Decision 12-04-009 April 19, 2012

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Suburban Water Systems (U339W) for Authority to Increase Rates Charged for Water Service by $19,234,576 or 35.85% in 2012, by $3,032,827 or 4.18% in 2013, and by $1,973,200 or 2.61% in 2014.	Application 11-02-002 (Filed February 1, 2011)

DECISION ADOPTING THE REVENUE REQUIREMENTS FOR TEST YEAR 2012 AND POST-TEST YEAR RATE ADJUSTMENTS FOR 2013 AND 2014

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DECISION ADOPTING THE REVENUE REQUIREMENTS FOR TEST YEAR 2012 AND POST-TEST YEAR RATE ADJUSTMENTS FOR 2013 AND 2014

1. Summary

Today's decision adopts a proposed partial settlement between Suburban Water Systems (Suburban) and the Division of Ratepayer Advocates and resolves all other litigated disputed matters necessary to adopt the revenue requirement for a test year 2012 and two years of subsequent adjustments. This decision results in an overall rate increase of $12,975,000 or 24.31% for 2012. We decline to fine Suburban or to order any additional audits of Suburban at this time. This proceeding is closed.

2. Background

Suburban Water Systems (Suburban) a California corporation, organized under the laws of the State of California, is a Class A regulated water utility subject to this Commission's jurisdiction. It is a subsidiary of SouthWest Water Company. Suburban provides water services in various areas of Los Angeles County and Orange County. This general rate case was filed in compliance with Decision (D.) 07-05-062 which is the currently applicable rate case plan for Class A water utilities. The application seeks rate increases based upon a forecast test year 2012 and post-test year rate adjustments in 2013 and 2014. Rates, if granted, would increase by $19,234,576 (35.85%) in 2012, $3,032,827 (4.18%) in 2013, and $1,973,200 (2.61%) in 2014. The adopted revenue requirement in 2012 is a 24.74% increase, which is less than requested by Suburban.

3. Standard of Review

Applicant bears the burden of proof to show that the regulatory relief it requests is just and reasonable.

3.1. Proposed Partial Settlement

We can find as required by Rule 12.1 of the Commission's Rules of Practice and Procedure (Rules),[1] the proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest. The settled positions are a balance between the positions as otherwise litigated in the prepared testimony of Suburban and the Division of Ratepayer Advocates (DRA). We therefore adopt the attached settlement (Attachment A) without further discussion. No item settled in this proceeding is dispositive of the appropriate rate treatment in subsequent proceeds. (Rule 12.5.).

4. Litigated Issues

4.1. Litigated Issues

Based upon our review of prepared testimony, the evidentiary hearings, and a comprehensive briefing of litigated issues, we find that Suburban met its burden of proof in this proceeding. On an issue-by-issue basis we determine whether Suburban or DRA was the most persuasive in the disposition of individual disputed issues which were litigated and excluded from the proposed partial settlement.

Suburban and DRA identified six individual disputed issues which were litigated and excluded from the proposed partial settlement. We therefore review and resolve the following issues in the reminder of this decision:

- Treatment of State Taxes in Determining the Federal Income Tax Expense (Section 5.)
- Whether to Include a Domestic Production Activities Deduction in Determining the Federal Income Tax Expense (Section 6.)

[1] http://docs.cpuc.ca.gov/WORD_PDF/AGENDA_DECISION/143256.PDF.

- Determining the Appropriate Rate Allowance for Rate Case Expense in Test Year Rates (Section 7.)
- The Correct Four-Factor Allocation For Indirect Costs (Sections 8 and 9.)
- Whether to Assess any Fines for Four Specific Allegations (Section 10.)
- Whether to Order a Specific Audit Related to Allocated Corporate Costs and the Determination of a Four-Factor Allocation (Section 11.)

5. Treatment of State Taxes

The disputed state tax issue is the correct determination of the state tax deduction in the test year as a part of calculating the federal income tax allowance. As discussed below we determine that we should use the 2012 test year estimate of state taxes as the 2012 federal tax deduction because it is the most reasonable application of our current ratemaking practices and the most reasonable calculation.

5.1. Background

The California corporate tax is a deductible expense for federal income tax purposes. The ratemaking questions are the correct calculation and application of that calculation. For federal tax purposes in the current year a taxpayer files a return on the prior year's business results. (Thus, the federal tax return filed in 2012 addresses 2011 operations.) The state tax deduction allowance for 2012's return is the amount paid in 2011. For ratesetting purposes, we allow the utility to collect in current year rates the state and federal income taxes applicable to that current year.

5.2. Suburban's Position

Suburban reviews a lengthy history of the treatment for state taxes and argues its test year 2012 state tax deduction should be the actual state tax incurred in 2011. (Suburban (Sub.) Opening Brief at 2 – 3.) Suburban's request is for $1,001,108 for its 2012 state income tax deduction.

