000	$19,321	2010 Annual Report, Exhibit P-5, p. 23

SCE replies that the $19,321 figure in its 2010 Annual Report was an error which will be corrected in its 2011 Annual Report. The past five years of Power for Pumping costs were between $256,000 and $387,000. We find for test year 2011, $291,000 is reasonable.

7.2. Account 630 – Employee Labor

Protestants recommend that SCE's estimate of $819,000 be reduced by $114,500, the probable annual savings due to the Supervisory Control and Data Acquisition (SCADA) system, to $634,500. SCE showed that its most recent annual reports reported labor costs exceeding $900,000 per year. SCE's estimate of test year 2011 labor costs of $819,000 is reasonable. The SCADA system issue is discussed below in Section 10.1.

[8] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

ACCOUNT 630 LABOR			
Year	**HITE, SCE-01, p. 16**	**Annual Reports**	
2005	$1,024,000	$431,491	2005 Annual Report, Work Papers, p. 115
2006	$895,000	$436,931	2006 Annual Report, Work Papers, p. 149
2007	$878,000	$802,036	2007 Annual Report, Work Papers, p. 187
2008	$926,000	$972,332	2008 Annual Report, Work Papers, p. 226
2009	$952,000	$963,128	2009 Annual Report, Work Papers, p. 264
2010	$819,000	$1,110,766	2010 Annual Report, Exhibit P-5, p. 23

7.3. Account 640 – Materials

SCE is seeking $251,000 for Materials for Test Year 2011, the same amount it claims to have spent in 2010.

ACCOUNT 640 MATERIALS			
Year	**HITE, SCE-01, p. 21**	**Annual Reports**	
2005	$312,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$456,000	$406,779[9]	2007 Annual Report, Work Papers, p. 187
2007	$570,000	$627,314	2007 Annual Report, Work Papers, p. 187
2008	$298,000	$295,277	2008 Annual Report, Work Papers, p. 226
2009	$204,000	$203,585	2009 Annual Report, Work Papers, p. 264
2010	$251,000	$158,864	2010 Annual Report, Exhibit P-5, p. 23

SCE's witness testified as follows regarding this account:

> Materials captured in this account can be characterized in two broad categories; chemicals and hardware. Chemicals are used for activities such as water disinfection, treatment, and analysis. Hardware includes items used in pumping, transporting, and

[9] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

> storing water. The transportation of these chemicals and hardware items are also captured in this account and includes activities such as trucking on the mainland, as well as flying or barging over materials to Catalina Island.[10]

Protestants point out that the USOA is clear as to what should be included in Account 640.

> 640. Materials
>
> This account shall include all materials and supplies used in operation and maintenance of the water system, other than repair and maintenance materials charged to Account 650, Contract Work and chemicals charge to Account 618, Other Volume Related Expenses.

Protestants claim that chemicals are not to be charged to this account,[11] but instead should be charged to Account 618. Protestants argue that it is impossible to tell if any of the items charged to this account are the type of expenses the Commission ordered reported in Account 640. Therefore, Protestants recommend that the entire Materials account should be disallowed.

SCE counters that while it is true that chemicals are included as part of this account, in SCE's operations chemicals are considered to be materials. Going forward, (starting in the 2011 Annual Report) chemicals can be categorized into Account 618 and SCE agrees to do so. For ratemaking purposes, the Commission's Water Division and DRA have historically accepted SCE's inclusion of chemicals in this account. We will include the $251,000 for ratemaking purposes, but SCE is admonished to comply with the USOA.

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[10] Exhibit SCE-01 at 20, II. 13-19.

[11] D.85-04-076 at 40.

7.4. Account 650 – Contract Work

SCE is seeking $1,016,944 for Contract Work for test year 2011, the same amount it spent in 2010. SCE's witness testified that SCE's recorded expenses for contract work adjusted to constant 2009$ were as depicted in the following table, which also sets out the dollar amounts shown for Account 650 Contract Work in SCE's Annual Reports for the years 2005-2010:

ACCOUNT 650 CONTRACT WORK			
Year	**HITE, SCE-01, p. 23**	**Annual Reports**	
2005	$484,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$732,000	$616,807[12]	2007 Annual Report, Work Papers, p. 187
2007	$786,000	$693,860	2007 Annual Report, Work Papers, p. 187
2008	$541,000	$1,257,388	2008 Annual Report, Work Papers, p. 226
2009	$826,000	$151,223	2009 Annual Report, Work Papers, p. 264
2010	$1,017,000	$1,010,618	2010 Annual Report, Exhibit P-5, p. 23

Contract Work is a major item of SCE's revenue requirement. In 2010, the amount spent represents 25% of SCE's estimated operating revenues of $4,066,000. Contract Work is 14% of SCE's proposed revenue requirement. Contract Work is a broad general category. At a minimum, Protestants assert that in order to meet its burden of proof, a utility should present evidence listing the services for which it intends to contract in the test year, the anticipated cost of the services, and the reason it is using the services. This is particularly true of those services that could be performed by SCE's own employees. SCE's witness testified that SCE contracts for "maintenance of equipment at the pumping and

[12] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

treating facilities such as valve repair, cleaning and rebuilding of equipment; calibration of instruments and equipment; repair and replacement of failed equipment [and] … collection … of water samples."[13] Protestants state it is hard to imagine what is left for SCE's employees to do. These are all tasks normally performed by a utility's employees. The only item listed by SCE that is normally contracted for by water utilities is the analysis of water samples. This should only involve sending samples collected by SCE's employees to the mainland for testing.

Protestants' analysis persuades us. SCE predicts test year Contract Work at $1,017,000 while Employee Labor is only forecast at $819,000. Contract Work is estimated to more than double SCE's entire work force for the purpose of maintaining equipment, repairing valves, etc., work usually performed by employees. SCE has not shown why 2011 differs from prior years where Contract Work was substantially below the requested amount. SCE has not shown why Contract Work can't be done by SCE's own employees. SCE has not met its burden of proof. But, as there is a need for Contract Work, we estimate that $600,000 is a reasonable amount in test year 2011.

7.5. Account 660 – Transportation Expenses

The water that is provided throughout the island travels through more than 32 miles of pipeline outside the city of Avalon. SCE's operating permit requires SCE to monitor the water distribution system on a daily basis. In addition, there is a need to have vehicles and equipment to address water leaks as needed, in order to minimize the interruption of water services throughout

[13] Exhibit SCE-01 at 22.

the service territory. SCE's inventory of vehicles includes four service trucks, one backhoe, a dump truck, and a small pick-up truck. Reliable operations of these vehicles requires ongoing maintenance and repair, the costs of which are charged to this account. SCE is requesting a total of $49,000 for test year 2011; the same expense as 2010.

Account 660 Transportation Expenses			
Year	**HITE, SCE-01, p.25**	**Per Annual Reports**	
2005	$71,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$62,000	$56,395[14]	2007 Annual Report, Work Papers, p. 187
2007	$36,000	$33,373	2007 Annual Report, Work Papers, p. 187
2008	$41,000	$40,139	2008 Annual Report, Work Papers, p. 226
2009	$374,000	$34,171	2009 Annual Report, Work Papers, p 264
2010	$49,000	$748	2010 Annual Report, Exhibit P-5, p. 23

Protestants recommend only $748, the amount shown in SCE's 2010 annual report. Because of the constant use of equipment to service the water system, we consider $49,000 on the high side, but reasonable to ensure reliable operation of vehicles.

7.6. Account 670 – Office Salaries

SCE seeks $110,000 for Account 670 Office Salaries. SCE's recorded expenses for Office Salaries adjusted to constant 2009$ were as depicted in the following table, which also sets out the dollar amounts shown for Account 670 in SCE's annual reports for the years 2005-2010.

[14] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

Account 670 Office Salaries			
Year	**HITE, SCE-01, p.27**	**Per Annual Reports**	
2005	$82,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$85,000	$131,857[15]	2007 Annual Report, Work Papers, p. 187
2007	$105,000	$132,382	2007 Annual Report, Work Papers, p. 187
2008	$154,000	$202,182	2008 Annual Report, Work Papers, p. 226
2009	$110,000	$109,643	2009 Annual Report, Work Papers, p 264
2010	$110,000	$13,089	2010 Annual Report, Exhibit P-5, p. 23

The difference between what Mr. Hite testified are SCE's recorded expenses for Office Salaries and what SCE represents to the Commission in its annual reports is confusing. SCE's witness testified that SCE requests the same amount for test year 2011 as it recorded in 2010, i.e., $110,000. Protestants point out that SCE's 2010 Annual Report shows $13,089 recorded, for this account; therefore, we should allocate just $13,089.

This is not the only account where SCE's testimony regarding recorded amount differs from the amounts recorded in its annual reports. Again, these discrepancies make it very difficult to find that SCE has met its burden of proof. However, we must apply common sense. The testimony states that Office Salaries for the water company account for three part-time employees (the three split their time between SCE's Catalina gas, electric, and water companies). In our view, $13,089 is inadequate to meet the salaries of three part-time employees. The 2009 annual report amount of $109,643 appears sufficiently reliable on which to base a forecast. We find SCE's recommended $110,000 to be reasonable.

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[15] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

7.7. Account 671 – Management Salaries

SCE seeks $35,000 for Account 671 Management Salaries. Mr. Hite testified that SCE's recorded expenses for Management Salaries adjusted to constant 2009$ were as depicted in the following table, which also sets out the dollar amounts shown for Account 671 in SCE's annual reports for the years 2005-2010:

Account 671 Management Salaries			
Year	**HITE, SCE-01, p.28**	**Per Annual Reports**	
2005	$38,000	$0	2005 Annual Report, Appendix A, p. 115
2006	$39,000	$21,602[16]	2007 Annual Report, Appendix A, p. 187
2007	$52,000	$48,767	2007 Annual Report, Appendix A, p. 187
2008	$61,000	$59,621	2008 Annual Report, Appendix A, p. 226
2009	$35,000	$1,151	2009 Annual Report, Appendix A, p 264
2010	$35,000	$54,291	2010 Annual Report, Exhibit P-5, p. 23

SCE's estimate of $35,000 for test year 2011 is reasonable.