5.3. DRA's Position

DRA proposes to use the prior-year expense for the test year. (DRA Opening Brief at 5.) Further, DRA argues Suburban did not consistently follow the existing ratemaking practice and that it has filed other estimates in recent advice letters, which are inconsistent with its estimate in this proceeding. DRA notes that Suburban had positive state tax estimates/test year about subsequent escalation years and therefore proposes to use the amount adopted from Advice Letter 279-W.[2]

5.4. Discussion

The Commission, in D.89-11-058, required that for ratemaking purposes the prior year's state tax expense should be used as a deduction in the calculation of the test year's federal income tax. However Assembly Bill 1843, enacted in 2000, amended the California Revenue and Taxation Code to provide that corporations are no longer required to make estimated state tax payments one year in advance.[3] Thus there is no need to follow D.89-11-058 because the timing

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[2] This advice letter implemented the rate changes for 2010 as a part of the post-test year treatment authorized in Suburban's last general rate case.

[3] *See*: http://www.leginfo.ca.gov/pub/99-00/bill/asm/ab_1801-1850/ab_1843_bill_20000929_chaptered.pdf at 14. "SEC. 4. Section 18415 of the Revenue and Taxation Code is amended to read: 18415. Unless otherwise specifically provided therein, the provisions of any act: … (b) That change the provisions of Sections

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difference of the current year's state tax payments as a deduction in the current year's federal income tax calculation is no longer an issue. Use of the current year's state taxes as a deduction in the current year's federal tax calculation is a better match of revenues and expenses for the same period. Because the tax calculations are based on test year expenses and revenues, it is logical to use the test year state tax estimate as the deduction for the test year's federal income taxes.

We therefore find that neither Suburban nor DRA are reflecting the current tax law and we will instead calculate the test year 2012 federal tax deduction using the estimated 2012 state tax expense as a deeduction.

6. Domestic Production Activity Deduction

Federal tax law allows qualified taxpayers an economic stimulus deduction as a part of the American Jobs Creation Act of 2004. We find below that Suburban as a stand-alone tax payer would be eligible for the deduction when calculating its federal income tax expense in this rate case and therefore we include this deduction in calculating the adopted 2012 test year revenue requirement.

6.1. Suburban's Position

Suburban does not include the deduction arguing that the consolidated federal income tax return filed by its parent company does not qualify for the deduction. It does not dispute that on its own, it would qualify. Suburban

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19023 to 19027, inclusive, (relating to payment of estimated tax) or Section 19136 or Sections 19142 to 19151, inclusive, (relating to underpayment of estimated tax) shall be applied to taxable years beginning on or after January 1 of the year immediately after the year in which the act takes effect."

argues that in its last general rate case the Commission did not include this deduction because Suburban's parent was operating at a consolidated loss and was therefore ineligible. Suburban also argues that the Commission found in that decision, D.09-03-007, (rehearing denied in D.10-04-053) Suburban did not have to include a deduction which its parent company could not use in a consolidated return. (Suburban (Sub) Opening Brief at 4 -5.)

6.2. DRA's Position

DRA argues that D.09-03-007 is incorrect: the proper ratemaking practice for all industries regulated by this Commission is to treat the utility's tax position as a stand-alone entity for ratemaking purposes regardless of the profits or losses encountered on a consolidated return from affiliated companies. DRA argues that the continued poor performance of Suburban's parent is not the concern of California ratepayers, and the ratepayers should not therefore be burdened by the loss of the deduction. DRA cites to a long-standing decision, D.84-05-036, as supporting the policy of stand-alone rate making treatment. (DRA Opening Brief at 6-7.)

6.3. Discussion

The Commission generally follows its own decisions but is not strictly bound to precedent: this is apparent when we see D.09-03-007 depart from D.84-05-036,[4] by not using a tax deduction Suburban could qualify for on its own, but is then lost to the consolidated filer.

In D.84-05-036 the Commission made the two following Findings of Fact:

[4] D.84-05-036 is the Commission's seminal decision on the ratemaking treatment of federal income taxes. No subsequent decision has ever displaced it as the overarching statement on tax policy. (1984 Cal. PUC LEXIS 1325, *; 15 CPUC2d 42.)

1. The current practice in the development of income taxes for rate fixing is to exclude as a tax deduction the interest expense associated with nonutility plant and investment.
12. It is the practice of the Commission, in calculating test-year income tax expenses, to assume a separate return basis considering solely utility operations.

The same decision reached Conclusion of Law No. 3:

The separate return method is the more reasonable basis for calculating test-year income tax expense.

The reason for treating the utility as a stand-alone taxpayer is to ensure that ratepayers are not harmed nor benefited by the tax position of unregulated affiliates. For example, in this proceeding, Suburban does not propose to pass along any share of the parent's tax loss to otherwise offset the tax allowance it seeks to impose on California ratepayers. Under Suburban's approach, California ratepayers would have the disadvantages but none of the advantages of treating Suburban's tax expenses on a consolidated basis. If we logically and fully apply taxes for ratemaking on a consolidated basis Suburban would have to show whether the parent company incurred any actual federal tax expense, or had a loss, in its consolidated filing and Suburban would have to allocate that expense or loss across all affiliates. Suburban chose not to do that. Instead, Suburban cherry-picked a ratemaking proposal which includes a pro forma allowance for federal taxes, but deliberately excludes a deduction which would lower that allowance. Suburban did so only because its parent's consolidated federal tax return is not eligible for the deduction, not because Suburban is not eligible on its own.

We find now it would be wrong to continue to follow D.09-03-007 because to do so here would unreasonably impose an excessive tax burden on ratepayers as if Suburban actually paid the federal government the full ratemaking

allowance. Suburban fails to include all deductions to minimize the ratemaking tax obligation. Suburban cannot pick and chose to recover taxes in a way that maximizes cash flow to its parent without regard to the allowances that otherwise reduce the tax expense imposed on ratepayers.

7. Rate Case Expense

Reasonable costs are allowable in rates for Suburban to participate in general rate cases and other regulatory proceedings. At dispute in this proceeding is whether to allow the amortization of actual prior years' regulatory costs or a forecast of regulatory costs to be incurred in the test year and subsequent years. We find it is reasonable to continue the current practice to amortize actual prior years' regulatory costs because we would otherwise have to "catch up" for the unamortized years as well as include a future forecast in rates to avoid a gap in Suburban's recovery of reasonable costs. We therefore also direct Suburban to present a catch-up option in the next rate case which, if adopted then, would convert to a forecast rather than an amortization.

7.1. Suburban's Position

Suburban cites to the consistent history for the Commission's practice for Class A water companies to amortize actual prior years' regulatory costs and not adopt a forecast of regulatory costs to be incurred in the test year and subsequent years. (Sub Opening Brief at 10 – 13.)

7.2. DRA's Position

DRA argues that the Commission as a matter of policy sets rates, including the component for regulatory expense, on a prospective basis and thus does not amortize prior years' actual costs in a current rate case to be recovered over the test year and subsequent years. DRA argues with cites to other general rate case

decisions for other utilities that the Commission adopts a forecast for regulatory expenses rather than amortizing actual prior years' regulatory costs.

7.3. Discussion

Unfortunately, our last rate case decision for Suburban is not dispositive on how its regulatory expenses were included in rates. In fact regulatory expenses appear only once in the entire decision, D.09-03-007, as a line item in the settlement's summary of earnings. It shows that DRA and Suburban proposed the same amount and the settlement used that amount for regulatory expense. We cannot test here what DRA did or did not understand in the last rate case, nor do we ever rely on prior settlements. But we see no Suburban-related decision, D.09-03-007 or any other citation, which shifts Suburban from an amortization to a forecast method. It appears that amortizing Suburban's prior costs, to be consistent with prior practice, is the most reasonable option today. DRA has not objected to the recorded costs as unreasonable: it only proposes to change to a forward forecast.

There are good reasons to use a forecast because, for example, it provides a limit on costs or at least an incentive to control costs, whereas amortizing prior costs provides little or no incentive for Suburban to control costs. We have no reliable and complete test year 2012 forecast from Suburban nor is DRA's proposal a complete proposal to catch-up on amortization and move to a forward looking forecast.

We will adopt Suburban's proposal that we should amortize prior regulatory costs as the most reasonable proposal currently before us. We direct Suburban in its next rate case to present 10-years of actual data and, in addition to whatever proposal it prefers, to also present a three year forecast for the next

rate case cycle as well as a catch-up adjustment to shift from amortization to a forward forecast. We therefore adopt the following allowance for amortization:

2011 general rate case costs:	$512,865
2009 cost of capital costs:	62,494
Total for amortization	$575,359
Annual (divided by 3)	$191,787

8. Four-Factor Allocation – Parent

We find that the record does not support using the Commission's preferred method, a four-factor allocation, as proposed by Suburban for general cost allocation to affiliated companies and other unaffiliated entities served by Suburban's parent company. The data provided this time by Suburban is incomplete, inconsistent, and therefore unreasonable to distribute general costs incurred to benefit multiple entities. We find only two factors, operating expense and payroll, are sufficiently accurate and therefore reliable as a means of allocating costs. This results in an adopted allocation factor of 15.85% and not 32.7% as requested by Suburban for parent company costs to affiliated and unaffiliated entities. We do find that the use of the four-factor allocation method proposed by Suburban within the utility group, excluding the unaffiliated entities, is reasonable.