7.8. Account 674 – Employee Pension and Benefits

The USOA states what should be reported using this account:

674. Employee Pensions and Benefits

This account shall include all accruals under employee pension plans to which the utility has irrevocably committed such funds, and payments for employee accident, sickness, hospital and death benefits, or insurance therefore. Include also expenses for medical, educational or recreational activities of employees.

[16] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

SCE does not show an expense in this account; instead water employees' pension and benefits expenses are allocated to the utility through the Administrative and General (A&G) expense adjustment discussed below.

Protestants contend that Account 674 exists so that ratepayers and their representatives can determine if this expense is reasonable. Failure to use this account precludes SCE from seeking to include, directly or indirectly, employee pension and benefits expenses in its revenue requirement.

We discuss this issue below in Section 8.

7.9. Account 676 – Uncollectibles

SCE is seeking $9,000, based upon the same percentage (.229%) of revenue in its electrical GRC for uncollectibles.[17] Protestants argue SCE's collection experience for its gigantic electrical utility bears no relationship to its collection experience for its water utility on Catalina Island. SCE has apparently collected everything it billed because it never reported any uncollectibles to the Commission. Consequently, it should not be allowed any amount for uncollectibles.

SCE responds that water customers are on the same bill as electric customers so the uncollectibles would be the same. This is a common-sense approach and we agree.

7.10. Account 681 – Office Supplies and Expenses

SCE seeks $15,000 for Account 681 Office Supplies and Expenses. Mr. Hite testified that SCE's estimate for office supplies and expenses adjusted to constant

[17] Exhibit SCE-01 at 94, II. 6-9.

2009$ were as depicted in the following table which also sets out the dollar amounts shown for Account 681 in SCE's annual reports for the years 2005-2010:

Account 681 Office Supplies and Expenses			
Year	**HITE, SCE-01, p.30**	**Per Annual Reports**	
2005	$3,000	$0	2005 Annual Report, Work Papers, p. 115
2006	$10,000	$9,311[18]	2007 Annual Report, Work Papers, p. 187
2007	$8,000	$7,882	2007 Annual Report, Work Papers, p. 187
2008	$16,000	$15,809	2008 Annual Report, Work Papers, p. 226
2009	$13,000	$13,001	2009 Annual Report, Work Papers, p 264
2010	$15,000	$914	2010 Annual Report, Exhibit P-5, p. 23

We note that for the years 2006-2009, the amounts claimed as recorded expenses by SCE's witness correspond to the amounts reported in the annual reports for those years. Protestants assert there is no reason to believe that the amount reported for 2010 is any less accurate. SCE seeks the same amount in Test Year 2011 as was spent in 2010. Consequently, SCE should be allowed $914 for the office supplies and expenses in Test Year 2011.

It is difficult to understand how "adjustments made for escalation and other ratemaking mechanisms" (SCE Reply Brief at 4) can explain how a mundane account for office supplies could fluctuate from $13,000, to $914, to $15,000. On its face $914 seems wrong. In Exhibit SCE-01, SCE states that its office expense in 2010 is estimated at $15,000 and that SCE requests the same amount in 2011. The 2010 annual report shows $914 for this account. SCE has

[18] The 2006 Annual Report shows $0 for this account; it was corrected in the 2007 Annual Report.

not met its burden of proof. A practical estimate for the account seems closer to $10,000, which we find reasonable.

7.11. Account 689 – General Expenses

SCE seeks $31,000 for Account 689 General Expenses. Mr. Hite testified that SCE's recorded expenses for general expenses adjusted to constant 2009$ were as depicted in the following table, which also sets out the dollar amounts shown for Account 689 in SCE's annual reports for the years 2005-2010:

Account 689 General Expenses			
Year	**HITE, SCE-01, p.34**	**Per Annual Reports**	
2005	$314,000	$1,990,984	2005 Annual Report, Work Papers, p. 115
2006	$243,000	$940,455	2006 Annual Report, Work Papers, p. 149
2007	$156,000	$167,088	2007 Annual Report, Work Papers, p. 187
2008	$8100	$211,570	2008 Annual Report, Work Papers, p. 226
2009	$31,000	$230,760	2009 Annual Report, Work Papers, p 264
2010	$31,000	$670,738	2010 Annual Report, Exhibit P-5, p. 23

Mr. Hite's testimony varies widely from what SCE reported to the Commission for this account. He claims that "the majority of the charges to this account are related to the travel and lodging expenses for Catalina employees attending meetings and training on the mainland and other SCE employees' temporary stay on the Island to assist with water operations."[19]

There is no way to judge the reasonableness of the amount sought for this account. Resolution W-4665 found that in 2005 the water company had operating revenue of $1,300,610. The annual report for 2005 says travel and lodging for the water company was $1,990,984. Mr. Hite says the correct number

[19] Exhibit SCE-01 at 32, II. 11-14

was $314,000. How could either number be accurate? We see similar discrepancies in the years 2006-2010. Reluctantly, because we know that a certain level of travel and lodging are needed to operate the water company, we will find $31,000 to be reasonable.

7.12. Account 480.2 – Other Operating Revenue (OOR)

SCE proposes to assign $153,000 in forecasted revenue received from cellular telephone companies as a credit against the revenue requirement in the test year. Protestants argue that the credit should be increased to reflect $846,000 in revenue received in prior years. SCE contends that such a result would be a violation of the prohibition against retroactive ratemaking. We agree. We will include $153,000 in OOR.

8. Administrative and General (A&G) Expenses

SCE requests $535,000 in A&G expenses for its Catalina water operations, which is the allocation of 0.06% of SCE's overall A&G expenses. SCE's overall A&G expense of $1.056 billion consists of SCE's company-wide A&G expenses, which, SCE claims, includes the currently-unallocated portion of the expenses that directly relate to the support of the Catalina water operations. Among other A&G expenses, SCE's electric customers are currently paying for the pensions and benefits of SCE's Catalina water employees. SCE states that it is trying to allocate a fair portion of SCE's overall A&G expenses to water ratepayers, expenses that are related to services that those ratepayers enjoy. If the Commission approves this re-allocation, SCE will in the future report the allocated components in its water annual reports in the appropriate accounts, in compliance with USOA guidelines. This will apply to Accounts 618, 674, and 676.

SCE used the "four-factor allocation" method to allocate 0.06% (or $640,000) of its company-wide A&G expenses to its Catalina water operation.[20] SCE subsequently corrected that number downward to $535,000 in response to TURN's testimony. SCE states the reason it allocated company-wide A&G to Catalina water is that previously there was a discrepancy between how it allocated costs for common plant expenditures (which have always been allocated to the water utility) and A&G expenses (which have previously been borne by electric ratepayers).[21] The $535,000 figure is a proxy for all of the A&G expenses associated with SCE's services that Catalina water customers currently use, including: the pension and benefits costs for Catalina water employees; legal, accounting, regulatory, and other employee costs that perform work for the water utility; off-Island information technology and other support services; and many others.[22]

Standard Practice U-6-W sets forth the procedures a California water company should follow for indirect allocations such as A&G expenses. The standard states that:

> … indirect expenses may be so general in nature as to require pro-rations based on a combination of several pertinent factors. Considering the relative complexity and magnitude of the

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[20] Exhibit SCE-04, Ch. III. at 16-21; *see also* Standard Practice U-6-W "Standard Practice for Allocation of Administrative and General Expenses and Common Utility Plant and the Four-Factor Method," D.07-11-037 (Golden State Water Company); D.10-11-035 (Golden State Water Company); D.87-11-062 (Park Water Company – Vandenberg Disposal Division); D.09-03-007 (Suburban Water Systems); D.03-10-005 (California Water Service Company).

[21] Exhibit SCE-04, Ch. III at 16.

[22] Hite, Tr. Vol. 4 at 430:25-433:6.

operations usually involved, it is believed that the application of the arithmetical average of the percentages derived from the use of four factors listed below produces results within the range of reasonableness in most instances. The four factors are as follows:

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

SCE utilized these same four factors in its four-factor allocation to allocate indirect A&G expenses from the electric utility to the Catalina water utility.

Southern California Edison's Four-Factor Allocation					
Line No	**Description**	**Gas**	**Water**	**Electric**	**Total**
1.	2009 Year end Customers Allocation	0.03%	0.04%	99.93%	100%
2.	2009 Year end Employees Allocation	0.02%	0.05%	99.93%	100%
3.	2009 O&M Allocation	0.03%	0.08%	99.87%	100%
4.	2009 Year end Gross Utility Plant Allocation	0.01%	0.08%	99.91%	100%
5.	Average percentage	0.02%	0.06%	99.92%	100%

DRA has proposed a figure of $189,000, premised on its opposition to SCE's proposed new line items for A&G. SCE's A&G allocation stems from applying the four-factor methodology to SCE's total company A&G amounts. DRA asserts it 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.

DRA says SCE created confusion in its workpapers and the R/O model because the model incorporates the 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 failed to demonstrate 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 consistent with the models used by other regulated water utilities. DRA recommends that SCE be required to submit a better R/O model for its next Catalina water GRC.

Protestants point out that SCE's water utility is a tiny part of a gigantic electrical generating and distribution company. Protestants claim that the district manager of the water company had little knowledge of whether the water utility benefits from the A&G expense. A&G expense was not included in his monthly budgeted expenses to actual expenses report. For the 48 years prior to this application, SCE allocated no A&G expense to its water or gas utility, allocating these expenses to its electrical customers. SCE is a large electric utility; it owns one tiny gas utility and one tiny water utility. In sum, Protestants contend that SCE's A&G expenses exist to support its electric business, not its water utility on Catalina Island. Protestants describe the situation as one where we have a utility providing water and gas in a very small geographical area while providing electricity in a much larger area and incurring substantial administrative expenses in connection with its electrical business that in no way benefit the gas and water utility. It is not reasonable to expect the small gas and water utility to bear a fractional portion of expenses that in no way benefit them.