8.1. Background

The Commission staff, in 1956, issued the still used standard practice "Allocation of Administrative and General Expenses and Common Utility Plant" (Allocation Practice) which is used to allocate indirect costs that cannot otherwise be reasonably charged directly to different departments within a company, between related companies or different regulatory jurisdictions. The Allocation Practice uses a weighted average of four common factors to allocate

indirect costs. These are: (1) direct operating expenses, excluding uncollectible revenue, general expenses, depreciation and taxes; (2) gross plant (3) number of customers (or subscribers of telephone service); and (4) number of employees (using direct operating payroll, excluding general office payroll. (DRA Opening Brief at 9 – 10 citing to the Allocation Practice.)

There are four groups of entities which have a cost allocation from Suburban's parent: (1) Suburban; (2) 11 affiliated Texas Utilities; (3) five affiliated Southeast Utilities; and (4) 547 unaffiliated entities serviced under a contract. Thus there are 564 separate entities[5] allocated costs and whose data is used by Suburban for its proposed four-factor allocation of parent costs.

As shown in Table 1, Suburban's California Operations have four widely varied factors, ranging from a high of 57.8% factor for customers to a low of only 13.5% for payroll, for an average of 32.7%. Table 2 shows Suburban's proposed derivation of allocation factors for all entities. The only entity or group with a larger allocation than Suburban's is the entire group of 547 unaffiliated entities serviced under a contract. The next largest single entity is Monarch Utilities with 16.4%.

Table 1 Suburban Proposed Test year 2012 Allocation Using Suburban 2009 Data		
Direct Operating Expense	$27,221,789	18.2%
Gross Plant	$181,567,267	41.4%
Customers	75,392	57.8%
Payroll	$6,361,682	13.5%
Weighted Average - Suburban		32.7%
(Source: DRA Opening Brief at 10 citing Suburban's work papers.)		

[5] (1 + 11 + 5 + 547 = 564.)

8.2. Suburban's Position

Suburban argues that its proposed four-factor allocation of 32.7% is calculated consistently over time in compliance with the Allocation Practice and recent decisions in Suburban proceedings. Suburban states the only changes since the last general rate case are a reduction in the number of non-regulated customers served by affiliates (i.e., the unaffiliated entities served under contract). There has been little or no change in the operations of SouthWest (Texas) and the non-regulated affiliates, other than a contraction in the client base of non-regulated utilities, since the Commission issued its decision in the last general rate case. (Sub Opening Brief 15 – 17.) Suburban further argues that the contracts (at least the exemplars used in examining DRA's witness) do not include the number of customers served by the unaffiliated entities.

8.3. DRA's Position

DRA objects to the data used by Suburban in calculating the four-factor. DRA argues the gross plant data is incomplete and inconsistent because it does not reflect the gross plant of unaffiliated entities serviced under a contract. (DRA Opening Brief at 21.) DRA argues that without the correct data this calculation is skewed and therefore it excludes the gross plant factor.

DRA also objects to the customer count used by Suburban. For example, Suburban uses 75,392 for its own customer count, 27,110 customers for Monarch Utilities, the next largest affiliated utility in Texas, but uses only one customer for each of the 547 unaffiliated entities serviced under a contract. As a result, Suburban and Monarch Utilities are calculated to have 57.8% and 20.8% of all customers while each entity served under a contact is counted as one for each of the 547 separate entities. These 547 separately serviced entities are calculated by Suburban to be 0.4% of all customers. Through data requests and other research

DRA believes the more accurate customer count for these 547 entities would be approximately 350,000 customers and it therefore recalculates the weighted factor using this figure. (DRA Opening Brief at 18.) DRA thus argues that the meaning of "customer" in the Allocation Practice must be consistent and the 547 unaffiliated entities serviced under a contract should not be counted as a single customer each when Suburban is counted as 75,392 customers.

Finally, DRA objects to Suburban's imputation of no payroll to three of the Southeast Utilities because Suburban states these companies are operated by other affiliates and do not have their own employees. DRA argues this "grossly skews the allocations toward other affiliates including Suburban." (DRA Opening Brief at 24 quoting Ex. DRA-1 at 8-49.)

8.4. Discussion

Most costs are directly allocated to an activity or event that precipitates the cost. This is the basic "matching concept" in generally accounting principles. For example, the cost of meter reading (labor, equipment, etc.,) is separately identified as an operating expense just as the cost of digging a new well (engineering, labor, equipment, materials, etc.,) is separately identified and recorded as plant in service. Other less direct costs are allocated on the most reasonable method. Administrative costs related to employees for example can be allocated based on the direct labor costs of different activities. In a similar fashion, the four-factor allocation method is intended to be the method of last resort, i.e., when no other allocation is more accurate.

We find Suburban's arguments and calculations to be unreasonable because its interpretations applied to the plant and customer factors are not credible. In order to include any data in a calculation the Commission must have

complete faith in the truthfulness and accuracy of the data and cannot rely not a selective reading of the Allocation Practice.

Most problematic is the customer count. It is not likely that Suburban receives 75,000 times the service received by each one of the unaffiliated entities who are counted as a single customer. Thus Suburban's proposed customer count calculation is not a credible allocation factor.

DRA objected in the prior proceeding but was not found persuasive at that time. Therefore this time DRA tried to determine the more likely number of customers who are served by the 547 unaffiliated entities and derived an estimate of 350,000 customers. But it is not DRA's burden to find and develop the data. Suburban's burden of proof is to provide the whole truth in a fair and consistent manner. Counting each contract as a single customer, while counting Suburban as over 75,000 customers, is not credible, therefore it is not fair or reasonable. To the extent that Suburban has shown there is no need to include the number of customers in the individual contract, we conclude that if the number of customers is irrelevant to the services provided to the unaffiliated entities then the number of customers (either 1 or 75,000) is an irrelevant factor for allocation purposes.

We could simply treat Suburban as one of 564 (sum of all entities) which would result in an allocation of 0.0017%, which is effectively zero. Suburban argues that the parent company, "SouthWest, has a legal relationship" with 547 client non-affiliated entities. (Transcript at 130 – 131.) And that Suburban has a legal relationship with 75,000 customers. Both are true. But they are not the same thing. SouthWest, whose costs are allocated to Suburban and all the other entities affiliated or unaffiliated, does not serve 57,000 customers: Suburban does. SouthWest only has a single entity relationship with Suburban.

By a sleight of hand the witness attributes Suburban's customers to SouthWest when SouthWest directly serves only the single entity of Suburban, not Suburban's 75,000 customers – who are directly served only by Suburban. This is misleading and we find Suburban's testimony and argument unpersuasive.

By comparison, while the 547 unaffiliated entities are only attributed 0.4% of customers, they constitute 63.8% of direct operating expenses. We note that Suburban seems to have direct operating expense data while it claims in data responses and in evidentiary hearings that it does not have customer data. It is not likely that the unaffiliated entities group, which has 63.8% of total operating expenses, would only serve 0.4% of the total customers. We find Suburban not to be credible on this point.

We also find that Suburban's calculations for gross plant are not reliable. As with customers, Suburban is not reasonable in its application of the Allocation Practice. It is trying to rely on prior decisions which allowed the use of a four-factor method. We are not bound by those prior decisions: we are bound to use the evidentiary record before us today.

DRA persevered in this proceeding and demonstrated the one necessary point: the data offered by Suburban is not consistent for all entities. Because the data is not consistent any proposed allocation based on that data is not fair.

We find DRA may also be correct that three of the companies do not have any employees. When we look at the financial impact, however, we find that any allocation of employees/payroll to these three companies does not materially alter the remaining allocation compared to using the two factors of payroll and direct operating expense. The operating expenses for the three Southeast Utilities with no payroll are each 0.1% of the total. We therefore need not make an adjustment for personnel because it would be immaterial.

We will not use DRA's alternative calculations of a four-factor. Although DRA tried to correct the inconsistent data offered by Suburban we find it simpler and more accurate this time to use only two factors, gross operating expense and payroll. Using Suburban's data in Tables 1 and 2 the adopted allocation is the average of 18.2% for gross operating expense and 13.5% for payroll, for an allocation factor of 15.85%.[6]

In the next general rate case Suburban may either use these two factors (with accurate and consistent data) or the preferred four-factor allocation, but only if it can conclusively demonstrate the data is accurate and consistent across all entities.

9. Utility Group Allocation

There is a second allocation of costs within the utility group which is allocated on a four-factor by Suburban only to the affiliated utilities, i.e., it excludes the 547 unaffiliated entities serviced under a contract by the parent company. In its opening brief DRA (at 25 – 29) summarizes its analysis of the allocation proposed by Suburban which is a 50.9% rate for Suburban whereas DRA recalculates the rate to be 50.8%. DRA is mainly concerned with Suburban's manipulation of payroll and labor data. We find this to be too granular (a tenth of a percent) at this time given the comparatively large adjustment above for parent costs allocated to all entities and we therefore decline to make another minor adjustment at this time. We again warn Suburban that it must be reasonable in its calculations and consistent in its data in the next general rate case.

[6] (13.5% + 18.2%)/2 = 15.85%.)

10. Fines

Both Suburban and DRA snipe at each other's conduct in this proceeding (DRA Opening Brief and Sub Reply Brief) and DRA proposes fining Suburban for three alleged transgressions. DRA alleges that Suburban:

1) failed to fully support its application as required by the water rate case plan;
2) failed to "facilitate Informal Communications" in order to create a better understanding of the position of the parties and to avoid and resolve discovery disputes and eliminate unnecessary litigation;" and
3) failed to provide DRA access to its affiliates' relevant books and records.