Protestants argue that the evidence does not establish the reasonableness of departing from SCE's practice, apparently followed since 1962, of allocating A&G expenses to its electrical customers. Since the electrical customers coming to the Island are major users of water, charging them for whatever little benefit the water utility gets from SCE's A&G expenses, as SCE apparently has done since 1962, is both reasonable and equitable. SCE claims that A&G expenses are the way it seeks to include its pension and benefits costs in its proposed revenue requirement. Protestants argue that the proper way is to use Account 674 Pensions and Benefits. By properly reporting these expenses in accordance with USOA in its annual reports, SCE can obtain an amount for pensions and benefits in future GRCs. Protestants state that SCE has not met its burden of proof with regard to A&G expenses, and nothing should be allowed.

We agree with SCE. Although common capital plant costs have been historically allocated among its three utilities (SCE systemwide electric, SCE Catalina water, and SCE Catalina gas), A&G costs were not (10% allocation to SCE's systemwide electric). The $535,000 proposed A&G cost recovery (0.06%) is a proxy for all of the A&G expenses associated with SCE's services that Catalina water customers currently use, including: the pension and benefits costs for Catalina water employees; legal, accounting, regulatory, and other employee costs that perform work for the water utility; off-Island information technology and other support services; and may others. SCE has made a corresponding -0.06% reduction in its proposed electric rates.[23] SCE has demonstrated through the four-factor allocation method (which is Commission-

[23] *See* Exhibit SCE-04, SCE Rebuttal at 16; A.10-11-015, Exhibit SCE-25.

endorsed per Standard Practice U-6-W) that its proposal allocates a fair portion of company-wide A&G costs to Catalina water rates. Catalina water employees have real Pensions and Benefits costs, which make up a substantial portion of overall A&G expenses. We adopt SCE's proposed A&G cost recovery.

9. Overview of Capital Accounts

The scoping memo provides that the issues within the scope of this proceeding include capital projects and rate base going back to 1985. Protestants raise this issue because of the great disparity between what SCE spent for capital improvements in the past and what it has spent in recent years. Deferring capital improvements both increases their cost and causes current ratepayers to bear the burden of what should have been spread over earlier years.

Mr. Brady, expert witness for Protestants, reviewed SCE's capital expenditures since 1985. Here are his findings:

- In 1985, SCE spent $64,900 on capital improvements, and its rate base for the Catalina Water subsidiary, adopted by the Commission, was $4,538,000.
- From 1985 to 2000, a period of 15 years, capital improvements averaged $175,129 per year. Thirty-four percent of the amount for capital improvements was spent on new wells. Only $74,397 was spent per year on maintaining existing infrastructure.
- Capital improvements between 2000 and 2005 were included in Advice Letter W000144, filed December 9, 2005. In that Advice Letter, SCE sought to increase its rate base by $5,986,000. In Resolution No. 4665, issued November 1, 2007, the Commission added $6,838,965 to the rate base and adopted a rate base for SCE of $10,851,000 for 2007.
- In this GRC, SCE seeks to increase its rate base by $15,930,000.
- From 1985 to 2000, a period of 15 years, SCE spent $2,626,941, or $175,129 per year, on capital improvements. From 2000 to 2010, a period of 10 years, SCE spent $18,758,965, or $1,875,897 per year.

> Such spending in the period 2005-2010 is either as a result of neglect of the system in prior years or an attempt to make the utility more saleable, or a combination of the two.

Protestants assert that there is a correlation between SCE' sudden change in its pattern of capital expenditures and its desire to sell its water utility. None of the capital improvements made since 2000 were made because of customer growth. There has been little growth in the service connections since 2000. Protestants state that current ratepayers should not have to pay for capital improvements that are a result of deferred maintenance or which are intended to make the water utility more saleable. We discuss the specific additions to rate base below.

9.1. Station Office Betterment

SCE seeks approval of $1,295,500, the amount to be added to its rate base at a later date, as the water utility's 25% share of the $5,182,000 SCE is spending to remodel offices. Protestants contend there is no evidence as to how 25% was arrived at.

Mr. Hite testified that the office employees working for the water utility consisted of the following:

- Two clerks who work part-time for the gas utility and part-time for the water utility.
- One customer service representative working for all three utilities.
- Mr. Hite himself who is working for all three utilities.[24]

[24] RT 315, l. 3-15.

Mr. Hite testified that there were 29 office employees working in the remodeled office. Needless to say, the four part-time water utility employees referenced above do not make up 25% of the office employees.

Again, SCE has failed to meet its burden of proof with regard to the money it seeks for Station Office Betterment. Assigning 25% of the cost to the water utility appears arbitrary and is not based upon any reasonable attempt to allocate the cost between the three utilities based upon the number of office employees of each utility who use the office space. SCE is not seeking to have the requested amount included in its rate base in this proceeding because the project will not be completed in 2011. Approval of the requested amount at this time will be denied. SCE may request a reasonable amount for this project in its next water rate case.

10. Capital Projects and Rate Base

This section provides descriptions of the capital projects expected to be completed and placed into service between 2005 and the end of 2010. The table below lists each project, the related capital expenditures, and our adopted rate base amount.

Summary of Capital Expenditures
($ millions)

Project	SCE Request	Adopted
Water SCADA	$2.187	.500
Pump House #2 Replacement	$4.568	2.510
Pebbly Beach Water Line Replacement	$0.393	.343
Middle Ranch Canyon Bedrock Piezometers	$0.392	.392
West End Pipeline Replacement	$0.755	.755
Isthmus Area Water supply & SCADA	$0.975	.389500
Thompson Reservoir Siphon	$2.160	2.160

Catalina Island Fire Watershed and Above-Ground System Restoration Projects	$3.204	0
Total	$14.634	7.090

In November 2007,we issued Resolution W-4665 which found reasonable, and adopted, a rate base for SCE's Catalina water company of $5.l4 million in 2005, increasing to $10.4 million in 2008. Today SCE seeks a rate base of $23.8 million for test year 2011; an increase of approximately 130% in three years. We review the projects that are included in that increase to determine if they are reasonable.

10.1. Water Supervisory Control and Data Acquisition (SCADA) System

SCE seeks the $2,327,000 it spent for a SCADA system added to rate base. A SCADA system obtains data, such as the level of water in a tank, and transmits it to a central location. The system can also be designed to allow equipment located in a remote area to be started or stopped from a central location. The SCADA system installed by SCE did not integrate the five individual water systems. Rather, it provides information at a central location and some control over equipment from the central location. It went into operation in late 2007.

Protestants do not oppose the installation of a SCADA system, but claim SCE spent far too much for the system. Ratepayers should only have to pay for a system suitable to the size of the water utility, obtained at a reasonable cost. Protestants recommend $500,000 as a reasonable cost. TURN recommends total denial of costs. It later agreed with Protestants that $500,000 was reasonable. DRA supports SCE.

Protestants assert that in attempting to justify the system, SCE greatly exaggerated the extent and complexity of the five individual systems operated

by the water utility, and also greatly exaggerated the extent of the SCADA system. Mr. Hite testified that the SCADA system provides integrated control and monitoring capabilities for the water facilities at the following locations:

1. Pebbly Beach Generating Station
   (central location for control and monitoring)
2. Pump House #2
3. Middle Ranch Wells
4. Wrigley Reservoir
5. Baker Tanks
6. Million Gallon Tank
7. Pressure Reducing Stations

The SCADA system for the Million Gallon Tank is included in the Isthmus Area Water Supply and SCADA project discussed below. Protestants' expert testified that all of the other locations are part of the system that serves Avalon. We conclude that this project did not integrate the many remotely-located components of a geographically extensive and very complex system. Rather, it provides data and control over a single system serving Avalon.

SCE seeks to add $2,327,000, including the Isthmus portion of the system, to its rate base for the SCADA system. SCE's water revenue in 2009 was $3,843,870. It had operated without a SCADA system for over 45 years. A decision to put in a system that cost 60% of operating revenue can only be based upon one consideration – tremendous cost savings. This fact is recognized by SCE. Mr. Hite testified: "One of the tenets of a professional engineering

assessment is that the recommendation must be cost-effective. … This type of automation assists to reduce overall costs."[25]

To justify the cost of the SCADA system, SCE's engineers prepared a document in which they predicted with 100% probability the following cost savings:

O&M & Admin. Labor/Personnel	$184,500	per year
O&M $ Admin. non-labor (Nat'l, Transp/IMM, Tools, Contr)	$284,906	per year
SCADA Water Loss Reduction Savings	$120,161	per year[26]

SCE points to this document as the justification for installing the SCADA system.[27] SCE has not offered one bit of evidence as to how the SCADA system has reduced costs. Mr. Hite could not identify any savings attributable to the SCADA system.

Mr. Brady discussed what other water utilities paid for SCADA systems, having himself purchased and upgraded several systems:

- The extent of the system is based upon what a utility can afford relative to its revenue stream, normally just what you absolutely need.
- Fallbrook Water District is four or five times larger than SCE's water utility and its SCADA system cost just under $500,000 and it also controls a wastewater treatment plant.
- Borrego Springs's SCADA system cost $300,000.

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[25] Exhibit SCE-04 at 26, II. 17-19 at 27, I. 10.

[26] Exhibit P-8, Appendix G.

[27] Appendix G: The SCADA system had a $4.3 million net present value benefit, which is a benefit—to-cost ratio of more than 2 to 1. (*See,* Exhibit SCE-04 at 28, II. 1-2.)

- Foothill Municipal Water District's SCADA system was estimated at $500,000 and came in at $365,000, and the water system is twice the size of SCE's.