These allegations were first raised in DRA's direct testimony (Ex. DRA-1 at 8-65 – 8-68.) DRA proposes a fine of $10,250 for each of the three allegations.[7] DRA equates this to a fine imposed on another company in D.07-05-062. Suburban had an opportunity in its rebuttal and briefs to address these claims. These allegations highlight a continual tension in rate cases: the limited time available to DRA and the disincentive for the utility to cooperate.

DRA argues, for example, that Suburban witnesses "hard wired" data[8] in spreadsheets which made it more difficult to use those worksheets later. (DRA Opening Brief at 33.) Suburban argues DRA failed to sufficiently examine the

[7] (Ex. DRA-1 at 8-66 and footnote 104.) $10,250 is the mid-point of the $500 to $20,000 per event range of fines allowed under the Public Utilities Code.

[8] In a series of Excel spreadsheets, when a piece of data is computed on one sheet, and is then used on another, that data can either be "linked" or "hard wired." Linked data automatically updates for any changes in the first sheet so all subsequent linked sheets cascade to reflect those changes. "Hard wired" data points, however, must be individually identified and changed to correctly make all subsequent calculations.

advance version of the application as a part of the "deficiency review process." In other words, because DRA did not catch Suburban soon enough it somehow becomes DRA's fault. We also note that in preparing this decision, the Division of Water and Audits also confronted hurdles with hard wired data as it prepared rate tables for the proposed decision. This is a very cynical attitude and is not conducive to efficient regulation. We will therefore order Suburban to avoid all possible usage of hard wired data in work papers for its next general rate case and all other applications or advice letters and it must distinguish or highlight all unavoidable hard wired data. We expect DRA in turn to thoroughly review the next advance copy of the next general rate case application and work papers to more fully identify deficiencies. The rate case plan clearly envisions DRA reviewing application material before filing precisely to avoid disputes over adequate data, modeling, and spreadsheet calculations delaying or distracting parties during the active litigation phase of a proceeding.

As noted in most scoping memos, we encourage parties to raise discovery issues early and here the parties did engage in constructive dialogues. In this proceeding the assigned Judge conducted several unrecorded discovery conferences. It is our belief that these conferences tended to expedite the proceeding, but the discovery problems were rooted in the deficiencies of the application which should have been identified before the application was filed. We will not fine Suburban for communication issues at this time.

Finally, DRA argues that Suburban failed to provide access to all affiliates' relevant books and records. DRA has the authority to audit Suburban and, if necessary, to travel to the parent company facilities if the utility does not provide all relevant data in California, to audit the relevant records of Suburban's parent related to all affiliated transaction. DRA did not do so.

It is clear that DRA was frustrated in its dealings with Suburban. Suburban needs to re-examine it regulatory relationship with DRA and establish a more cooperative attitude. DRA needs to ensure that it is thorough and timely in reviewing the draft rate case application for deficiencies and continue to use the discovery procedures to facilitate access to data.

We will not impose any fine at this time.

11. Audit

DRA argues that the Commission should order audits of: (1) Suburban's parent company's allocable costs; (2) the Non-Utility Group's four-factor values, specifically the number of customers served under each contract and gross plant value of its clients; and (3) Suburban's Non-Tariff Product Services.

DRA already has the authority to audit Suburban pursuant to Pub. Utilities Code § 314(a),[9] including auditing Suburban's parent and affiliates. Affiliate Transaction Rule VIII.B states:

> The utility and its affiliated companies shall provide the Commission, its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities in examining any of the costs sought to be recovered by the utility in rate proceedings or in connection with a transaction or transactions between the

[9] 314(a) The commission, each commissioner, and each officer and person employed by the commission may, at any time, inspect the accounts, books, papers, and documents of any public utility. The commission, each commissioner, and any officer of the commission or any employee authorized to administer oaths may examine under oath any officer, agent, or employee of a public utility in relation to its business and affairs. Any person, other than a commissioner or an officer of the commission, demanding to make any inspection shall produce, under the hand and seal of the commission, authorization to make the inspection. A written record of the testimony or statement so given under oath shall be made and filed with the commission.

> utility and its affiliates. The utility shall continue to maintain its books and records in accordance with all Commission rules. The utility's books and records shall be maintained and housed available in California. (D.10-10-019, Appendix A at A-9.)

The affiliate rules adopted in D.10-10-019 also provides in Rule VIII.E for regular audits beginning in 2013.

> Independent Audits. Commencing in 2013, and biennially thereafter, the utility shall have an audit performed by independent auditors if the sum of all unregulated affiliates' revenue during the last two calendar years exceeds 5% of the total revenue of the utility and all of its affiliates during that period. The audits shall cover the last two calendar years which end on December 31, and shall verify that the utility is in compliance with these Rules. The utility shall submit the audit report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than September 30 of the year in which the audit is performed. The Division of Water and Audits shall post the audit reports on the Commission's web site. The audits shall be at shareholder expense.

We need to be clear about "relevant" books and records as referenced in Rule VIII-B above. Quite simply, all documents (electronic and paper) that apply directly or indirectly to any cost which Suburban seeks to include for recovery in its rate application, or any rate recovery mechanism such as the four-factor allocation, are "relevant." We expect our judges in subsequent proceedings to interpret "relevant" in the most inclusion fashion. Suburban may not recover any cost where it fails to provide full and complete access to all relevant records. If Suburban delegates the performance of any duty or task to an affiliate or parent it cannot hide behind any structural separation between the utility and its parent or affiliates to withhold data or hinder DRA's review.

Despite the clear evidence that Suburban and DRA did not have an amicable or efficient relationship in this proceeding we nevertheless find it is not necessary to order any other audit at this time.

12. Procedural History

A timely protest was filed by DRA on March 7, 2011, and Suburban timely replied on March 17, 2011. A scoping memorandum was issued on April 20, 2011. Suburban filed on August 16, 2011 a motion to strike a portion of DRA's Opening Brief. The assigned Administrative Law Judge (ALJ) denied the motion by e-mail ruling on August 17, 2011. We affirm this and all other rulings made by the Judge during this proceeding.

A duly noticed settlement conference occurred on July 5 through July 7, 2011 and a motion to adopt a settlement was filed on August 31, 2011. No one commented on the proposed settlement.

13. Interim Rates Memorandum

By ruling dated November 22, 2011 Suburban was authorized to establish an Interim Rates Memorandum Account pursuant to Pub. Util. Code § 455.2 and the rate case plan adopted in D.07-05-062. This allows Suburban to track the difference between the rates in effect before this decision and the final rates adopted herein beginning on January 1, 2012. The tracking must end upon implementation of the rates adopted in this decision. Suburban must subsequently file a Tier 1 advice letter to amortize the balance in the Interim Rates Memorandum Account.

14. Post-Test Year Ratemaking

Consistent with both the settlement and the additional litigated outcomes adopted herein, Suburban must timely file Tier 1 advice letters in conformance with General Order 96-B proposing new revenue requirements and corresponding revised tariff schedules as set forth in the Commission's Rate Case Plan (D.07-05-062) for Class A Water Utilities. The filings must include

appropriate supporting work papers to request authority implement new rates effective January 1, 2013 and January 1, 2014.

15. Comments on Proposed Decision

The proposed decision of ALJ Long in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed by Suburban and DRA on December 12, 2011, and reply comments were filed by both parties on December 19, 2011. Some corrections and clarifications have been made to this decision based on the comments. In particular, we have modified the proposed decision's discussion and outcome on the state tax expense used as a deduction in the calculation of federal income tax expense to more reasonably reflect current law and the Commission's ratemaking practices. However, to the extent that parties merely reargued their litigation positions, those comments were accorded no weight. The attached appendices are corrected to reflect minor errors and to reflect the change for the test year's state tax deduction.

16. Assignment of Proceeding

Catherine J.K. Sandoval is the assigned Commissioner and Douglas Long is the assigned ALJ in this proceeding.

Findings of Fact

1. Suburban is a class A water company subject to the Commission's jurisdiction.
2. There is an adequate record composed of all filed and served documents.
3. The proposed settlement is a balance between the positions as otherwise litigated in the prepared testimony of Suburban and DRA.

4. Ratemaking practice uses the current year state tax expense as a federal income tax deduction in the current year.

5. Suburban presented inconsistent data on state taxes.

6. The DRA 2011 state tax estimate is inconsistent with current practices.

7. The state tax estimate used to calculate the test year federal tax expense is the current year's expense.

8. Suburban is eligible as a stand-alone tax payer for a federal deduction pursuant to the American jobs Creation Act of 2004.

9. A stand-alone federal income tax allowances is the standard ratemaking treatment in California.

10. Suburban's parent is ineligible for the deduction when it files a consolidated return.

11. Under Suburban's approach, California ratepayers would have the disadvantages but none of the advantages of treating Suburban's tax expenses on a consolidated basis.

12. The Commission has consistently amortized Suburban's prior regulatory costs in general rate cases and has not forecast regulatory cost for the test period.

13. Forecasting regulatory costs for test year 2012 and forward would leave prior costs unrecovered unless there was also a catch-up amortization.

14. There is not a reliable forecast in the record for 2012 regulatory costs.

15. The Commission generally uses a four-factor mechanism to allocate indirect costs when there is not a more applicable method for direct allocation.

16. Suburban used inconsistent data for the number of customers for unaffiliated entities served by Suburban's parent company. Suburban counted each unaffiliated customer as a single customer whereas it counted itself as over 75,000 customers.