Mr. Brady also explained why SCE's SCADA system cost so much:

- SCE spent $100,000 on an engineering assessment and $1,000,000 on engineering for a system that cost $865,000 to install.
- SCE should have gone out for bids to companies that regularly install SCADA systems and include the cost of engineering and project management in the cost of the equipment because the engineering and technology is fairly standardized.
- There is nothing particularly unusual about Catalina Island that would impede the installation of a SCADA system.

TURN refers us to SCE's rebuttal which claimed "the SCADA system had a $4.3 million net present value benefit, which is a **benefit-to-cost ratio of more than 2 to 1.**"[28] Appendix G of SCE's rebuttal testimony shows a calculation of over $4 million in savings that will result from the increased efficiency of operations due to the SCADA system. TURN points to several problems with SCE's calculations. First and foremost, nowhere in SCE's testimony and supporting papers does the utility include the dollar savings from the increased efficiency of the SCADA system as an offset to the request in their application. Under SCE's approach, its customers bear all of the costs, but its shareholders reap all of the benefits. Furthermore, Mr. Hite admitted that SCE has not, even four years later, quantified any benefits from this system:

> Q Your answer is nonresponsive. I'm asking you about savings, dollar savings that would translate to ratepayers. It is your answer that you cannot say with any certainty whether even $0.01 was saved of this item here O&M, administrative, nonlabor, material

[28] SCE Exhibit-04 at 27-28 (emphasis in original).

> transportation, IMM tools and contract, outside contracting, since the SCADA system was put in?
>
> A What I've said was there was a savings. I couldn't quantify that without looking further into the details. (RT at 346.)

TURN asserts it is easy for SCE to claim that there are efficiencies from SCADA, but those claims are not based on cost savings in the data presented in this record.

SCE's witness testified that prior to the installation of the SCADA system, remotely-located water facilities were operated by personnel dispatched to each of the various locations during normal business hours. Given the remoteness of various sections of the system, the system was operated manually and very little monitoring instrumentation existed prior to the upgrade. Accordingly, potential problems with the system could go undetected for long periods of time because they could not be monitored remotely due to their antiquated instrumentation and controls. With the installation of the SCADA system, the system now can be monitored around the clock by the central control room located at the Pebbly Beach Station. As a result, operators and/or maintenance personnel can be dispatched in a timely manner to correct any trouble situations. Witness Hite said the installation of a SCADA system provides more reliable operation and maintenance as it provides real time data on the system, provides for better water management, automatically records any and all regulatory-required data, and provides for a more secure and safe operation because of the installation of intrusion monitors.

SCE disagrees with Protestants' and TURN's conclusions regarding water SCADA and assets that the small water utility example cited by both TURN and Protestants is really not comparable to SCE's water operation on Catalina Island. SCE's water operation faces different challenges than a typical small water

utility. It is a lot easier to get to outlying facilities on paved streets or flat graded roads than it is over mountainous terrain on roads subject to being washed out or too steep and muddy to traverse. Thus, SCE contends that the SCADA system is cost-effective, and has the additional justification of reliable data acquisition for regulatory purposes. As Appendix G demonstrates, the SCADA system had a $4.3 million net present value benefit, which is a benefit-to-cost ratio of more than 2 to 1.

SCE admits that SCE operated its water utility for over 45 years without a SCADA system. However, as Mr. Hite testified, operating the water system prior to the installation of the SCADA system is not as reliable, is more labor intensive, and could lead to unacceptable operating and reliability issues. The equipment and instrumentation and controls are not suitable for connection to a SCADA system as they are outdated. SCE maintains that the timing for the installation of the SCADA system is appropriate, because it was installed with other more recent system changes such as the replacement of Pump House #2. In response to SCE's data request, Protestants provided an evaluation that Mr. Brady conducted for the small Borrego Water District. In that assessment, Mr. Brady concluded that its water SCADA system was technologically appropriate for this small, remote water utility. SCE contends that Protestants' own witness acknowledges that a SCADA system is appropriate for small water utilities.

Mr. Hite said TURN's testimony suggests that spending $1,200 for every customer on a SCADA system is not reasonable. In his opinion, TURN's conclusion is incorrect because it neglects the need for the SCADA system and the subsequent benefits derived, including the benefit-to-cost ratio described above.

In our opinion the SCADA system is too expensive for this small water company. Therefore, we will allow only $500,000 of capital expenditure for the SCADA system. It is a system that cost $2,327,000 for a company whose water revenue in 2009 was $3,843,870, a cost of almost $1,200 per customer. The SCADA system may be convenient but it is not necessary. However, it is useful and for that reason we will allow $500,000. Merely because SCE spent $2,327,000 does not make the expenditure reasonable. That is why we have reasonableness review hearings. SCE must demonstrate that the expenditure is reasonable: in our opinion, the conflicting evidence shows that $500,000 is a reasonable expense for the SCADA system.

10.2. Pump House #2

SCE seeks $4,567,753 for the replacement of Pump House #2. No party disputes that the pump house itself and the single horizontal pump inside needed to be replaced. The dispute is over costs. Protestants believe the cost should have been about $2 million, which is all that should be allowed.

The pump house and its equipment were in service in 1930. The pump house and its single pump were 32 years old when SCE took over the water utility. It is the lynch-pin of the system that serves 95% of its ratepayers. The primary source of water for Avalon is three wells in Middle Canyon. Pump House #2 pumps that water to the Wrigley Reservoir which serves Avalon.

There were 1,965 water service connections in 2007, and there were 1,977 service connections in 2010, an increase of 12 connections. Demand is flat, if not lessening.

Protestants' expert, Mr. Brady, reviewed SCE's workpapers and testified that 50% of the pump house replacement cost, or $2,268,696, was for SCE's engineering and management of the project. Material and Construction was

only $2,229,057, and that includes $510,000 for three vertical pumps, which Mr. Brady testified were unwarranted when a single horizontal pump had served for 80 years.

Mr. Brady testified that an engineering assessment was made to determine whether the 80+ year old pump house, which was falling down, needed to be replaced. This study took SCE's engineers over 14 months (2,470 man-hours) to complete, at a cost of $210,000, to reach the obvious conclusion: the pump house was falling down and the pump needed to be replaced. It took over 16,000 man-hours to design the pump station that houses just three pumps. This is equivalent to eight engineers working full time for over one year. Despite the incredible amount of time charged to the project for engineering, the plans had significant errors, which resulted in $500,000 in change orders. Mr. Brady testified that a pump station this size should require three months of onsite construction, even on Catalina Island. The construction management cost was $527,515 and the project management cost was $142,578. This totals $670,093, or the equivalent of four men working for one year on a three-month project.

Protestants admit that the pump house and its single pump needed to be replaced, but state that SCE has not met its burden of proof that the amount SCE spent for the project -- $4,567,753 -- is reasonable. In Protestants' opinion, $2,000,000 is reasonable. Protestants argue that regulated utilities and particularly Class C utilities are typically extremely cautious about expending capital because of their limited resources. As a result, the issue is usually under-spending, not over-spending. Unlike the typical Class C water utility, SCE has virtually an unlimited capital supply from the standpoint of its water utility. However, simply because a water utility spends money on capital improvements, does not mean that the ratepayers have to repay it.

Mr. Hite testified that Pump House #2 performs a vital function in the water system in that it is the sole means of transferring water between the Island's water supply and SCE's customers in Avalon. He said the pump house replacement has been deferred for years because until recently it has continued to perform as originally intended. The pumping facility had only recently begun to experience reliability problems. In addition to correcting reliability issues, the old pump house was not very secure or safe, and security and safety are now a large part of SCE's engineering and operating criteria. Mr. Hite said that SCE had years of experience with regard to water systems and pump houses. The engineering required to design or improve steam electric generating stations, hydroelectric generating facilities, and fuel oil storage pumping and piping systems is all applicable to water systems and pump houses. All of the engineers and designers in SCE's Engineering and Technical Services (E&TS) group have many years of appropriate experience. Over the years, the E&TS group has designed, installed, and started up many pumping systems.

Protestants argue that moving the pump house 60 feet up the valley would have saved $250,000 in tree removal and foundation costs. Mr. Hite said there is no evidence in support of this number. Furthermore, moving the pump house 60 feet up the valley would have had it located outside of the existing lease area with the Catalina Island Conservancy. Acquiring new land lease rights would have added time to the schedule and expense to the overall project.

Protestants argue that SCE spent an inordinate amount of engineering cost/time, 2,470 man hours, to reach an obvious conclusion. Mr. Hite countered the time was necessary because it also included the time to perform preliminary engineering for a number of alternatives, to develop the scope of the work, material list, resource schedule for each alternative, and to perform the cost

estimates for each alternative. It also included a number of scope changes during the process. This work in developing the scope of work for various alternatives is part of a standard engineering evaluation.

Protestants argue that the pump house was over-designed, resulting in unneeded construction. Mr. Hite countered that in addition to the pump house, there were additional items included in the cost of the project:

1. The design for the relocation of the Middle Ranch Canyon Creek.
2. A new flood control channel was designed which also required the design of a footbridge across the channel. This design had to be redone to cope with the watershed threat as a result of the May 2007 wildfire.
3. A no-climb fence required for water system security.
4. A new concrete driveway
5. A new Motor Control Center and electrical switchgear.
6. The following items required by the Los Angeles County Fire Department (LACFD):
    a. A new fire suppression system consistent for the severe hazard Zone IV region of Catalina;
    b. A new, exterior underground fire water system with a hydrant for use by the LACFD; and
    c. A graded three-point turn area to accommodate LACFD fire trucks.

In addition, the LACFD required a fire water flow of 1,250 gallons per minute (gpm) which SCE could not provide without expanding the size of the entire pump house water supply. SCE expended a considerable amount of time negotiating a variance with the LACFD to get them to accept a smaller fire water flow (775 gpm) that could be provided by the existing water system. This negotiation resulted in significant savings.

Mr. Hite testified that Protestants argue, without any analysis, that the engineering for a project this size should not have been over 10% of the total cost. Protestants do not provide support or data for this number. The 10% number might be reasonably accurate for a "greenfield site," but it does not take into consideration the unique circumstances of designing a retrofit installation, some of which were:

1. The "as-is" conditions had to be verified;
2. Demolition packages had to be prepared;
3. System, equipment, components, construction methods, etc. had to be examined and designs made to accommodate the complex design conditions that exist on the site and to minimize the costs of transportation to and from an island location; and
4. There were numerous regulatory and permit compliance required changes.

Mr. Hite testified the engineering required for this project is consistent with projects that are similar in size, scope, and complexity. While it is true that SCE spent $1,388,603 on Engineering, Technical Support & Permits, this amount is warranted by the scope of work and the scope changes during the course of the project.

Protestants stated that despite the incredible amount of time charged to the project for engineering, the plans had errors which resulted in $500,000 in change orders. Mr. Hite testified that that figure is overstated and not supported with factual evidence. He said Protestants have apparently equated scope changes with errors. While there may be inevitable errors in a design, by far the greatest cost changes in this project are related to the changes in scope and/or unforeseen events once the project had begun. The great majority of the approximately $500,000 in change orders relates to a single change order in the

amount of approximately $350,000 as a direct result of the unanticipated May 2007 fire.

Protestants state that "The cost of over $510,000 for pumps and motors is over twice what the cost should be for a pump station this size." Mr. Hite testified that Protestants' number is simply wrong. He said that the materials cost for the project totaled approximately $510,000, including approximately $95,000 in scope changes during the project to up-rate the pump capabilities and add the fire system as required by the fire department. The pumps and motor did not cost $510,000; they cost $225,000; the total cost for all of the construction materials was $510,000.

Protestants state that MCS Construction received a contract of $1 million to construct Pump House #2 and argue that it would have been considerably less if the project had not been over-designed by SCE's engineers. Mr. Hite responded that Protestants' claims are erroneous. The final contract for MCS Construction was approximately $1.5 million, and with the $510,000 for materials the total cost of these two items is approximately $2 million. The remainder of the $2,229,057 (approximately $230,000) was for such items as tree removal and trimming, and other construction-related contracts such as environmental remediation, inspection services, etc.

Mr. Hite contends Protestants argue without any factual analysis that the construction schedule should have been only three months. This argument is not a realistic reflection of the actual facts surrounding the construction of the pump house. The schedule was considerably longer due to the scope changes that occurred during construction, most notably the flood channel redesign necessitated by the May 2007 fire. The fire itself also delayed the project schedule.

Mr. Hite contends that Protestants argue without any factual analysis that SCE spent $142,578 on project management costs and $527,515 for construction management for a total cost of $670,093, or four men for one year on a three-month project. This project took over two years for all of the work to be done including the preliminary engineering, permitting, final engineering, construction, start-up, testing and turnover to Operations. To manage this project required $142,578 and $528,000 in project and construction management. SCE claims the $4,567,753 replacement cost for Pump House #2 is both reasonable and justified and should be included in the GRC.

DRA supports SCE because SCE utilized competitive bidding in selecting the contractors and supply vendors to build the new pump house, and it awarded the work to the lowest bidder (about 30% lower than the second lowest bidder). Any cost increases in this project were due to change orders/scope changes. 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 LACFD requested the FDC and the Island Conservancy requested diverting the stream and fence. There were all special provisions that are not typical of a water utility's plant construction projects. Lastly, the pump house is similar to other facilities DRA has observed with other Class A water utilities.

Our concern is the cost, especially the engineering costs. We agree that the construction was necessary, but the engineering costs were excessive. There is something radically wrong when the experts can differ so widely on the time necessary to replace, at the site, a pump house and one pump for a Class C water company. Mr. Brady says three months; Mr. Hite says two years. SCE charged

$2,267,000 for engineering and project management by its own engineering department out of a total cost of over $4,500,000. This was not part of a competitive bid. DRA argues that the pump house is similar to other facilities DRA has observed with Class A water utilities. That observation is the heart of the problem. SCE's water utility is a Class C water utility. It has less than 2,000 connections. A Class A utility has at least five times the customers and should be able to afford more elaborate facilities. When possible we should avoid saddling ratepayers with facilities they cannot afford. The SCADA system is a prime example; the excessive pump house costs are another. We agree with Mr. Brady: a Class C utility operator would have constructed the pump house at a much lower cost. We find that $2,500,000 is a reasonable cost to put in rate base for Pump House #2.

10.3. Pebbly Beach Water Line Replacement

In 2006, SCE installed a new fresh drinking water pipeline to the Pebbly Beach Village at a cost of $393,420. Only DRA opposes its costs, because of cost-sharing of a combined fire water and drinking water project with the Santa Catalina Island Company that fell through. In DRA's view, SCE's customers should not have to pay for fire water infrastructure, which in this case is the responsibility of the Island Company. SCE explained that when the Island Company delayed on the potential joint project, SCE unilaterally went forward and built the drinking water line ***only***. The Island Company built its own fire water line. Accordingly, SCE is asking that its customers pay only for drinking water infrastructure, which is used and useful and providing service to SCE's ratepayers. We agree. The $393,420 cost for the Pebbly Beach Water Line Replacement project is reasonable and justified and should be approved.

10.4. Middle Ranch Canyon Bedrock Piezometer Project Costs

SCE seeks $392,064 for this project. No party objects to these project costs and they should be approved.

10.5. West End Pipeline Replacement Project

SCE seeks $754,951 for this project. Protestants agree that the pipeline needed to be replaced, but, they contend, it should have been replaced long ago. They claim this is another project where engineering and project management -- $280,298, or 37% of the project cost -- is much greater than a project of this nature should incur. This was simply a project to replace a 60-year old pipe that failed. SCE said it does not replace safe piping that might not need replacing for years or decades. Mr. Brady testified that Commission-regulated water utilities have a regular program of updating and upgrading their systems and replacing infrastructure. SCE's approach puts the cost of replacement on current ratepayers when a pipeline fails, instead of spreading it over the years the ratepayers are benefiting from the pipeline. Protestants recommend that current ratepayers should not be saddled with costs that should have occurred earlier; the amount SCE seeks should be reduced by 50%. We disagree. The water line needed to be replaced, and the $754,951 cost is reasonable.

10.6. Isthmus Area Water Supply and SCADA

SCE seeks to have $975,147 added to its rate base for repairs to the Million Gallon Tank, for installation of a portion of the SCADA system, and for installation of a supply line to a single customer. The SCADA installation cost was $140,000. The single customer is the Banning House at the Isthmus; the installation cost $340,000. The cost of repairs to the Million Gallon Tank was $495,000.

The Isthmus Area Water Supply system used the Million Gallon Tank as the core of its operation. The Million Gallon Tank was constructed in 1967 as part of the "Enlarged Water Facilities" project in order to meet the fire water needs of the University of Southern California (USC) Marine Biology Laboratory located in Fisherman's Cover. The tank was constructed to hold 900,000 gallons of fire water storage and an extra 100,000 gallons of storage capacity to serve the Isthmus community on the west end of the Island. Studies between 2002 and 2006 indicated that the tank level frequently fell well below the required 900,000 gallon level necessary for fire protection. This was not only unacceptable based on the 900,000 gallon commitment for fire water supply, but it also meant that the remaining 100,000 gallon storage that acted as backup to the Isthmus water system was often not available in case of an emergency. The Isthmus system also feeds the Banning House (a hotel in the Isthmus area) which sits about 150 feet above the rest of the system. Water pressure had decreased to an unacceptable level. In order to alleviate this problem, a new 3-inch polyethylene pipe loop was constructed to the Banning House.

Mr. Hite testified that the work was necessary for fire protection and safety reasons, to comply with SCE's agreement with the USC laboratory, and to solve other associated piping and controls problems in the Isthmus water supply system. The Million Gallon Tank was built solely to provide fire protection for USC's facilities located at the Isthmus. The LACFD required USC to have 900,000 gallons available for fire protection. It was built pursuant to an agreement dated November 1, 1967, between USC and SCE[29] which provides

[29] Exhibit SCE-06.

that "so long as [SCE] is obligated to provide public utility water service to the Laboratory, [SCE] will operate and maintain the Enlarged Water Facilities."[30] Paragraph 4 of the agreement provides a cost-sharing formula; a letter dated May 3, 1979, provided by SCE shows a cost-sharing formula of 90% to USC and 10% to SCE.[31]

SCE has not met its burden of proof with regard to the entire $975,000. A substantial portion of the amount sought should have been borne by USC. Ratepayers should not be charged for maintaining USC's fire protection tank. We calculate the appropriate amount as follows:

SCE Request		$975,000
Less Banning House	$340,000	
Less SCADA	$140,000	
		$495,000
Less 90% to USC		-445,500
Rate base – Million Gallon Tank		$ 49,500
- Banning House		340,000
Total Rate Base		$389,500

We find it reasonable to add $389,500 to SCE's rate base for the repairs of the Million Gallon Tank and the line to the Banning House.

10.7. Thompson Reservoir Safety Drain System (Siphon)

10.7.1. Background and Project Need

The Thompson Dam Middle Ranch Reservoir captures rainwater runoff, and is hydrologically connected to the groundwater wells which provide the majority of the Island's fresh water. During a routine inspection in 2004 of the

[30] *Id.* at paragraph 3 of the Water Facilities Agreement.

[31] *Id.*

dam that impounds the reservoir, the California Department of Water Resources Division of Safety of Dams (DSOD) questioned the operability of the 10-inch emergency drain line that was a part of the original construction of the dam prior to SCE taking over the water system on Catalina in 1962. The drain was subsequently tested and found to be inadequate to meet the DSOD requirements due to plugging.[32] The line was cleared, but it soon partially plugged once again. In parallel, SCE conducted engineering calculations that demonstrated the inability of the originally-installed 10-inch drain line to meet current DSOD criteria for a 7-day drawdown, even if the plugging were completely eliminated. Thus, SCE determined that new drainage facilities sufficient to comply with DSOD requirements needed to be installed.

SCE installed a siphon at Thompson Reservoir at a cost of $2.160 million, so that the reservoir could be quickly drained in the event that the structural integrity of the dam is damaged in an emergency, in accordance with DSOD regulations. DRA supports the cost of the project. TURN questions its costs. Protestants argue that the project is a result of a failure to maintain existing infrastructure. The DSOD questioned the operability of the 10-inch emergency drain line. Protestants say this is not surprising. The drain had to be regularly operated and maintained. SCE failed to do so. Ultimately, the drain was abandoned and replaced with a siphon, but not, in Protestants' opinion, before an inordinate amount of money was spent on an engineering assessment -- $659,000, or 31% of the amount sought; an incredible 63% of the project cost was spent on engineering and project management. Regarding the maintenance

[32] The emergency drain is necessary to relieve pressure in case of a seismic event or other emergency that weakens the dam.

issue, SCE explained that the original drain, even if perfectly maintained, would not have met the new DSOD requirements. We find that Protestants' arguments do not adequately consider the necessity of this safety- and regulatory-requirement-driven project.

While the overhead costs seem high, the problems encountered during the safety review provide sufficient explanation. The $2.160 million cost for the Thompson Reservoir Siphon project is reasonable and justified.

10.8. Catalina Island Fire – Watershed and Above-Ground System Restoration

SCE spent approximately $3.2 million to repair and replace necessary capital infrastructure after the May 10, 2007 wildfire that destroyed more than 4,200 acres of watershed area and severely damaged the potable water system to the city of Avalon. SCE requests that the entire $3.2 million be included in rate base. DRA recommended that SCE only recover approximately $920,000 from ratepayers, and that SCE's insurance policy should have covered the balance. Protestants argue for a complete disallowance of the $3.2 million, essentially maintaining that SCE should have obtained fire insurance that would have covered all of the damage.

SCE's fire insurance has a $5,000,000 deductible. Protestants argue that the only reason SCE has a $5,000,000 deductible is to benefit its electrical ratepayers and its shareholders, because such a deductible greatly reduces the overall cost of insurance for its electric business. However, the deductible has the effect of making the water utility's ratepayers self-insurers, something they cannot afford to be.

Mr. Brady testified that a water utility acting reasonably carries fire insurance. It is not reasonable for a water utility to make ratepayers

self-insurers. On cross-examination, Mr. Brady was asked what the water district he now heads pays for insurance. He testified that the district has $110 million in assets, that it pays $58,000 a year for general liability and property damage insurance, and that the policy has a $25,000 deductible. The fire portion of the policy costs $31,000, with a $10,000 deductible.

DRA was able to obtain the property insurance deductible information from eight water utilities, of which we take official notice. In order to preserve the confidentiality of each company, DRA presented generalized information that shows a given deductible amount based on the level of rate base:

Rate Base Level	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

It is clear that a $5,000,000 deductible applicable to SCE's water utility is not reasonable. SCE should have provided fire insurance covering its water utility with a small deductible. Based upon DRA's information, that deductible should be $5,000. We cannot find that it is reasonable to include these fire-related infrastructure replacement expenditures in rate base and therefore disallow the entire $3.2 million.

11. Potential Sale of the Water Utility

It is Protestants' contention that starting in approximately 2002, SCE's capital expenditures were motivated in substantial part by the rundown condition of the system's infrastructure and its small rate base which made the utility unattractive to potential buyers. Protestants claim that while the expenditures are of marginal benefit to ratepayers, they were not made simply to

assure ratepayers a safe water supply at reasonable rates, as SCE contends. They were made, in substantial part, to make the water utility saleable. Current ratepayers should not have to bear the burden of deferred capital expenditures or capital expenditures intended to make the water utility attractive to a buyer.

SCE agrees that it has been attempting to sell its water utility, but SCE argues that if it sells its water assets at a price equal to its investment in the assets as planned, it will make no profit. SCE will actually lose money because of the several hundred thousand dollars of sale-related transaction costs it has incurred and is continuing to incur, all of which SCE is specifically tracking and charging to a shareholder expense account. SCE denies Protestants suggestion that SCE simply decided to sell the assets for $35 million, then decided to put millions of dollars of investment at risk in an effort to bring rate base in line with that number, all so that SCE could complete a transaction in which it will lose money.

We prefer not to involve ourselves in deciding whether or not a potential sale influenced the capital expenditures. The better course is to review the capital expenditures within the criteria of a general rate case to determine if the expenditures assure the ratepayers of a Class C water company a safe water supply at reasonable rates. We have analyzed those expenditures in the preceding sections of this decision. Therefore, we find that the potential sale (or not) of the water company is irrelevant to the issues in this application.

12. Depreciation

TURN proposed to reduce depreciation expense by $200,000 as a step toward mitigating the impact of SCE's proposed near-doubling of the Catalina water utility revenue requirement. Protestants agree with TURN. SCE says its proposed depreciation rates are just and reasonable. DRA agrees with SCE.

TURN argues that reducing depreciation expense will not harm shareholders in the long term; it will just defer recovery of costs to the future. SCE responds that this is a common argument that fails to capture the long-term effects of deferring depreciation expense. In fact, the deferral of depreciation expense harms customers and shareholders alike over the life of the assets. SCE says TURN fails to address that, although the deferral of depreciation expense benefits current ratepayers, the burden of funding the deferral is passed on to future ratepayers who will be paying amounts greater than the service value of assets received.

We have deferred depreciation expense in the past to mitigate rate shock, and may do so in the future; but it is not warranted in this rate case given that this decision maintains the existing revenue requirement.

13. Taxes

No party challenges SCE's forecast tax expense, as modified by our adopted revenues, and it will be adopted.

14. Rate of Return

SCE's proposed rate of return in this proceeding is 8.74%, almost the same number authorized for SCE's company-wide operations (8.75%). DRA noted that the use of SCE's company-wide rate of return provides a direct benefit to Catalina customers by lowering the revenue requirement, when compared to the higher rate of return granted to Class C and D water utilities by the Commission. Thus, Catalina customers have been enjoying this savings since SCE has owned the operations. TURN, however, argues that SCE's rate of return for its water operations should be set as if it were a Class A water utility. SCE asserts there is no basis for such a proposal. No intervenor claims that SCE's water utility is a Class A water utility.

We agree with SCE. It is reasonable to adopt 8.74% as the rate of return for the Catalina Water subsidiary, an approach that is consistent with precedent and is beneficial to ratepayers.

15. Alternate Ratemaking Proposal

SCE proposes that, if the Commission decides that it would be inequitable for Catalina water customers to bear the entire cost of service reflected in SCE's rate increase proposal, an alternate cost recovery mechanism is acceptable to SCE. SCE's proposal will have the effect of keeping average Catalina water rates stable while ensuring SCE's full recovery of the reasonable and prudent capital expenditures and ongoing costs to operate the system. SCE's alternate proposal would remove approximately $19 million from rate base (thus keeping the revenue requirement to be recovered from Catalina water customers at the same level as current revenue requirements), and seek a one time recovery of the approximately $19 million from SCE's approximately 4.8 million electric customer accounts.

SCE recognizes that this alternate rate recovery structure is novel, but notes that Catalina water capital infrastructure (which represents the bulk of the money transferred to electric rate base under this alternate scenario) benefits a much broader group than the limited water ratepayer base. About 805 of Catalina's businesses are dependent upon the tourism industry, and the water infrastructure that serves those businesses is therefore largely built to serve tourists, and not only water ratepayers. In fact, although Catalina has only 1,934 water ratepayers, it has approximately 750,000 annual visitors. These tourists all use and enjoy the water infrastructure. Correspondingly, about 80% of Catalina's water ratepayers work in the tourism industry. This shift of costs will reduce SCE's proposed 2011 test year revenue requirement to $3.948 million.

Upon Commission approval of this cost recovery structure, SCE would file an advice letter to recover these costs through electric rates from customers across SCE's system over a one year period. Nowhere has SCE identified the approximately $19 million it proposes to remove from its water utility's rate base. The amount SCE seeks to remove exceeds the $15,930,000 it seeks to add to its rate base.

We agree that SCE's water utility exists not only to serve the permanent residents on Catalina, but also the many tourists that come to Catalina from the mainland, the majority from areas where SCE provides electric service. According to the 2010 US Census, about 4,000 people live on the island. This number contrasts with the number of tourists:

- Over 600,000 visitors who come to the island on cross-channel boats.
- 68,000 visitors to the seven camps which cater primarily to school-age children.
- 40,000 visitors who come to the island by private plane.
- Private boaters who come to the island and stay at the various yacht clubs.
- 6,000 visitors who stay at the various campgrounds open to the public.

Approximately 750,000 people visit the island every year. There are over 200 times more visitors than there are residents. The water system primarily serves those visitors. Protestants argue there is no easy way to pass on the cost of water to the tourists who use it. Businesses serving tourists must compete with mainland attractions that enjoy much lower water rates. SCE's proposal is a reasonable way to at least partially achieve that goal. Many Catalina ratepayers who already have what are currently the highest rates in California face a

doubling or more of their current bills. The ratepayers would welcome the relief, as was made clear at the public hearing.

Protestants support SCE's alternate proposal.

Both DRA and TURN oppose the alternate proposal. DRA classifies the proposal as a subsidy which provides no benefit to the 4.8 million SCE electrical customers, ignoring the fact that it is those customers who make up a significant proportion of the visitors to Catalina Island. As a class, the 4.8 million customers do benefit.

TURN claims there is no common nexus, other than corporate ownership, between Catalina ratepayers and SCE electric service customers, also ignoring the fact that a significant proportion of the visitors come from the class consisting of SCE's electrical ratepayers. They do not come in any great number from San Diego or Northern California, as TURN suggests.

We adopt SCE's alternate rate proposal. SCE proposes an allocation methodology whereby approximately $19 million of water utility plant in service would be allocated to electric operations in furtherance of the goal of reasonable rates for water utility customers. This proposal is supported by the water customers. The objections of DRA and TURN are not persuasive. From the viewpoint of the customers providing the subsidy the kind of utility service being subsidized is irrelevant. Due to the unique circumstances of SCE's diverse public utility operations and consistent with the principles underlying regional water rates, we grant SCE's request. Because our objective is to avoid a rate increase, we shift $7.780 million (rather than $19 million) of the water company's rate base to the electric side.

Our adoption of SCE's alternate proposal is consistent with past decisions regarding SCE's operations on Catalina Island and with more general principles

regarding cost allocation. In a prior SCE Catalina water case we reviewed favorably what we had done on the electric side when we shifted $2 million of the Catalina Island electric revenue requirement to the mainland electric ratepayers. In D.83-10-045 we said:

> Through integrating electric rates with the mainland in 1983, as authorized by D.82-03-059 dated March 16, 1982 in Application (A.) 611038, approximately $1 million in annual base rate revenue requirements was shifted from Catalina to mainland electric ratepayers. Also, sometime in 1984 the current Energy Cost Adjustment Clause (ECAC) surcharge for Catalina will terminate, resulting in an annual reduction of about $250,000.[fn]
>
> [fn] The surcharge was established by D.93129 dated June 2, 1981 in A.59830 to amortize the amount in the Catalina Balancing Account upon merging Catalina ECAC rates with ECAC mainland rates. This ECAC merging also shifted approximately $1 million in Catalina revenue requirements to mainland electric ratepayers. (D.83-10-045 in A.83-01-35 at 4.)

In our discussion of A&G expenses, *supra*, we noted that for 48 years prior to this application, SCE allocated no A&G expenses to its water or gas utility, allocating those expenses to its electrical customers. In addition, the four-factor allocation of common overheads is at best an approximation, with the strong possibility of cross-subsidization. Common costs are allocated between gas and electric customers in utilities such as PG&E and SDG&E. The possibility of cross-subsidization is evident, but minor. So it is here. The shift of $7.780 million in a company with a $10 billion revenue requirement is a de minimis impact to electric ratepayers which will keep water rates on Catalina Island just and reasonable. It is appropriate. There is a compelling need for rate relief on Catalina Island and the adopted alternate proposal will have a minimal impact on SCE's 4.8 million electric ratepayers. (cf. Re, Single Tariff Pricing, D.00-06-075 at 15-19.)

15.1. 2011 Results of Operation Comparison ($000)

	Item	SCE present Rates	SCE Recommended Rates	Adopted Rates
	Operating Revenue			
	General Metered Sales	$ 3,948	$ 7,118	$ 3,842
		$ 3,948	$ 7,118	$ 3,842
	Operating Expenses			
615	Purchased Power	$ 291	$ 291	$ 291
681	Other Volume Related Expenses	0	0	0
630	Employee Labor	$ 819	$ 819	$ 819
640	Materials	$ 251	$ 251	$ 251
650	Contract Work	$ 1,017	$ 1,017	$ 600
660	Transportation Expenses	$ 49	$ 49	$ 49
664	Other Plan Maintenance	0	0	0
670	Office Salaries	$ 110	$ 110	$ 110
671	Management Salaries	$ 35	$ 35	$ 35
674	Employee Benefits	0	0	0
676	Uncollectibles Expense	$ 9	$ 16	$ 9
678	Office Services & Rentals	0	0	0
681	Office Supplies & Expenses	$ 15	$ 15	$ 10
682	Professional Services	0	0	0
684	Insurance	0	0	0
688	Regulatory Commission Expense	0	0	0
689	General Expenses	$ 31	$ 31	$ 31
	A&G Allocation	$ 674	$ 535	535
800	Minus expenses capitalized	0	($ 148)	($ 147)
480	Revenue Credits	($ 154)	($ 154)	($ 154)
689	Franchise Fees	$ 39	$ 71	$ 38
	Escalation	$ 157	$ 152	$ 135
	Subtotal	$ 3,343	$ 3,090	$ 2,612
	Depreciation	$ 774	$ 774	$ 592
	Taxes Other Than Income	$ 282	$ 282	$ 180
	Income Taxes	($ 462)	$ 890	($ 360)
	Total Deductions	$ 3,937	$ 5,036	$ 3,024
	Net Revenue	$ 11	$ 2,082	$ 818
	Rate Base	$ 23,808	$ 23,780	$ 9,357 [33]
	Rate of Return	0.05%	8.75%	8.74%

[33] $7,780,000 has been transferred to electric rates per SCE's alternate rate proposal.

16. Recovery of the purchased Power Expenses Memorandum Account (PPEMA) and Catalina Water CARE Memorandum Account (CWCMA)

SCE requests cost recovery of the expenses recorded in the PPEMA and CWCMA from the inception of these accounts through the date of a final decision in this application. A summary of the undercollected balances of $194,000 recorded in the PPEMA and the CWCMA from 2008 through September 30, 2010, is set forth below. In accordance with Resolution W-4665, SCE proposes to recover the undercollected balances in the PPEMA and the CWCMA through rates effective upon the issuance of a Commission decision in this proceeding, over a one year period. SCE proposes to update its undercollected balances when it submits its compliance advice filing upon receiving a final Commission decision. SCE also proposes to eliminate the PPEMA and CWCMA once the Commission authorizes SCE to include the undercollected balances in rates. No party objects; this approach is reasonable and recovery is approved. SCE should file a Tier 2 advice letter to amortize the balances in the PPEMA and CWCMA as of the effective date of this decision.

Southern California Edison Company
September 30, 2010 Balance
Thousands of Dollars

PPEMA	$127,000
CWCMA	$67,000
Total	$194,000

17. Rate Design Issues – Settlement

SCE, DRA, TURN, and Protestants (collectively, Joint Parties) move the Commission to adopt the Joint Parties' Settlement of Rate Design Issues

(settlement), Appendix A. We adopt the Settlement as reasonable in light of the whole record, consistent with law, and in the public interest.

The Joint Parties discussed and reviewed the various parties' proposals regarding revenue allocation and rate design. A goal of the discussions was to correct the disparity between residential and non-residential cost recovery in the current rate design. Thus, the majority of the discussion centered on developing an allocation structure that provided equity across rate classes while sending a strong conservation signal during the high usage summer period. The Joint Parties recognized the goals of equitable cost recovery and conservation could be achieved by adjusting: (1) the amount of revenue recovered through fixed charges as opposed to volumetric charges; (2) the allocation of volumetric revenue recovered from the residential and non-residential classes and; (3) the differential between the summer and winter volumetric rates. By adjusting these parameters, the Joint Parties ensure the overall revenue allocation is representative of the usage distribution across rate classes, where 49% of the water is used by the residential class and the remaining 51% used by the non-residential classes. The overall revenue allocation in the Settlement results in 49% of revenues recovered from the residential class with the balance recovered from non-residential classes. When applied to SCE's forecasted sales and current (and adopted) revenue requirements, the Settlement results in an overall average rate for the residential class of $30.40 per 1,000 gallons. The overall average for the non-residential class is $30.00 per 1,000 gallons. The addition of SCE's requested revenue requirement results in overall averages of $56.30 and $55.50 per 1,000 gallons for the residential and non-residential classes, respectively.

A comparison of the average monthly bills associated with current rates and settlement rates is shown in the table below. The average bills resulting from the settlement are shown at two different revenue requirement levels to illustrate the effects of the Settlement adjustments alone (Column C), and the effects of the Settlement adjustment with SCE's requested revenue requirement increase in this application (Column D). For example, a residential customer with an average monthly bill of $74.04 under current rates and the current revenue requirement would have a bill of $90.49 as a result of the revenue allocation and rate design changes proposed in this Settlement alone. Adding the full revenue requirement changes proposed in this application to the settlement rate design would result in an average monthly bill of $167.65 for this same residential customer. Similarly, a commercial customer with an average monthly bill of $549.98 under current rates would have a bill of $500.84 as a result of the Settlement revenue allocation and rate design changes. Adding the full revenue requirement adjustment proposed in this application to the settlement rate design would result in an average monthly bill of $927.84 for this same commercial customer.

Average Monthly Bill by Customer Type[34]

(A)	(B)	(C)	(D)	(C)/(B)	(D)/(B)
Customer Type	Current Rate	Settlement Rates at Current Rev. Req.	Settlement Rates at Full Rev. Req.	Impact at Current Rev. Req.	Impact at Full Rev. Req.
Res	$74.04	$90.49	$167.65	22%	126%
Res-Dual	$195.58	$206.30	$382.73	5%	95%
Res-CARE	$74.00	$88.38	$163.73	19%	121%
Res-CARE-Dual	$65.16	$77.58	$143.73	19%	121%

[34] The rates shown in this table are illustrative only. The actual rates are set forth in Appendix B.

Res-DE	$89.35	$106.39	$197.09	19%	121%
Dual	$105.99	$117.23	$217.17	11%	105%
Res-MM[1]	$881.54	$552.34	$1,023.26	-37%	16%
Com	$549.98	$500.84	$927.84	-9%	69%
Com-CARE	$27.92	$41.36	$76.62	48%	174%
IRRI	$345.00	$326.67	$605.19	-5%	75%
FIRE	$44.76	$49.11	$90.98	10%	103%
Total	$165.34	$165.65	$306.88	0%	86%

1 Monthly bills shown are at the Master Meter Level.

17.1. The Settlement is Reasonable in Light of the Record

Rate design and revenue allocation are essentially a zero sum game – in the water context, if commercial customers' revenue allocation goes up, residential customers' revenue allocation must go down. Protestants' opening position was that commercial customers should pay less and residential customers should pay more than under SCE's proposed revenue allocation. DRA's opening position was the opposite, i.e., that residential customers should pay less and commercial customers should pay more than under SCE's proposed revenue allocation. The settlement is a fair compromise essentially in the middle of those two positions. In addition, the Settlement resolves other issues around rate design and revenue allocation that are unique to Catalina Island, including issues surrounding multi-family units and campgrounds. Overall, the settlement is reasonable in light of the record.

17.2. Rate Design

SCE, DRA, TURN, and Protestants have reached a nearly-comprehensive settlement on rate design issues. The one exception to the rate design settlement is SCE's proposal to continue the Domestic Employee (DE) discounted rate of 25%. Protestants do not agree with the discount. This discount (which has a *de minimus* effect on rates) is currently implemented pursuant to a

Commission-approved tariff and it should be continued. We believe the proposed rate design reached in that settlement to be just and reasonable, as is the DE discount.

17.3. The Settlement is Consistent With Law

In agreeing to the terms of the Settlement, the Joint Parties explicitly considered the relevant statutes and Commission decisions. The Settlement does not violate applicable statutes or prior Commission decisions.

17.4. The Settlement is in the Public Interest

The Settlement resolves long-standing disputes between Protestants and SCE regarding revenue allocation and rate design issues and also issues TURN and DRA raised regarding the alternative rate design proposals. Therefore, adoption of the Settlement will likely result in the avoidance of future litigation and the conservation of scarce Commission resources. In addition, DRA and TURN, representing a broader group of California ratepayers, are signatories to the Settlement. Accordingly, the Settlement is in the public interest.

18. Comments on Proposed Decision

The proposed decision of ALJ Barnett 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 by SCE, DRA, TURN, and Protestants. We have reviewed the comments and modify the proposed decision as follows: we allow $500,000 for SCADA; allow $535,000 for A&G expenses; reduce the operating revenue by $106,000; and reduce the rate of return from 8.75% to 8.74%. Rate base has increased by $3.791 million and the amount transferred to electric rates has been reduced from $10.704 million to $7.786 million.

19. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner and Robert Barnett is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. SCE's water utility is a Class C water utility, with the highest rates of any water utility in California.

2. The past five years of Account 615-Power for Pumping costs were between $256,000 and $387,000. We find that for test year 2011, $291,000 is reasonable.

3. Test year 2011 Account 630-Labor costs of $819,000 are reasonable.

4. Test year 2011 Account 640-Materials costs of $251,000 are reasonable.

5. SCE has not shown why 2011 differs from prior years where Account 650-Contract Work was substantially below the requested amount of $1,017,000. Nor has SCE shown why the annual reports differ substantially from Mr. Hite's statement of yearly expenditures. SCE has not met its burden of proof. But, as there is a need for Contract Work, we estimate that $600,000 is a reasonable amount in test year 2011.

6. Because of the constant use of equipment to service the water system, we consider test year 2011 Account 660-Transportation Expenses of $49,000 on the high side, but reasonable.

7. We find SCE's recommended test year 2011 Account 670-Office Salaries of $110,000 to be reasonable.

8. SCE's estimate of $35,000 for test year 2011 Account 671-Management Salaries is reasonable.

9. SCE's water customers are on the same bill as electric customers so the uncollectibles would be the same. Account 670-Uncollectibles Expense of $9,000 for test year 2011, is reasonable.

10. SCE has not met its burden of proof for Account 681-Office Supplies. A practicable estimate for the account is $10,000 for test year 2011, which we find reasonable.

11. Because travel and lodging are needed to operate the water company, we find $31,000 to be reasonable for Account 689-General Expenses for test year 2011.

12. For test year 2011, we find $153,000 in Account 480.2-Other Operating Revenue, to be reasonable.

13. For test year 2011 A&G Expenses of $535,000 are reasonable.

14. Approval of the requested amount for station office betterment is denied. SCE may request a reasonable amount for this project in its next water rate case.

15. We allow $500,000 of capital expenditure for the SCADA system. It is a system that cost $2,327,000 for a company whose water revenue in 2009 was $3,843,870, a cost of almost $1,200 per customer. The SCADA system is convenient but not necessary. However, it is useful and for that reason we allow $500,000.

16. SCE seeks $4,567,753 for the replacement of Pump House #2. No party disputes that the pump house itself and the single horizontal pump inside needed to be replaced. The dispute is over costs. Protestants recommend recovery of $2 million.

17. The pump house and its equipment were in service in 1930. The pump house and its single pump were 32 years old when SCE took over the utility. 50% of the cost, or $2,268,696, was for SCE's engineering and management of the project. Material and Construction was only $2,220,057, which includes $510,000 for three vertical pumps to replace the single horizontal pump which had served for 80 years. It took SCE about two years to complete the project.

18. SCE charged $2,267,000 for engineering and project management by its own engineering department out of a total cost of over $4,567,000. This was not part of a competitive bid.

19. DRA states that the pump house is similar to other facilities DRA has observed with Class A water utilities. SCE's water utility is a Class C water utility. It has less than 2,000 connections. A Class A utility has at least five times the customers and should be able to afford more elaborate facilities. When possible, we should avoid saddling ratepayers with facilities they cannot afford. The pump house was built at an excessive cost. A Class C utility operator would have constructed the pump house at a much lower cost. We find that $2,500,000 is a reasonable cost to put in rate base for Pump House #2.

20. The $393,420 cost for the Pebbly Beach Water Line Replacement project is reasonable.

21. The $392,064 for Middle Ranch Canyon Bedrock Piezometer Project costs is reasonable.

22. The West End Pipeline needed to be replaced; the $754,951 cost is reasonable.

23. The Million Gallon Tank was built solely to provide fire protection for USC's facilities located at the Isthmus. The LACFD required USC to have 900,000 gallons available for fire protection. It was built pursuant to an agreement dated November 1, 1967, between USC and SCE which provides that "so long as [SCE] is obligated to provide public utility water service to the Laboratory, [SCE] will operate and maintain the Enlarged Water Facilities." Paragraph 4 of the agreement provides a cost-sharing formula; a letter dated May 3, 1979, provided by SCE shows a cost-sharing formula of 90% to USC and 10% to SCE.

24. SCE has not met its burden of proof with regard to the entire $975,000 for the Isthmus Area water supply and SCADA. A substantial portion of the amount sought should have been borne by USC. Ratepayers should not be charged for maintaining USC's fire protection tank.

SCE Request		$975,000
Less Banning House	$340,000	
Less SCADA	$140,000	
		$495,000
Less 90% to USC		-445,500
Rate base – Million Gallon Tank		$ 49,500
- Banning House		340,000
Total Rate Base		$389,500

We find it reasonable to add $389,500 to SCE's rate base for the repairs of the Million Gallon Tank and the line to the Banning House.

25. In regard to the Thompson Reservoir Safety Drain System, the original drain, even if perfectly maintained, would not have met the new DSOD requirements. Protestants' arguments do not adequately consider the necessity of this safety- and regulatory-requirement-driven project. While the overhead costs seem high, the problems encountered during the safety review explain why. The $2.160 million cost for the Thompson Reservoir Siphon project is reasonable.

26. DRA was able to obtain the property insurance deductible information from eight water utilities, of which we take official notice, which shows a given deductible amount and the magnitude of rate base that a company would have.

Rate Base Level	**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

27. A $5 million insurance deductible applicable to SCE's water utility is not reasonable. SCE should have provided fire insurance covering its water utility with a small deductible. That deductible should be $5,000.

28. The $3.2 million Catalina Island Fire Restoration Project Capital Expenditure is disallowed because SCE should have provided fire insurance for its water subsidiary.

29. We have deferred depreciation expense in the past to mitigate rate shock, but it is not needed in this rate case, based on the alternative approach we are adopting.

30. No party challenges SCE's forecast tax expense, as modified by our adopted revenues, and it will be adopted.

31. SCE's proposed rate of return in this proceeding is 8.74%, almost the same number authorized for SCE's company-wide operations (8.75%). It is reasonable, consistent with precedent, and benefits ratepayers.

32. SCE shall recover the expenses recorded in the PPEMA and CWCMA from the inception of these accounts through the date of a final decision in this Catalina Water 2011 GRC, by filing a Tier 2 advice letter.

33. The rate design settlement is reasonable in light of the record.

34. The rate design settlement is consistent with law and in the public interest.

35. Schedule W-10 – General Metered Fresh Water Residential Service to Utility Employees continues to be applicable to SCE employees.

36. The sales forecast presented in SCE's application is adopted and implemented with the Settlement rate design

Conclusions of Law

1. The rate design set forth in Appendix A is just and reasonable.

2. The rates and charges set forth in Appendix B are just and reasonable.

3. SCE shall shift $7.780 million of its water company rate base to its electric revenue requirement. SCE shall file an advice letter to recover these costs through electric rates from customers across SCE's system over a one-year period.

O R D E R

IT IS ORDERED that:

1. Southern California Edison Company shall file within 30 days after the effective date of this order, in accordance with General Order 96-B, and make effective on not less than five days' notice, the revised tariff schedules included as Appendix B to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

2. Southern California Edison Company (SCE) shall shift $7.780 million of its water company rate base to its electric revenue requirement. SCE shall file an advice letter to recover these costs through electric rates from customers across SCE's system over a one-year period. Based on this shift and the various disallowances and adjustments adopted today, the revenue requirement for SCE's Catalina Island water subsidiary is $3.842 million.

3. Southern California Edison Company shall file a Tier 2 advice letter to amortize the balances in the Power Expenses Memorandum Account and Catalina Water CARE Memorandum Account as of the effective date of this decision.

4. Application 10-11-009 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

Barnett Agenda Dec Revision 2 Appendix A