17. Suburban used inconsistent data for gross plant for unaffiliated entities served by Suburban's parent company.

18. The data for gross operating expenses and payroll appear to be consistent for all entities.

19. The four-factor allocation for only the Utility Group uses consistent data.

20. Suburban and DRA had an acrimonious relationship in this proceeding.

21. There were work paper deficiencies that added to DRA's workload and delayed its analysis. Suburban had many "hard wired" pieces of data in its spreadsheets.

22. DRA has authority to review and audit any and all costs requested by Suburban, including direct and indirect affiliate costs.

23. The Commission's Affiliate Transactions Rule VIII.E requires biennial audits beginning in 2013.

Conclusions of Law

1. Applicant bears the burden of proof to show that the request is reasonable.

2. The proposed settlement is reasonable in light of the whole record, consistent with law, and in the public interest, therefore the Commission may adopt it.

3. The Commission has the discretion and authority to resolve issues which were not addressed in the settlement.

4. It is reasonable to use the 2012 estimate of state taxes as a deduction for 2012 federal income taxes.

5. It is reasonable to calculate Suburban's federal income tax allowance on a stand alone basis and include the deduction pursuant to the American Jobs Creation Act of 2004.

6. It is reasonable to continue to amortize prior regulatory costs because there would be a gap in recovery without a catch-up adjustment and there is not a reliable forecast in the record for 2012 regulatory costs.

7. It is not reasonable to allocate costs using the number of customers as an allocation factor when Suburban counts its 75,000 customers but then counts unaffiliated entities served by Suburban's parent company as a single customer each.

8. It is not reasonable to use inconsistent data for gross plant as an allocation factor.

9. It is reasonable this time to use only two factors, gross operating expense and payroll, to allocate costs to all entities including the unaffiliated entities because only that data is consistent for all entities.

10. The utility group four-factor allocation is reasonable because it uses consistent data, excluding the inconsistent data for unaffiliated entities served by Suburban's parent company.

11. No behavior by Suburban during this proceeding warrants a fine.

12. It is not necessary to order any additional audit of Suburban or its parent company.

13. Pub. Utility Code § 455.2 permits the creation of an Interim Rates Memorandum Account to track the difference between the rates in effect before this decision and the final rates adopted herein.

14. This decision should be effective today.

15. This proceeding should be closed.

O R D E R

IT IS ORDERED that:

1. The proposed test year 2012 ratemaking settlement (Attachment A) between Suburban Water Systems and the Division of Ratepayer Advocates is adopted.

2. The adopted test year revenue requirement for Suburban Water Systems (Suburban) was calculated using:

   a. The results of the proposed settlement (Attachment A) between Suburban and the Division of Ratepayer Advocates;

   b. The 2012 estimate of State taxes as a 2012 federal tax deduction;

   c. the federal income tax allowance on a stand-alone basis and include the deduction pursuant to the American jobs Creation Act of 2004;

   d. The amortization of prior regulatory costs and not a forward forecast;

   e. A two-factor allocation rate of 15.85% to Suburban for general cost allocation to affiliated companies and other unaffiliated entities served by Suburban's parent company; and

   f. A four-factor allocation of 50.9% to Suburban for general and cost allocation to the Utility Group of affiliated companies.

3. Suburban Water Systems must file a Tier 1 advice letter within 14 days of this decision to implement the rates and charges adopted herein.

4. Suburban Water Systems (Suburban) must cease tracking the difference between the rates in effect before this decision and the final rates adopted herein upon implementation of the rates adopted in Ordering Paragraph 1. Suburban must file a Tier 1 advice letter to amortize the balance in the Interim Rates

Memorandum Account. The account shall remain in effect until the balance is fully amortized.

5. Suburban Water Systems must timely file Tier 1 advice letters in conformance with General Order 96-B proposing new revenue requirements and corresponding revised tariff schedules for post-test year rates effective on January 1, 2013 and January 2014 as set forth in the Commission's Rate Case Plan (Decision 07-05-062) for Class A Water Utilities and shall include appropriate supporting work papers. These filings must also comport with and comply with the settlement as adopted in Ordering Paragraph 1 of this decision and effect of the outcomes adopted in Ordering Paragraph 2 of this decision.

6. Suburban Water Systems must include as an option in its next general rate case a detailed proposal, as described in this decision, to catch-up amortization of prior regulatory costs and transition to a test year forecast.

7. Suburban Water Systems must include and use in its next general rate case an indirect cost allocation method with verifiable and consistent data for all entities that receive an allocation of indirect costs.

8. Suburban Water Systems (Suburban) must avoid all possible usage of hard wired data in work papers for its next general rate case and all other applications or advice letters, and it must also distinguish or highlight all unavoidable hard wired data. Suburban's work papers must include sufficient descriptions and explanations to allow the Commission's Division of Ratepayer Advocates and Division of Water and Audits to readily follow the organization and method Suburban employs to develop the work papers.

9. Application 11-02-002 is closed.

This order is effective today.

Dated April 19, 2012, at San Francisco, California.

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners