

Docket: : A.17-01-001
Exhibit Number : _____
Commissioner : Martha Guzman-Aceves
Admin. Law Judges : Gary Weatherford
: Darcie L. Houck
ORA Project Manager : Victor Chan
ORA Witness : Mehboob Aslam



**OFFICE OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION**

PUBLIC VERSION

**REPORT ON
SUBURBAN WATER SYSTEMS'
PARENT COMPANY, SOUTHWEST
COST ALLOCATIONS**

**Test Year 2018 and
Escalation Years 2019 and 2020
Application 17-01-001**

For authority to increase water rates in the San Jose Hills and
Whittier/La Mirada Service Areas

Los Angeles, California
May 1, 2017

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1 **MEMORANDUM**

2 The Office of Ratepayer Advocates (“ORA”) of the California Public Utilities
3 Commission prepared this report presenting its analysis and recommendations on the
4 issue of Southwest Water Company’s allocation in the Suburban Water Systems’ General
5 Rate Case Application 17-01-001.

6 Victor Chan serves as ORA’s project coordinator in this proceeding. ORA
7 witness Mehboob Aslam is responsible for the preparation of this report; his statement of
8 qualifications is in Appendix A of ORA’s May 1, 2017 Report on the Results of
9 Operations – Suburban Water Systems (A.17-01-001).

10 ORA’s Legal Counsels for this case are Selina Shek and Tovah Trimming.
11

1 **REPORT ON THE SOUTHWEST WATER COMPANY**
2 **ALLOCATION TO SUBURBAN WATER SYSTEMS**

3 **A. INTRODUCTION**

4 This Report covers Suburban’s request for indirect costs and allocations for its
5 parent company, Southwest Water Company (“Southwest”), and the costs and allocations
6 for one of Southwest’s affiliates, the Utility Group.

7 In addition, this Report addresses Southwest’s capital expenditures in Information
8 Technology (“IT”) for 2018 and 2019 that are allocated to Suburban’s ratebase. The
9 Report also evaluates Suburban’s request for its various lines of insurance such as
10 medical, dental, various property and casualty insurances and their allocations. The
11 Report addresses the issue of Suburban’s non-cooperative behavior during discovery and
12 its non-compliance with several Commission decisions. The Report also points out
13 Suburban’s failure to justify and support direct legal fee charges from Southwest. Lastly,
14 the Report addresses Suburban’s request to modify its existing Employee Healthcare
15 Balancing Account.

16 **Parent Company Background**

17 In 1975 Southwest, then a regulated utility, requested the Commission’s authority
18 to purchase Suburban, also a regulated utility, in its Application, (“A.”) 55655. In the
19 Application, Southwest sought the Commission’s permission to purchase Suburban and
20 consolidate its regulated operations in California. The Commission approved the
21 transaction in Decision, (“D.”) 84466; however, the Commission did not authorize
22 Southwest to be a holding or a parent company. Since then, Southwest has transformed
23 itself into a parent company and Suburban has become a subsidiary regulated by the
24 Commission. Therefore, unlike most other Class-A water utilities that have received
25 Commission approval to establish a parent or holding company organizational structure,
26 Suburban never operated under any formal Affiliate Transaction Rules (“ATRs”).

1 It was not until 2007, upon the request of Office of Ratepayer Advocates (“ORA”)
2 (then the Division of Ratepayer Advocates, or DRA), that the Commission ordered
3 Suburban to formally file an application to establish a holding company structure (A.09-
4 07-015). This application was subsequently dismissed without prejudice in D.10-05-001
5 due to the fact that the Commission opened an industry-wide rulemaking proceeding to
6 establish generic ATRs for water and sewer utilities that have a parent or a holding
7 company structure, Rulemaking (“R.”) 09-04-012. On October 14, 2010, the
8 Commission issued D.10-10-019 in R.09-04-012, which established industry-wide ATRs
9 on Class-A water utilities including Suburban.

10 In the interim, while the R.09-04-012 was underway, Suburban filed A.10-04-009
11 on April 6, 2010 to seek Commission approval to transfer indirect control of itself and
12 direct control of its parent company, Southwest, to an investment fund, IIF Subway
13 Investment, LP managed by J.P. Morgan Investment Inc. Water Asset Management,
14 LLC also contributed to the purchase of Southwest through USA Water Services, LLC,
15 and has an ownership interest of approximately 10%. The Commission authorized this
16 transfer of control under the condition that once the generic ATRs were adopted in R.09-
17 04-012, both the new owners and Suburban would operate under those ATRs.¹

18 Currently, the various subsidiaries of Southwest are grouped under two major
19 business segments: Southeast Utilities and Texas Utilities. These two business segments
20 have numerous water systems in the states of Alabama and Texas that they own, operate,
21 and manage.² Southeast Utilities has nine service contracts with various local cities and
22 municipalities to operate and manage their respective water and wastewater systems. It is
23 important to note that these service contracts have been a source of contention in terms of

¹ D.10-09-012.

² See Attachment-A (Southwest Organizational Chart showing its various Business Segments).

1 Southwest’s cost allocations. The history of these contentions is briefly discussed in the
2 Southwest’s Cost Allocations section below.

3 In addition to the two business segments, Southeast and Texas Utilities, Southwest
4 created a group of employees it refers to as the “Utility Group.” According to Suburban,
5 Southwest created this new entity in 2003 to provide management, regulatory, and
6 communications services to Suburban and its affiliates located in Texas, Alabama,
7 Oklahoma, and more recently Southern California. The Utility Group was staffed by
8 Suburban employees.³ The operating and administrative costs for the Utility Group are
9 allocated among Southwest’s various subsidiaries including Suburban.

10 **B. SUMMARY OF RECOMMENDATIONS**

11 Suburban is requesting an allocable cost for Southwest of \$11,265,781 for Test
12 Year (“TY”) 2018. Of this amount, Suburban seeks to allocate \$5,238,588 for
13 Suburban’s operations.⁴ Suburban used the three-factor allocation method to assess this
14 allocation amount based upon its calculated allocation rate of 46.50%. Southwest’s
15 executive compensations are also included in this allocation. The Commission should
16 approve an overall allocable cost of Southwest in the amount of \$10,544,072 and a
17 subsequent cost allocation to Suburban of \$4,649,936 at the allocation rate of 44.1%.

18 In its current general rate case (“GRC”), Suburban requests an overall allocable
19 cost of its business segment, the Utility Group, of \$1,270,370 for Test Year 2018. Of this
20 amount, Suburban requests to allocate \$628,833 to Suburban’s operations.⁵ Suburban
21 assessed this allocation amount based upon its calculated allocation rate of 49.50% using
22 the three-factor allocation method. The Commission should approve an overall allocable

³ P. 5-5, Section 5.5 Utility Group Expenses, Suburban’s Result of Operations For Test Years Ending December 31, 2018 and 2019 And Attrition Year 2020.

⁴ Suburban Workpapers, File: GRC 2017-A.17-01-xxx, Tab: MODEL, Cells: O3317:O3320.

⁵ Suburban Workpapers, File: GRC 2017-A.17-01-xxx, Tab: MODEL, Cells: N3438:N3442.

1 cost of \$751,295 and a subsequent cost allocation to Suburban in the amount of \$331,321
2 at the allocation rate of 44.1%.

3 *****BEGIN CONFIDENTIAL***** [REDACTED]

4 [REDACTED]
5 [REDACTED]
6 [REDACTED]

7 *****END CONFIDENTIAL***** Ratepayers should not be required to fund
8 these positions because Suburban has not provided adequate support to justify their need.

9 Suburban requests a capital expenditure at Southwest in the amount of \$2,687,000
10 and \$2,745,000 for various IT projects in Test Year 2018 and 2019, respectively.⁶ The
11 Commission should not allow any capital expenses without a robust need analysis and a
12 showing of competent project management.

13 Finally, Suburban requests various lines of insurance, including medical, dental,
14 and numerous property and casualty insurance policies such as workers' compensation,
15 business auto liability insurance, general liability, umbrella liability insurance, property
16 insurance, pollution legal liability insurance, directors and officers insurance, crime
17 coverage, fiduciary liability, employment practices liability, cyber and technology
18 liability insurance, and broker fee. The premiums for medical and dental insurance are
19 calculated on the basis of Per Employee Per Month ("PEPM") values whereas all other
20 line of insurance have a more conventional approach of having a specific premium
21 amount. For the most part, Suburban's request for various premiums and their allocation
22 to Suburban appear reasonable except the medical and dental insurance escalations
23 factors are reverted back to the conventional labor escalation rates per the 2004 Rate Case
24 Plan adopted in D.04-06-018. The following Table-1 shows the summary of ORA's
25 recommendation:

⁶ Suburban Workpapers, File: GRC 2017-A.17-01-xxx, Tab: Parent Co. RB, Cell: L50:M50.

1

Table-1: Summary of ORA’s Recommendations

Adjustments	ORA	Suburban	Difference	Percent
	Recommendations	Request		
Parent Company's Expenses	\$10,544,072	\$11,265,781	(\$721,709)	-6.41%
Parent Company's IT Projects	\$0	\$5,432,000	(\$5,432,000)	-100%
Parent Company's Allocation Rate	44.10%	46.50%	-2.40%	-5.16%
Utility Group's Allocation Rate	44.10%	49.50%	-5.40%	-10.91%
Utility Group's Expenses	\$751,295	\$1,270,370	(\$519,075)	-40.86%

2

3 **C. DISCUSSION**

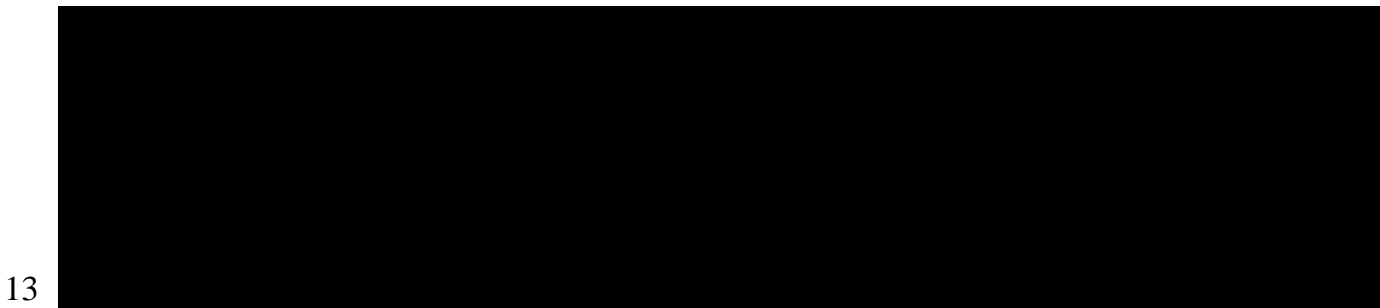
4 **1. Parent Company’s Expenses**

5 **a. Executive Compensation**

6 Suburban requests increases for Southwest executives’ base salary and short-term
7 incentives. Southwest currently has four executives: Chief Executive Officer (“CEO”),
8 Chief Financial Officer (“CFO”), General Counsel, and Vice President of Human
9 Resources. The following table shows the requested amount of executive compensation
10 comprised of base salary and short-term incentives:

11 **Table-2: Southwest Executive Pay as of 2015⁷**

12 *****BEGIN CONFIDENTIAL*****



13

14 *****END CONFIDENTIAL*****

⁷ Suburban’s Responses to AMX-006 and AMX-008.

1 ***BEGIN CONFIDENTIAL*** [REDACTED]

2 [REDACTED]

3 [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED] ***END

9 CONFIDENTIAL***⁸

10 There are several shortcomings in Southwest’s compensation philosophy.

11 **i. Mercer’s Compensation Survey is Too General to be Applicable**

12 In 2010, Southwest became a privately held company when it was acquired by an
13 investment fund, IIF Subway Investment LP managed by J.P. Morgan Investment Inc.
14 Water Asset Management was also a purchaser of Southwest through USA Water
15 Services, LLC and has an ownership interest of approximately 10%.⁹ Because Southwest
16 is a small, private water and wastewater utilities company, earning \$146.80 million
17 annually,¹⁰ its executive compensation is not comparable to the types of salaries in the
18 50th percentile of the general market as identified in the Mercer Compensation Survey
19 (“Mercer Survey”). The Mercer Survey includes participants from global giants such as
20 General Electric, General Motors, Pfizer Inc., Ernst & Young LLP, Deloitte LLP,
21 Citigroup Inc., Nestle USA Inc., The Coca Cola Company, The Boeing Company, Abbot
22 Laboratories, and Siemens Corporation, etc. Some of these international companies have
23 revenues in the billions of dollars annually.

⁸ Jocelyn Padilla’s Prepared Testimony, p. 3, lines 14-20.

⁹ A.10-04-009; D.10-09-012.

¹⁰ Walter Bench’s Prepared Testimony, p. 63, lines 9-13.

1 For example, The Coca Cola Company’s reported annual revenues were \$44.294
2 billion in 2015. Similarly, Pfizer’s reported annual revenues were \$48.851 billion in
3 2015. Based on these revenue levels, Southwest is only 0.33%¹¹ of The Coca Cola
4 Company and 0.30%¹² of Pfizer. The presence of these global companies in the Mercer
5 survey grossly skews the executive compensation listed in the 50th percentile level of
6 Mercer Survey toward the salaries of the executives of these global companies.
7 Suburban’s ratepayers should not pay these incommensurable executive pays and their
8 subsequent allocations.

9 Recently, other Class-A water companies in California, both publicly held and
10 privately owned, have presented their respective executive compensation surveys that
11 were based on a comparable group in the water or energy utilities and were therefore
12 closer in the level of operations to the Class-A water utility in question.¹³ Suburban fails
13 to justify that the use of Mercer general industry survey is a reasonable benchmark for
14 Southwest’s executive compensation.

15 **ii. Southwest’s Executives are Not Managing a Publicly Traded**
16 **Company**

17 The amount of risk and responsibility to manage a publicly traded company are
18 very different than those associated with managing a privately owned company. Unlike
19 public companies, private companies have far less risk and therefore must have
20 compensation that matches executive responsibility. For example, under Sarbanes-Oxley
21 Act of 2002 (“SOX”), the executives of publicly traded companies are subject to added
22 scrutiny, liability, and regulatory risk. Additionally, the Security and Exchange
23 Commission (“SEC”) requires the principle executive and financial officers of a public

¹¹ $(\$146.80/\$44,294) \times 100\% = 0.33\%$.

¹² $(\$146.80/\$48,851) \times 100\% = 0.30\%$.

¹³ Golden State Water Company (A.14-07-006) and San Gabriel Valley Water Company (A.16-01-002).

1 company to certify their company’s annual/quarterly report for accuracy, which exposes
2 them to the risk of civil and criminal enforcement action.¹⁴ No such regulatory
3 requirements exist for the officers of private companies. Therefore, it is unreasonable to
4 compare salaries between the two classifications of companies as compensation reflects
5 different levels of responsibility and risk.

6 **iii. Southwest’s Executive Compensation is Poorly Aligned with the**
7 **Interests of Suburban’s Captive Ratepayers**

8 The Prepared Testimony of Jocelyn Padilla does not adequately explain how the
9 executive compensation adds value to the ratepayers to support the requested executive
10 compensation. For example, the testimony describes Southwest’s compensation
11 philosophy by stating:

12 The Southwest Water Company’s policy and philosophy regarding
13 compensation is to:

14 ... Promote a pay for performance compensation philosophy that
15 will attract and retain talented and experienced individuals to
16 achieve the company’s strategic performance goals.¹⁵

17 However, it fails to explain what the company’s strategic performance goals are.
18 During discovery, Suburban admitted that the **only** strategic performance goal of
19 Southwest is Earning Before Interest, Taxes, Depreciation, and Amortization
20 (“EBITDA”).¹⁶

21 The popular financial site Investopedia defines EBITDA as follows:

22 EBITDA is one indicator of a company's financial performance and
23 is used as a proxy for the earning potential of a business, although
24 doing so has its drawbacks. Further, EBITDA strips out the cost of

¹⁴ SEC Release No. 34-46079.

¹⁵ Prepared Testimony of Jocelyn Padilla, p. 2, lines 8-16 (emphasis added).

¹⁶ Suburban’s Response to ORA’s Data Request AMX-003_Q1 follow up, Q1-4 and statement made by Suburban’s V.P. Regulatory Affairs, Robert Kelly during a teleconference held on March 21, 2017.

1 debt capital and its tax effects by adding back interest and taxes to
2 earnings.

3 ...

4 EBITDA is a non-GAAP measure that allows a greater amount of
5 discretion as to what is and what is not included in the calculation.
6 This also means that companies often change the items included in
7 their EBITDA calculation from one reporting period to the next.

8 EBITDA first came into common use with leveraged buyouts in the
9 1980s, when it was used to indicate the ability of a company to
10 service debt.¹⁷

11 Investopedia explains the drawbacks of EBITDA as follows:

12 A common misconception is that EBITDA represents cash earnings.
13 EBITDA is a good metric to evaluate profitability but not cash flow.
14 EBITDA also leaves out the cash required to fund working capital
15 and the replacement of old equipment, which can be significant.
16 Consequently, EBITDA is often used as an accounting gimmick to
17 dress up a company's earnings. When using this metric, it is key that
18 investors also focus on other performance measures to make sure the
19 company is not trying to hide something with EBITDA.¹⁸

20 On March 21, 2017, during a call with Suburban, Suburban admitted that
21 Southwest's sole strategic goal is to focus on increasing its EBITDA. As part of Data
22 Request AMX-003_Q1 follow up, Q1-4, ORA sought to confirm this statement, but did
23 not receive a response from Suburban. Nevertheless, such a solitary goal is very
24 problematic. A well-balanced executive compensation plan for regulated water utilities
25 providing services to ratepayers should have multiple performance matrices that are
26 focused on safety, quality of service, reliability, customer service, and affordability.
27 Often these performance measures are mutually competitive. For example, quality and
28 safety has its cost that will reduce the EBITDA. Therefore, tying executive

¹⁷ Investopedia, definition EBITDA, <http://www.investopedia.com/terms/e/ebitda.asp> (last visited April 12, 2017).

¹⁸ Investopedia, definition EBITDA, <http://www.investopedia.com/terms/e/ebitda.asp> (last visited April 12, 2017) (emphasis added).

1 compensation to the sole strategic performance goal of making profit in terms of
2 EBITDA is an inappropriate strategy that could jeopardize safety, reliability, quality,
3 customer service, and affordability— crucial considerations for Suburban’s captive
4 ratepayers.

5 Suburban claims that initiatives in the areas of customer service, safety, water
6 quality and conservation, risk management, attracting and retaining talent, and
7 community involvement exist at the level of Southwest’s subsidiaries (business units)
8 including Suburban.¹⁹ Suburban further explains that business units exchange best
9 practices in the area of field operations, safety, customer service metrics and programs,
10 suppliers, and employee development.²⁰ However, Southwest’s executives are evaluated
11 solely on the EBITDA strategic performance goal, which fails to add value to ratepayers;
12 therefore, Suburban’s ratepayers should not be required to share the burden of
13 Southwest’s executive compensation.

14 Unlike Suburban, other Class-A water utilities in California have well-defined and
15 balanced criteria for their respective executives’ short-term incentives. For example, a
16 typical Class-A water utility will have a mix of financial performance goals such as
17 Earning Per Shares (“EPS”), in the case of publicly traded company; Earnings Before
18 Interest and Taxes (“EBIT”); capital expenditure; maintenance expenses; supplier
19 diversity; capital investment; employee safety goals such as Occupational Safety and
20 Health Administration (“OSHA”) incidents; safety training; corporate due diligence goals
21 such as SOX deficiencies; and customer satisfaction goals such as customer complaints,
22 customer satisfaction, quality of service and water, etc.

23 No such performance goals are set for Southwest’s executives that can create a
24 balance between the interests of the shareholders and the ratepayers. Instead the sole

¹⁹ Suburban’s response to ORA’s Data Request AXM-003, 1(d).

²⁰ Suburban’s response to ORA’s Data Request AMX-003, 1(e).

1 strategic performance goal for Southwest’s executives is increasing EBITDA, which is
2 purely a profitability goal that inherently competes with the general performance goals
3 desirable for ratepayers such as safety, reliability, quality, and affordability.

4 **iv. Southwest’s Executives are Paid Above and Beyond the 50th Percentile**

5 In addition to establishing executive compensation by comparing Southwest with
6 global companies 332 times its size,²¹ Southwest pays its executives more than salaries in
7 the 50th percentile of the grossly skewed general industry pool. For example, in response
8 to ORA Data Request AMX-003, question 5(b), Suburban disclosed that three of four
9 Southwest executives are paid *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
10 **CONFIDENTIAL***** above the 50th percentile of market level identified in the Mercer
11 Survey.

12 Not only are these executives paid *****BEGIN CONFIDENTIAL***** [REDACTED]
13 *****END CONFIDENTIAL***** above the 50th percentile, they also receive performance
14 rewards in addition to their total compensation. For example, based on Suburban’s
15 response to ORA Data Request, AMX-003, question 3(c), *****BEGIN**
16 **CONFIDENTIAL***** [REDACTED]
17 [REDACTED]
18 [REDACTED]
19 [REDACTED] *****END**

20 **CONFIDENTIAL***** Importantly, Suburban was unable to support the basis for the
21 compensation level of *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
22 **CONFIDENTIAL***** above the 50th percentile and did not provide the details of the
23 “exceptional performance” categorization to demonstrate the merit of the executives’
24 reward pay. For example, Suburban’s response to ORA Data Request AMX-003,

²¹ Pfizer Inc.: \$48,851/\$146.80 = 332.77 times. The Coca Cola Company: \$44,294/\$146.80 = 301.73 times.

1 question 5(a) claimed that the practice of paying *****BEGIN CONFIDENTIAL***** [REDACTED]
2 *****END CONFIDENTIAL***** above the 50th percentile is “*widely accepted market*
3 *methodology is rooted in the practice of using the market median as a proxy for the*
4 *targeted market rate.*” However, Suburban failed to provide any documentary support
5 for this claim.

6 Similarly, Suburban’s Response to ORA Data Request AMX-003, question 3(c),
7 dated February 13, 2017, failed to provide the specific details such as market benchmarks
8 and rating criteria for the “exceptional performance” bonus for Southwest executives.²²
9 On March 31, 2017, after several attempts to obtain this information, Suburban provided
10 copies of the “exceptional performance” evaluations. *****BEGIN**

11 **CONFIDENTIAL***** [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED] *****END**

16 **CONFIDENTIAL*****²³

17 It should be noted that the “exceptional performance” evaluation includes criteria
18 such as safety and customer focus which add value to ratepayers; however, these
19 elements are only applied to the exceptional performance bonus which is a very small
20 portion of the Southwest’s executive compensation.

21 **v. Southwest’s Executive Compensation Paid in 2015 Does Not Reconcile**
22 **with the Mercer Survey or Suburban’s Workpapers**

23 Suburban claims that Southwest’s executives are *****BEGIN**
24 **CONFIDENTIAL***** [REDACTED] [REDACTED] [REDACTED]

²² Suburban Response to ORA Data Request AMX-003, 3(c) and 5(a).

²³ See Attachment B.

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2
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12

[REDACTED] ***END
CONFIDENTIAL*** ²⁴ ***BEGIN CONFIDENTIAL*** [REDACTED]
[REDACTED]
[REDACTED] ***END

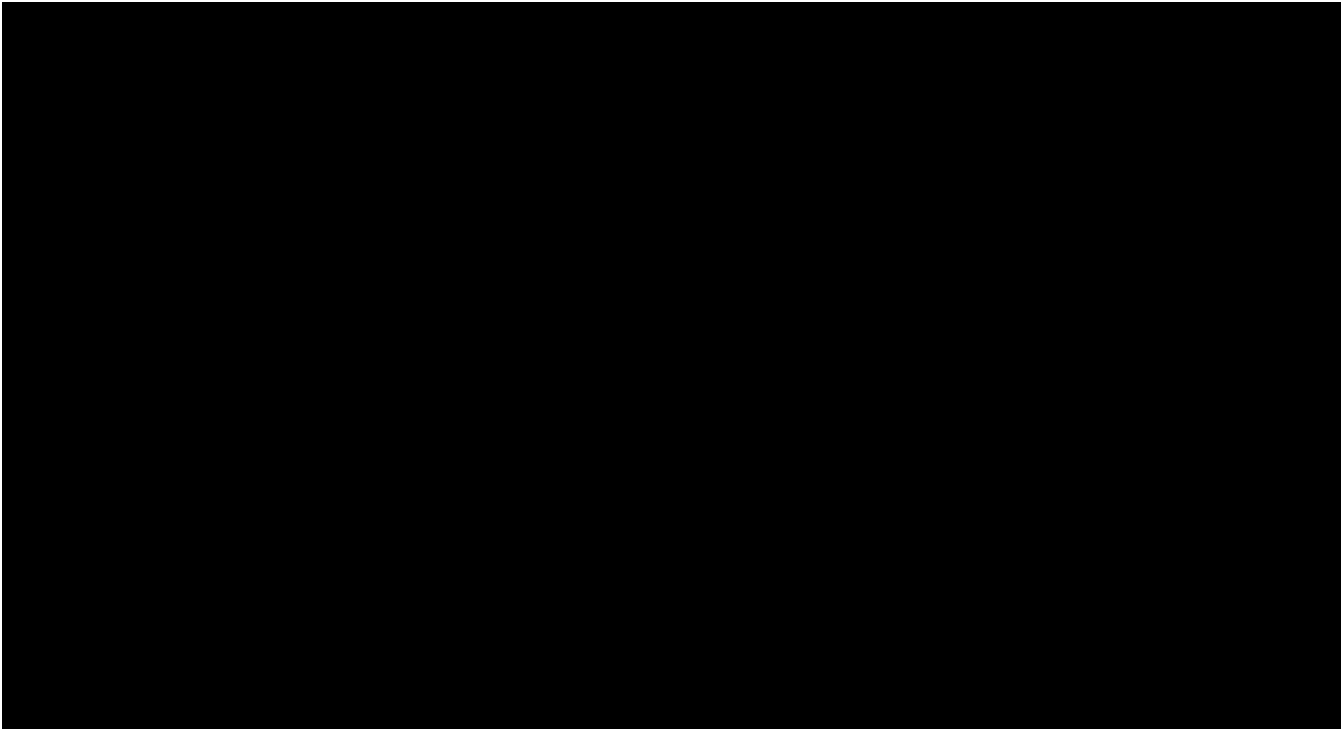
CONFIDENTIAL*** ²⁵ In addition, Suburban claims that various executives were paid performance incentives in 2015.²⁶ Suburban asserts that the short-term incentives for Southwest’s executives were excluded from rates because they were considered above and beyond the levels reported by the Mercer Survey.²⁷ However, Suburban’s workpapers discussing Southwest’s executive compensation does not reconcile with any of the information Suburban provided to ORA.

The following table compares information provided by Suburban during discovery and Southwest’s executive compensation as it appears in Suburban’s workpapers.

²⁴ Suburban Response to ORA Data Request AMX-003, 4(f).
²⁵ Suburban Response to ORA Data Request AMX-003, 5(b).
²⁶ Suburban Response to ORA Data Request AMX-003, 3 (c).
²⁷ Suburban Response to ORA Data Request AMX-008, 2(b).

1 **Table-3: Discrepancies in Reported Southwest’s Executive Compensation in 2015**

2 *****BEGIN CONFIDENTIAL*****



3
4 *****END CONFIDENTIAL*****

5 Table-3 shows numerous discrepancies between what Suburban reported to ORA
6 during discovery and what Suburban’s workpapers state. *****BEGIN**

7 **CONFIDENTIAL***** [Redacted]

8 [Redacted]
9 *****END CONFIDENTIAL***** As demonstrated by these inconsistencies,
10 Suburban’s workpapers and testimony are unreliable.

11 In addition to the identified discrepancies, there are several issues with
12 Southwest’s executive compensation. First, it seems illogical that although executives
13 were paid *****BEGIN CONFIDENTIAL***** [Redacted] *****END CONFIDENTIAL*****
14 above the 50th percentile their short-term incentives were reduced.

15 Second, Suburban asserts that the CEO was paid *****BEGIN**
16 **CONFIDENTIAL***** [Redacted] ***** END CONFIDENTIAL***** below the 50th

1 *percentile*,²⁸ but a closer look at the Mercer Survey reveals that Suburban compared the
2 CEO's compensation with the *mean* of the 50th percentile while it used the *median* of 50th
3 percentile for all other executives. Use of the mean to calculate the CEO's compensation
4 resulted in a value of *****BEGIN CONFIDENTIAL***** [REDACTED]
5 *****END CONFIDENTIAL*****²⁹ Suburban fails to explain why it took a
6 different approach for the CEO's compensation than it did for the other executives'
7 compensation.

8 **vi. Suburban's Ratepayers are Already Paying a Sizeable Expense for**
9 **Executive Oversight that Generates Direct Ratepayer Benefits**

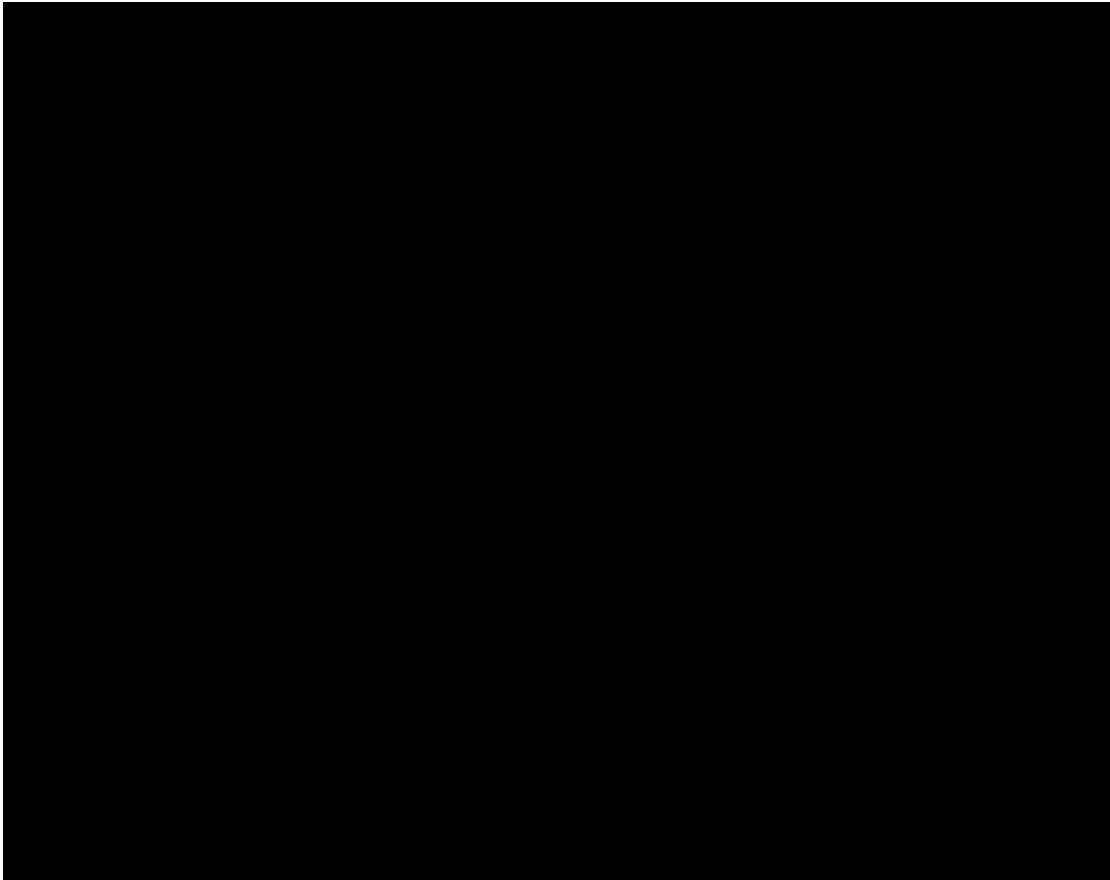
10 Notwithstanding Southwest's executives, Suburban has its own executives who
11 are directly involved in its day-to-day operations. According to Suburban, these
12 executives have diverse performance goals in the areas of customer service, safety, water
13 quality and conservation, risk management, attracting and retaining talent, and
14 community involvement. Suburban's ratepayers are paying these executives' salaries.
15 Suburban's response to ORA Data Request AMX-003, questions 9(a) and 9(b) provided a
16 list of its top executives and their respective compensation. The following table
17 summarizes executive functions and compensation:

²⁸ Suburban Response to ORA Data Request AMX-03, Question 5(b).

²⁹ Position:100-012.110 Chief Executive Officer {CEO/President Subsidiary}:2014 US MBD: Mercer Benchmark Database Executive Compensation Survey Report. See Attachment C (Mercer's survey excerpts).

1 **Table-4: Suburban’s Top Executives-their Function and Compensation**

2 *****BEGIN CONFIDENTIAL*****



3

4 *****END CONFIDENTIAL*****

5 As evident from the Table-4 above, Suburban’s captive ratepayers are already
6 paying high costs for the executives who are directly involved in the day-to-day
7 operations of Suburban and who apparently have balanced performance goals that benefit
8 both the shareholders and the ratepayers. Suburban’s ratepayers should not be burdened
9 by an additional cost of approximately \$1 million³⁰ for the compensation of Southwest

³⁰ Suburban is requesting 46.5% of Southwest’s costs be allocated to Suburban. Southwest’s total requested executive compensation is \$2,000,210. Therefore, 46.5% equals to \$930,093 of this executive compensation to be paid by Suburban.

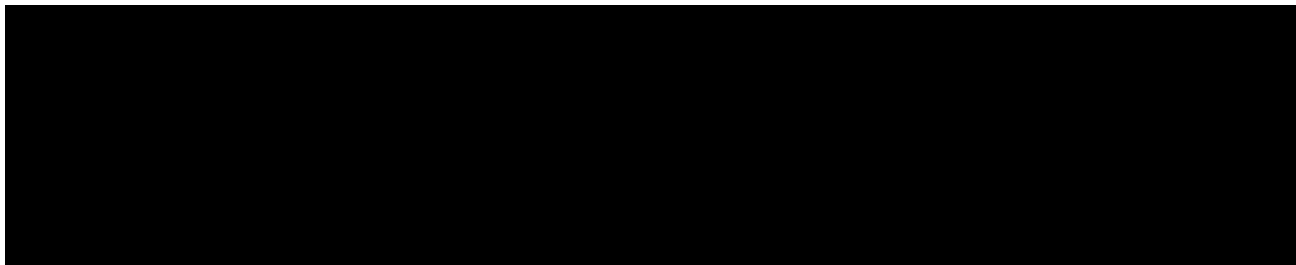
1 executives whose sole performance goal is to increase profits for shareholders and who
2 are also paid based on an incommensurable market average.

3 Based on the foregoing discussion and facts, ORA recommends that:

- 4 1) The Commission exclude Southwest's executive compensation from the allocation to
5 Suburban's ratepayers because Southwest's executives have exorbitant compensation
6 and do not add value to Suburban's ratepayers who already fund approximately \$1.7
7 million cost for Suburban's top executives.
- 8 2) If the Commission authorizes Suburban to allocate Southwest's executive
9 compensation, it should calculate the allocation based on the 25th percentile level of
10 the Mercer Survey, and not the 50th percentile which is grossly skewed due to the
11 presence of large international companies. The 25th percentile is not skewed because
12 it would more likely exclude the executive compensation for the relatively large
13 global companies. Table-5 below shows executive compensation at the 25th percentile
14 level as of 2014. These compensation values should then be escalated to 2018 values
15 by using Commission's traditional CPI-labor escalation factors.
- 16 3) The Commission should order Suburban to align Southwest's executive compensation
17 with the interest of ratepayers so that a balance is created between serving the
18 shareholders and the captive ratepayers.
- 19 4) The Commission should order Suburban to formulate a more realistic and comparable
20 group of utility companies based on gross revenue for the purpose of benchmarking
21 Southwest's executive compensation under ORA's supervision.

1 **Table-5: Southwest’s Executive Compensation for Ratemaking Purposes Based on**
2 **25% Percentile of the Mercer Survey**

3 *****BEGIN CONFIDENTIAL*****



5 *****END CONFIDENTIAL*****

6 **2. Parent Company’s Information Technology Capital Projects**

7 Suburban requests that the Commission authorize the allocation of 46.5% of
8 Southwest’s capital expenditures in various IT projects totaling approximately \$5.4
9 million over the period of 2018 through 2019. The Table-6 below shows the list of
10 various IT projects along with their respective capital cost:

11 **Table-6: Southwest’s IT Projects - 2018 through 2019³¹**

Description	Hardware	Software	External Labor	Internal Labor	2017	2018	2019
SAP Hana Business Suite	\$ 300,000	\$ 300,000	\$ 900,000	\$ 1,070,000		\$ 2,570,000	
Non SWS PC Refresh and Peripherals	75,000	0	5,000	5,000		85,000	
Phase I: Customer Service Automation	0	0	0	32,000		32,000	
Sub Total-2018	\$ 375,000	\$ 300,000	\$ 905,000	\$ 1,107,000		\$ 2,687,000	
Telecommunications and Customer Service Center Upgrade	\$ 250,000	\$ 350,000	\$ 150,000	\$ 440,000			\$ 1,190,000
Finance, Treasury, and Planning Automation	50,000	200,000	50,000	140,000			440,000
Data Centers Flash Storage Refresh	450,000	0	40,000	153,000			643,000
Corporate office storage	20,000	0	0	32,000			52,000
Next Generation Firewall Refresh	80,000	0	10,000	100,000			190,000
Phase II: Customer Service Automation & Operational Reporting Enhancements	0	0	10,000	220,000			230,000
Sub Total-2019	\$ 850,000	\$ 550,000	\$ 260,000	\$ 1,085,000			\$ 2,745,000
Total- 2018 & 2019							\$ 5,432,000

12 ³¹ Based on the data presented by Suburban (Workpapers, File: GRC 2017-A.17-01-xxx, Tab: Parent Co. RB).

1 The cost data in Table-6 above shows the breakdown of costs for hardware,
2 software, external labor, and internal labor. The internal labor cost consists of regular
3 labor expenses that are capitalized and subsequently removed from Southwest’s operating
4 and administration expenses.³² However, what Table-6 does not show, and what is
5 important for assessing this request, is Southwest’s previous IT projects which have not
6 been successful at providing benefits to ratepayers or even the Company.

7 **a. Southwest’s Prior IT projects**

8 Suburban claims that Southwest spent \$22.13 million on an IT project called the
9 Cornerstone-Oracle project that did not result in any tangible IT capabilities other than to
10 identify numerous shortcomings in the current IT systems.³³ Suburban asserts that the
11 Cornerstone-Oracle project was abandoned and the \$22.13 million costs were not
12 recovered in rates. Suburban also claims that the supporting documents, such as invoices,
13 for this huge \$22.13 million expenditure are not relevant for assessing the reasonableness
14 of the current IT projects costing \$5.4 million.³⁴ Suburban is incorrect.

15 The failed \$22.13 million IT project is very relevant and provides insight into
16 Southwest’s management practices. It is relevant that Suburban’s parent company did
17 not realize any IT capabilities even though it spent \$22.13 million on an IT project
18 because this demonstrates Southwest’s potential mismanagement of past IT projects and
19 spending. Thus, this creates uncertainty about whether the proposed IT project will also
20 fail. Suburban has not demonstrated that Southwest will competently manage the new IT
21 project. Why should the Commission trust Southwest to properly manage the currently
22 requested \$5.4 million IT projects?

³² Since ORA recommends disallowance of these IT projects, the capitalized labor would be reverted back to regular labor.

³³ Suburban Response to ORA Data Request AMX-006, 1(b).

³⁴ Ibid.

1 For comparison, other Class-A water utilities in California have presented in-depth
2 analysis of the numerous shortcomings of their IT systems and furnished a need analysis
3 to justify their IT projects. The average cost spent on a highly qualified outside
4 consultant hired to perform the in-depth need analysis and recommend corrective
5 measures was approximately \$150,000— not \$22.13 million. For example, San Gabriel
6 Valley Water Company recently paid \$150,000 to an outside IT consulting firm that
7 performed the following tasks:

- 8 ... Evaluated the company’s existing information systems, including billing,
9 general ledger, accounts payable, purchasing, budgeting, job costing,
10 payroll and HR management;
- 11 ... Interviewed key staff members to collect data, conduct a needs assessment,
12 and identify strengths and weaknesses;
- 13 ... Prepared a comparative analysis of current system capabilities with
14 industry best practices;
- 15 ... Prepared a Business Systems Assessment Report that
 - 16 o summarized all of the above,
 - 17 o documented the advantages and risks associated with replacing or
18 maintaining the company’s current systems,
 - 19 o identified alternatives along with budget-level cost estimates,
 - 20 o determined the level of IT support needed for each alternative, and
 - 21 o recommended a preferred alternative.³⁵

22 Spending \$22.13 million on an IT project that only produced a list of IT
23 shortcoming causes significant concerns about the executive oversight Southwest is

³⁵ See Attachment D (email from Mr. Joel Reiker, Vice President of Regulatory Affair, San Gabriel Valley Water Company to ORA’s Analyst, Mr. Mehboob Aslam).

1 providing for the benefit of Suburban and Suburban’s ratepayers. Suburban’s ratepayers
2 should not have to pay for Southwest’s potential poor oversight of another expensive IT
3 project that could end up useless given Southwest’s recent management failure. No IT
4 project should be authorized without a robust need analysis and effective project
5 management guarantees.

6 **b. Southwest has not Adequately Determined its IT Needs or the Available**
7 **IT Solutions**

8 The Prepared Testimony of Southwest’s IT Director, Jeff Farney, delineates the
9 details of several IT projects. *****BEGIN CONFIDENTIAL***** [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 *****END**
13 **CONFIDENTIAL***³⁶** He further states that Southwest has been using an older
14 version of SAP:

15 *****BEGIN CONFIDENTIAL***** [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 *****END CONFIDENTIAL***³⁷**

21 However, in a later Suburban’s response to ORA Data Request, AMX-001,
22 question 1(e), Mr. Farney acknowledged that even the new upgrade will need targeted
23 “fixes” because “no modern computer ERP [Enterprise Resource Planning] system is ‘out
24 of the box’ ready, [and therefore] there will always be added functions and features that

³⁶ Jeff Farney Prepared Testimony, p. 2, lines 19-20.

³⁷ Jeff Farney Prepared Testimony, p. 3, lines 13-20.

1 require programing to implement.”³⁸ Mr. Farney defines “fixes” “to include
2 programming new features that support evolving business requirements and customer
3 needs.”³⁹

4 Importantly, Mr. Farney’s testimony described the pitfalls of using “fixes” and
5 explained that “fixes” were the root of the failure of the current system and corresponding
6 need for a new system. Mr. Farney explains that Suburban

7 *****BEGIN CONFIDENTIAL***** [REDACTED]

8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED]
14 [REDACTED]
15 [REDACTED]
16 *****END CONFIDENTIAL*****⁴⁰

17 Because Mr. Farney acknowledges that the new system will require “fixes” and
18 that “fixes” are the root of the need for the requested upgrade, it appears that in a few
19 years Southwest will be back to square one and will be demanding yet another upgrade
20 based on argument that *****BEGIN CONFIDENTIAL***** [REDACTED]

21 [REDACTED]
22 [REDACTED] *****END**

23 **CONFIDENTIAL***** ⁴¹ In other words, as testified by Mr. Farney and admitted to in
24 data request responses, the requested *****BEGIN CONFIDENTIAL***** [REDACTED]

³⁸ Suburban Response to ORA Data Request AMX-001, 1 (e).

³⁹ Suburban Response to ORA Data Request AMX-001, 1 (e).

⁴⁰ Jeff Farney Prepared Testimony, p. 3, lines 13-24.

⁴¹ Ibid.

1 [REDACTED]

2 [REDACTED] *****END CONFIDENTIAL*****

3 Further diminishing confidence in the potential success of Southwest’s requested
4 IT project and Southwest’s management of such a project, is the fact that in 2011

5 Southwest decided to run *****BEGIN CONFIDENTIAL***** [REDACTED]

6 [REDACTED]

7 [REDACTED] *****END**

8 **CONFIDENTIAL***** Southwest claims that the

9 *****BEGIN CONFIDENTIAL***** [REDACTED]

10 [REDACTED] *****END CONFIDENTIAL***** provides a number
11 of benefits to the organization and our customers. In terms of cost
12 avoidance, this technology upgrade will add to our hardened and
13 state of the art data center (with backup and redundancy) provide
14 extremely high reliability in terms of system availability.⁴²

15 It is unclear why these advantages were not fully evaluated in 2011 when
16 *****BEGIN CONFIDENTIAL***** [REDACTED] *****END CONFIDENTIAL***** was
17 available and Southwest was just emerging from its \$22.13 million failed IT project. One
18 can only hope that Southwest has learned some lessons from its failed \$22.13 million IT
19 project.

20 Southwest has not demonstrated that it can efficiently evaluate its IT needs and the
21 available IT capabilities/solutions in the market. Southwest spent \$22.13 million on an
22 IT project in 2009 that was supposed to replace the existing SAP system with new
23 “Oracle” system. This project was later abandoned and no IT capabilities were achieved.

24 *****BEGIN CONFIDENTIAL***** [REDACTED]

25 [REDACTED]

26 [REDACTED] *****END CONFIDENTIAL***** These

⁴² Suburban Response to ORA’s Data Request AMX-001, 1(f).

1 facts help establish that Southwest is not in the best position to spearhead its current IT
2 project. Suburban’s ratepayers deserve reliable management and the Commission should
3 not allow any funds in rates for IT projects without adequate checks and balances in
4 place.

5 **c. Suburban’s Testimony States that Southwest’s Existing IT System is**
6 **Stable, Reliable, and Provides Platform for Future Growth.**

7 Suburban’s IT projects requested in this GRC are mainly focused on *****BEGIN**

8 **CONFIDENTIAL***** [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]

12 [REDACTED] *****END**

13 **CONFIDENTIAL***** ⁴³

14 However, Suburban’s witness Walter Bench, the former Treasurer of Southwest,
15 attests to Southwest’s robust IT department in contradiction to Jeff Farney’s testimony.
16 For example, while supporting Southwest’s computer and telecommunications
17 infrastructure and IT function, Walter Bench stated:

18 The Southwest IT function has realized the following
19 accomplishments and achievements in the last three years:
20 The new telecommunications wide area network (WAN) that utilizes
21 a modern Multiprotocol Label Switching (MPLS) provides a high
22 performance network that optimizes data traffic and avoids latency
23 and slow response time. **The average network availability for the**
24 **La Mirada customer call center increased from approximately**
25 **98.68% in early 2014 to an average of 99.83% (each 1% =1.6**
26 **hours of downtime) for the year 2015 which mean increased**
27 **availability of agents and system that provides customer**
28 **service.** In addition, IT configured network redundancy for each of

⁴³ See generally Jeff Farney Prepared Testimony.

1 the three Suburban locations so that in the event of a network outage
2 due to fiber cut, etc. the redundant connection will automatically
3 kick in and sustain operations until the primary is restored.

4 **In the company's two data centers, all major computing and**
5 **storage hardware components have been refreshed and**
6 **upgraded utilizing virtualization technology that provides**
7 **improved processing and storage capabilities with fewer**
8 **appliances.**

9 The IT Cyber Security function in 2015 employs modern Intrusion
10 Detection and Prevention (IDP) technology to proactively protect
11 business operations. The Cyber Security team has also performed a
12 Supervisory Control and Data Acquisition (SCADA) Vulnerability
13 Assessment to ensure risks are being mitigated.

14 **It has implemented a number of enhancements to customer**
15 **service operations that help customer service representative to**
16 **do their jobs more effectively and efficiently. Enhancements**
17 **implemented in the last three years follows:**

18 ... enabled customers to make online credits, debit or electronic
19 check payments which free up customers service agents to
20 perform more value added customer support as compared to
21 previous manual payment processing...

22 ... re-designed most SAP functionality that supports customer
23 service agents to make the workflows and screens more user
24 friendly and better aligned with business processes.

25 ... implemented Suburban Regulatory Trial Balance reporting
26 capabilities for revenue and expense accounting which has
27 greatly reduced manual work and the potential for errors
28 when providing regulatory financial information to various
29 stakeholders group.

30 ... configured and implement SAP's Consolidation reporting toll
31 known as Business Planning Consolidation (BPC) to support
32 the broader finance function in situations involving
33 acquisitions or consolidated reporting.

34 ... installed an SAP utility named Governance Risk and
35 Compliance which provides automation to track, manage, and
36 mitigate segregation of duties to control risk of fraud and
37 accounting errors and eliminate numerous manual processes
38 in Procurement, IT and Finance.

1 ... implemented banking automation enhancements in the
2 treasury department for Automated Clearing House (ACH)
3 and Credit Card transactions that include automated clearing
4 reconciliation and electronic bank statement processing.⁴⁴

5 Mr. Bench concludes that the “Southwest Water IT Platform for
6 Telecommunications and infrastructure, Cyber Security and Applications that exists in
7 2015 is stable, reliable, and state of the art computing platform that supports
8 business and customer requirement not only for the current steady state, but also
9 provides a platform for growth in the future.”⁴⁵

10 According to Mr. Bench, it is evident that Southwest’s current IT platform and
11 infrastructure are stable, reliable, and capable of taking on future challenges. Therefore,
12 there is no need to implement and fund the requested IT project.

13 **d. Southwest May Be Attempting to Collect its Past IT Costs in Future Rates**

14 In addition to the clear contradictions between the testimony of Walter Bench and
15 Jeff Farney, *****BEGIN CONFIDENTIAL***** [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED] *****END**

20 **CONFIDENTIAL***** ⁴⁶

21 Contrary to Mr. Farney’s assertions, Mr. Bench’s Prepared Testimony (as
22 reproduced and highlighted above) claims that these modules, namely *****BEGIN**
23 **CONFIDENTIAL***** [REDACTED]

⁴⁴ Walter Bench Prepared Testimony, pp. 30-33 (original emphasis omitted and emphasis added).

⁴⁵ Walter Bench Prepared Testimony, p. 37, lines 10-15 (emphasis added).

⁴⁶ Jeff Farney Prepared Testimony, p. 11, lines 2-8.

1 [REDACTED] *****END CONFIDENTIAL***** were already implemented three
2 years ago. This apparent inconsistency gives rise to the concerns that Southwest and
3 Suburban maybe attempting to recover the past IT costs (other than Project Cornerstone-
4 Oracle) in future rates from the ratepayers. The current request should only be recovered
5 in rates based on prospective Test Year estimates. Mr. Bench is clearly claiming that
6 these various IT modules were not only functional as of 2015, they **are deemed stable,**
7 **reliable, and sufficient to provide a platform for Southwest’s future growth.**
8 Suburban provides no convincing support that its current IT costs are different than those
9 spent in the various *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
10 **CONFIDENTIAL***** modules that were working fine, at least in 2015.

11 In sum, due to the conflicting testimony of Suburban’s witnesses, the recent failure
12 of the \$22.13 million IT project, and Suburban’s claim that this is the first time it has
13 requested allocations of Southwest’s capital expenditures, the Commission should be
14 alerted that the current IT request is potentially an attempt to recover past costs in future
15 rates. *****BEGIN CONFIDENTIAL***** [REDACTED]

16 [REDACTED]
17 [REDACTED] *****END CONFIDENTIAL***** Mr.
18 Bench corroborated Mr. Farney’s testimony by testifying that these *****BEGIN**
19 **CONFIDENTIAL***** [REDACTED] *****END CONFIDENTIAL***** modules were up and
20 running in 2015. Thus, there is a valid concern whether the entire cost of \$5.4 million or
21 portion of which was already spent between the period of 2011 and 2015.

22 **e. Suburban Has Not Established that the Past Costs of \$22.13 million for**
23 **Project Cornerstone-Oracle Were Not Recovered in Past Rates**

24 ORA also raised concerns during the discovery phase regarding the recovery of
25 the \$22.13 million past cost. Per the assigned Administrative Law Judge’s (“ALJ’s”)
26 direction, Suburban submitted an official declaration on April 3, 2017 claiming that its

1 current \$5.4 million IT request has nothing to do with the \$22.13 million costs spent up
2 until 2009 for its previous IT project.⁴⁷

3 Although Suburban declared that all of Southwest’s current request of \$5.4 million
4 for IT projects are unrelated to the \$22.13 million cost of the failed IT Project
5 Cornerstone, it is not established that no portion of \$22.13 million costs were recovered
6 from Suburban ratepayers in the past. This is because Suburban did not establish a
7 Commission-ordered memorandum account for this purpose or book any costs in the
8 memorandum account. Because ORA could not obtain these documents during
9 discovery, as explained above, ORA could not independently verify Suburban’s declared
10 claim that Project Cornerstone’s cost were not recovered in rates. Especially when it
11 comes to the capitalized labor, it can be easily shifted to expensed labor and recovered as
12 expenses and not as IT plant.

13 Further, the fact that Suburban failed to establish a memorandum account to
14 separately track all the costs associated with the Project Cornerstone per the requirement
15 set forth in D.09-03-007 raises more concerns as to why the Commission’s clear
16 directives were ignored. D.09-03-007 states:

17 **Suburban is directed here to track Project Cornerstone costs in**
18 **a memorandum account. However, we find that the matter is**
19 **premature, and will not authorize Suburban to utilize the Advice**
20 **Letter process at this time to recover those costs. Instead,**
21 **Suburban and DRA are directed to meet and confer informally**
22 **on this issue prior to the filing of any request to recover these**
23 **costs.** The parties may meet/confer themselves, or request a
24 mediation conference through the Commission’s ADR program. If
25 the parties agree, Suburban may file a request to recover these costs
26 through an Advice Letter. If no agreement is reached, Suburban
27 shall file a formal application for that purpose.⁴⁸

⁴⁷ See Attachment E (Amended declaration of Robert L. Kelly on behalf of Suburban Water Systems in response to Office of Ratepayer Advocates Data Request AMX-006).

⁴⁸ D.09-03-007, p. 27 (emphasis added).

1 Suburban claims that it did not establish the memorandum account ordered by
2 D.09-03-007⁴⁹ because Southwest and Suburban have not requested recovery of any of
3 the costs associated with Project Cornerstone.⁵⁰ However, the fact remains that neither
4 ORA nor the Commission have performed an independent evaluation to ascertain
5 whether Suburban's current claims are factual. Suburban's failure to establish the
6 memorandum account and its inability to show any tangible IT assets against the \$22.13
7 million investment raises great concerns about whether Suburban ratepayers
8 inappropriately shouldered some of these costs. ORA cannot verify Suburban's claims.

9 In addition, because IT projects usually have a great deal of internal capitalized
10 labor cost, the risk of mis-classifying such labor cost as expensed labor is possible. For
11 example, Southwest's current IT project for \$5.4 million has approximately \$2.2 million
12 built-in for internal capitalized labor (see Table-6 above). Therefore, it is imperative for
13 the Commission to determine whether or not the internal capitalized labor cost for the
14 project Cornerstone was indeed written-off and not recovered in rates as Suburban now
15 claims.

16 Based on foregoing discussion and facts it is recommended that:

- 17 1) The Commission should deny Suburban's current request to include Southwest's IT
18 capital projects in Suburban's ratebase.
- 19 2) The Commission should order an immediate third-party IT audit for Suburban's
20 parent, Southwest, to ensure that Suburban ratepayers are not subsidizing unnecessary
21 and past costs. ORA should be authorized to supervise the third-party IT auditor to
22 ensure that ratepayers' interests are protected and overall quality is maintained.

⁴⁹ Suburban Response to ORA Data Request AMX-006, 1(c).

⁵⁰ See Attachment E (Amended declaration of Robert L. Kelly on behalf of Suburban Water Systems in response to Office of Ratepayer Advocates data request, AMX-006).

1 3) The Commission should order Suburban to have its IT needs and existing IT
2 capabilities be evaluated by a third-party IT consultant under ORA's supervision.

3 **3. Southwest's Cost Allocations**

4 **a. Background**

5 ORA in the past has determined that Suburban's parent company costs allocated
6 amongst its various subsidiaries have been improperly calculated. Suburban's
7 unreasonable interpretation of the Commission's long standing Four- Factor Allocation
8 Methodology is the source of Suburban's improper allocation of its parent company's
9 costs.

10 In 1956, the Commission issued a Subject Reference, H32, titled *Allocation of*
11 *Administrative and General Expenses and Common Utility Plant*, which later became the
12 Commissions' Four-Factor Allocation Method. The Commission identified procedures
13 for the allocation of administration and general expenses and common utility plant among
14 departments, districts and states. While describing the allocation of indirect costs, the
15 Commission stated:

16 Indirect Allocations

17 Indirect general expenses which have a significant relationship to a
18 particular factor, such as pension expenses to payroll, should be
19 segregated and prorated on the basis of an appropriate single factor.
20 The remaining indirect expenses may be so general in nature as to
21 require prorations **based on a combination of several pertinent**
22 **factors**. Considering the relative complexity and magnitude of the
23 operations usually involved, it is believed that the application of the
24 arithmetic average of the percentages derived from the use of four
25 factors listed below produces **results within the range of**
26 **reasonableness in most instances**. The four factors are as follows:

- 27 1. Direct operating expenses, excluding uncollectibles, general
28 expenses, depreciation and taxes.
- 29 2. Gross Plant.
- 30 3. Number of employees (using direct operating payroll, excluding
31 general office payroll, as the best measure of this component).

1 4. Number of customers (subscribers of telephone).⁵¹

2 Historically, Suburban has misused the Commission’s Four-Factor Allocation
3 Method described above to calculate allocation rates by shifting unreasonably high parent
4 company costs toward its ratepayers. For example, starting in 2002, Suburban
5 unreasonably applied the Number of Customers factor to divert its parent company’s
6 costs toward Suburban by simply undercounting the number of customers its other
7 affiliates served under private contracts. The undercounting of Number of Customers
8 served by other affiliates effectively would have shifted allocation weight toward
9 Suburban where the Number of Customers is relatively higher. However, the
10 Commission disallowed Suburban’s application of the Number of Customers factor and
11 ordered Suburban to use only three factors instead by dropping the Number of Customer
12 factor. This subsequently did not allow the parent company’s cost allocations toward
13 Suburban to increase unreasonably.⁵²

14 Thus, Suburban’s witness Walter Bench’s Prepared Testimony is factually
15 incorrect when he claims that prior to 2013, the Commission ordered Suburban to use the
16 four-factor method to allocate indirect costs which was consistent with the procedures set
17 forth in the Commission’s memo “Allocation of Administrative and General Expenses
18 and Common Utility Plant,” dated July 26, 1956.⁵³

19 Similarly, in its GRC application, A.11-02-002, decided in D.12-04-009, the
20 Commission ordered Suburban to use only two factors since the Commission did not find
21 Suburban’s allocation data for the other two factors credible: Number of Customers and

⁵¹ Commission’s Subject Reference, H32, titled Allocation of Administrative and General Expenses and Common Utility Plant (emphasis added).

⁵² D.03-05-078, pp. 19-22.

⁵³ Walter Bench’s Prepared Testimony, p. 39, lines 18-22.

1 Gross Plant.⁵⁴ Thus, the statement in Walter Bench’s Prepared Testimony claiming that
2 the two-factor methodology resulted from a settlement per D.12-04-009⁵⁵ is incorrect
3 because the proceeding was litigated and decided by the Commission. Suburban also
4 applied for a rehearing on the matter, but the Commission denied Suburban’s request.⁵⁶

5 In its next GRC application, A.14-02-004, per D.14-12-038, Suburban settled the
6 issue of cost allocation and agreed to use a three-factor allocation method. Suburban also
7 agreed to the following specific conditions.⁵⁷

8 ... If Southwest is unable to divest itself of the remaining service contracts
9 by next general rate case, it will in its next application provide end-user
10 figures and the plant values of those systems under each contract.

11 ... To calculate the Utility Group allocation factor using the same three-
12 factor allocation agreed upon for parent company cost, including the
13 traditional calculation of gross plant, *and to keep the eleven contracts in*
14 *the calculations.*

15 **b. Current Three-Factor Allocations**

16 This time around, Suburban once again used inconsistent information for cost
17 allocations. For example, Suburban claims it could not divest 9 out of 11 remaining
18 service contracts, it also claims, in clear violation of its settlement obligation, that it was
19 unable to obtain the end-user and gross plant values for those systems still under
20 contract.⁵⁸

⁵⁴ D.12-04-009, pp. 15-18.

⁵⁵ Walter Bench’s Prepared Testimony, p. 38, lines 24-27.

⁵⁶ D.13-12-030, pp. 5-8.

⁵⁷ D.14-12-038, Settlement Document, pp. 31-32.

⁵⁸ Walter Bench’s Prepared Testimony, p. 40, lines 12-13.

1 Suburban failed to provide the needed gross plant and end-users (Number of
2 Customers) information under these service contracts and also excluded the remaining 9
3 service contracts for the purpose of assessing Utility Group’s allocations. This
4 information, some of which Suburban agreed to provide in the last GRC settlement,
5 would have enabled the Commission to apply its intended Four-Factor Allocation
6 Method. Instead, Suburban applies cost allocations in this GRC to unreasonably shift
7 cost to its captive ratepayers. Suburban flagrantly disregards the Commission’s directive
8 to provide the end-user figures and the plant values for its service contracts and deviates
9 from the reasonable approach to include the remaining service contracts for the
10 calculation of Utility Group’s allocations—an approach both ORA and Suburban agreed
11 to in settlement per D.14-12-038 in the last GRC (A.14-02-004). Notably, that approach
12 was also in-line with the Commission’ earlier directives on the same issues per D.12-04-
13 009 where the Commission warned Suburban that “*it must be reasonable in its*
14 *calculations and consistent in its data in the next general rate case.*”⁵⁹

15 Southeast Utilities, one of Southwest’s affiliates, serves the 9 service contracts.
16 Therefore, the information regarding the gross plant and number of customers (end-users)
17 served under each of these contracts helps define the true scope of the activity level of
18 Southeast Utilities, which is the main purpose of the Commission’s Four-Factor
19 Allocation Method. The four-factor allocation across the various subsidiaries must be
20 consistent; otherwise, the cost allocations will be skewed toward the subsidiary which
21 would have relatively higher values under these allocation factors.

22 For example, by not having the gross plant figure under the contracts, the cost
23 allocations are shifted away from Southeast and diverted toward Suburban because
24 Suburban has substantial amounts of gross plant. The Table-7 below shows the excerpt

⁵⁹ D.12-04-009, p. 18 (emphasis added).

1 from Suburban’s workpapers indicating that gross plant values were missing for the 9
 2 contracts.

3 **Table 7: Suburban’s Three-Factor Cost Allocation Calculations without Gross Plant**

COMPUTATION OF ALLOCATION PERCENT								
For Southwest without Gross Plant for Service Contracts								
Company	Direct Operating Expense		Payroll		End of Year Gross Plant		PROPOSED ALLOCATION %	
	Recorded 2015		Recorded 2015		Recorded 2015		Total	Average
	Amount, \$	Percent	Amount, \$	Percent	Amount, \$	Percent	Percent	(Percent)
ALLOCATION FACTORS								
Suburban Water Systems	35,636,123	49.7%	8,257,287	43.8%	252,399,351	45.9%	139.4%	46.5%
Texas Utilities								
Monarch Utilities	14,026,966	19.5%	4,543,571	24.1%	129,782,085	23.6%	67.2%	22.4%
Windermere	4,820,825	6.7%	1,419,718	7.5%	52,489,631	9.5%	23.7%	7.9%
Hornsby Bend Ops	2,606,754	3.6%	484,853	2.6%	30,978,549	5.6%	11.8%	3.9%
Diamond	672,321	0.9%	182,027	1.0%	6,809,529	1.2%	3.1%	1.0%
Water Services Inc.	1,307,477	1.8%	416,778	2.2%	8,941,256	1.6%	5.6%	1.9%
Huntington	61,605	0.1%	18,386	0.1%	715,383	0.1%	0.3%	0.1%
Inverness	133,712	0.2%	24,562	0.1%	1,811,669	0.3%	0.6%	0.2%
Mid-Tex	197,768	0.3%	22,758	0.1%	3,246,081	0.6%	1.0%	0.3%
SW Utilities	28,573	0.0%	9,780	0.1%	111,359	0.0%	0.1%	0.0%
Tenkiller	331,692	0.5%	170,104	0.9%	1,065,965	0.2%	1.6%	0.5%
Metro H2O	1,562,726	2.2%	129,332	0.7%	1,101,838	0.2%	3.1%	1.0%
Total for Texas Utilities		35.8%		39.4%		42.9%		
Southeast Utilities								
Riverview Wastewater	2,599,589	3.6%	580,375	3.1%	35,473,842	6.4%	13.1%	4.4%
North Shelby & Other	2,685,407	3.7%	414,198	2.2%	24,103,576	4.4%	10.3%	3.4%
North County Water	137,723	0.2%	62,993	0.3%	1,355,780	0.2%	0.7%	0.2%
Contracts	4,961,115	6.9%	2,114,871	11.2%	0	0.0%	18.1%	6.0%
Total for Southeast Utilities		14.4%		16.8%		11.0%		
	71,770,374	100.0%	18,851,590	100.0%	550,385,893	100.0%	300.0%	100.0%

4

5 Notice that under the factor “End of Year Gross Plant-Recorded 2015” value used
 6 of the gross plant is “0” for the contracts (See shaded row in Table-7 above). Therefore,
 7 based on this erroneous assumption and elimination of gross plant for the service
 8 contracts, this results in a 45.9% cost allocation of Suburban’s parent company toward
 9 Suburban under the gross plant factor. Later, Suburban applies the 45.9% allocation rate
 10 under the gross plant factor to calculate the weighted overall allocation of 46.5% for
 11 Suburban for all three factors. Similarly, the cost allocations for the other two
 12 subsidiaries under gross plant factor are 42.90% and 11.00% (See shaded cells in Table-7
 13 above) for Texas Utilities and Southeast Utilities, respectively.

1 Therefore, because Suburban reported the payroll value for the 9 service contracts
 2 as \$2,114,871, the missing Gross Plant value for the 9 contracts based on this average
 3 Payroll Multiplier of 47 can be calculated as \$99,398,936.⁶⁰

4 Table-9 below shows that with the use of the proxy value of \$99,398,936 for
 5 Gross Plant values for the 9 contracts, the costs allocation rate for Suburban decreases
 6 from 45.90% to 38.80%, which ultimately results in an overall weighted allocation rate of
 7 44.10% for Suburban.

8 **Table 9: Three-Factor Cost Allocation Calculations with Gross Plant Proxy**

COMPUTATION OF ALLOCATION PERCENT								
For Southwest with Gross Plant for Service Contracts								
Company	Direct Operating Expense		Payroll		End of Year Gross Plant		PROPOSED ALLOCATION %	
	Recorded 2015		Recorded 2015		Recorded 2015		Total	Average
	Amount, \$	Percent	Amount, \$	Percent	Amount, \$	Percent	Percent	(Percent)
ALLOCATION FACTORS								
Suburban Water Systems	35,636,123	49.7%	8,257,287	43.8%	252,399,351	38.8%	132.3%	44.1%
Texas Utilities								
Monarch Utilities	14,026,966	19.5%	4,543,571	24.1%	129,782,085	20.0%	63.6%	21.2%
Windermere	4,820,825	6.7%	1,419,718	7.5%	52,489,631	8.1%	22.3%	7.4%
Hornsby Bend Ops	2,606,754	3.6%	484,853	2.6%	30,978,549	4.8%	11.0%	3.7%
Diamond	672,321	0.9%	182,027	1.0%	6,809,529	1.0%	2.9%	1.0%
Water Services Inc.	1,307,477	1.8%	416,778	2.2%	8,941,256	1.4%	5.4%	1.8%
Huntington	61,605	0.1%	18,386	0.1%	715,383	0.1%	0.3%	0.1%
Inverness	133,712	0.2%	24,562	0.1%	1,811,669	0.3%	0.6%	0.2%
Mid-Tex	197,768	0.3%	22,758	0.1%	3,246,081	0.5%	0.9%	0.3%
SW Utilities	28,573	0.0%	9,780	0.1%	111,359	0.0%	0.1%	0.0%
Tenkiller	331,692	0.5%	170,104	0.9%	1,065,965	0.2%	1.6%	0.5%
Metro H2O	1,562,726	2.2%	129,332	0.7%	1,101,838	0.2%	3.1%	1.0%
Total for Texas Utilities		35.8%		39.4%		36.6%		
Southeast Utilities								
Riverview Wastewater	2,599,589	3.6%	580,375	3.1%	35,473,842	5.5%	12.2%	4.1%
North Shelby & Other	2,685,407	3.7%	414,198	2.2%	24,103,576	3.7%	9.6%	3.2%
North County Water	137,723	0.2%	62,993	0.3%	1,355,780	0.2%	0.7%	0.2%
Contracts	4,961,115	6.9%	2,114,871	11.2%	99,398,936	15.3%	33.4%	11.1%
Total for Southwest Utilities		14.4%		16.8%		24.7%		
	71,770,374	100.0%	18,851,590	100.0%	649,784,829	100.0%	300.0%	100.0%

9

⁶⁰ 47 x (Payroll for 9 contracts) = 47 x (\$2,114,871) = \$99,398,936.

1 **4. Utility Group Cost Allocations**

2 **a. Background**

3 According to Suburban, in 2003 Southwest created a new entity called the Utility
4 Group to provide management, regulatory, and communication services to Suburban and
5 its affiliates located in Texas, Alabama, Oklahoma, and recently Southern California.
6 Suburban requests continued application of the three-factor formula the Commission
7 approved in Suburban’s last rate proceeding.⁶¹ Use of Suburban’s allocation factor
8 results in approximately 49.50% of Utility Group costs being allocated to Suburban.⁶²

9 During 2009, Southwest had approximately 547 service contracts served by one of
10 its subsidiaries called “Non-Utility.” Suburban claims that since then Southwest has
11 divested most of its contracts. However, as discussed earlier, Southwest still serves the 9
12 remaining contracts.⁶³ Unlike the issue of eliminating factors such as gross plant and
13 number of customers for Suburban’s parent company costs, the allocation of the Utility
14 Group’s costs has one added dimension—Suburban claims that these 9 contracts should
15 be excluded from the cost allocation calculations. Suburban argues that as these contracts
16 are non-regulated activities and the Utility Group does not provide services to these
17 contracts.

18 For example, Suburban claims that certain characteristics of these service
19 contracts distinguish them from being regulated utilities. Southeast contracts are with the
20 contracting parties only. There is no extension of this contractual arrangement to actual
21 customers. Customers remain the customers of the contracting parties. Similarly,
22 Suburban claims that Southeast service contracts do not confer any legal interest in

⁶¹ Suburban’s Application: Results of Operations for Test Years ending December 31, 2018 and 2019, and Attrition Year 2020, p. 5-5.

⁶² Ibid.

⁶³ Walter Bench’s Prepared Testimony, p. 40.

1 contracting party facilities, ownership or otherwise. Plant and equipment remain the sole
2 property and ultimate responsibility of the contracting parties. Southeast has contracted
3 only to operate and maintain these facilities.⁶⁴

4 However, these arguments are unsupported and misleading. For example, the
5 Commission in its past decisions, D.12-04-009 and D.13-12-030, has outright rejected
6 similar arguments Suburban made during those proceedings. For example, regarding the
7 argument that Southeast has contractual relations only with the contractual parties, the
8 Commission noted the following in D.12-04-009:

9 We could simply treat Suburban as one of 564 (sum of all entities)
10 which would result in an allocation of 0.0017%, which is effectively
11 zero. Suburban argues that the parent company, “SouthWest, has a
12 *legal relationship*” with 547 client non-affiliated entities.
13 *(Transcript at 130 – 131.) And that Suburban has a legal*
14 *relationship with 75,000 customers. Both are true. But they are*
15 *not the same thing. SouthWest, whose costs are allocated to*
16 *Suburban and all the other entities affiliated or unaffiliated, does not*
17 *serve 57,000 customers: Suburban does. SouthWest only has a*
18 *single entity relationship with Suburban. By a sleight of hand the*
19 *witness attributes Suburban’s customers to SouthWest when*
20 *SouthWest directly serves only the single entity of Suburban, not*
21 *Suburban’s 75,000 customers – who are directly served only by*
22 *Suburban. This is misleading and we find Suburban’s testimony and*
23 *argument unpersuasive.*⁶⁵

24 The Commission was correct in its observation. Suburban’s logic is misleading,
25 because for the purpose of cost allocations, the “contractual” relationship is not
26 important; rather, it is the activity level of each entity measured under the four factors.
27 That is why it is imperative that these factors are consistently applied to each
28 participating affiliate. Otherwise the cost allocation will be skewed wherever the factors

⁶⁴ Walter Bench’s Prepared Testimony, pp. 42-43.

⁶⁵ D.12-04-009, pp. 16-17 (emphasis added).

1 used are greater in value. The Commission understood this fundamental principle of cost
2 allocation and thus clearly noted the following:

3 **We also find that Suburban’s calculations for gross plant are not**
4 **reliable.** As with customers, Suburban is not reasonable in its
5 application of the Allocation Practice. It is trying to rely on prior
6 decisions which allowed the use of a four-factor method. We are not
7 bound by those prior decisions: we are bound to use the evidentiary
8 record before us today. **DRA persevered in this proceeding and**
9 **demonstrated the one necessary point: the data offered by**
10 **Suburban is not consistent for all entities. Because the data is**
11 **not consistent any proposed allocation based on that data is not**
12 **fair.**⁶⁶

13 It is evident that Suburban is merely re-arguing its previously stated position that
14 the Commission already rejected as *misleading* and *unpersuasive*. Therefore, Suburban’s
15 removal of the 9 service contracts from the allocation calculations for the Utility Group’s
16 cost allocations is misleading as well as the removal of the contracts’ related operational
17 costs and gross plant that understate these factors for Suburban’s affiliate, Southeast.
18 Thus, this will unfairly shift the Utility Group’s costs toward Suburban’s ratepayers.

19 The Commission has strongly warned Suburban previously to apply the cost
20 allocation calculations properly and be more reasonable and consistent in its future
21 general rate cases.

22 **There is a second allocation of costs within the utility group**
23 **which is allocated on a four-factor by Suburban only to the**
24 **affiliated utilities, i.e., it excludes the 547 unaffiliated entities**
25 **serviced under a contract by the parent company.** In its opening
26 brief DRA (at 25 – 29) summarizes its analysis of the allocation
27 proposed by Suburban which is a 50.9% rate for Suburban whereas
28 DRA recalculates the rate to be 50.8%. DRA is mainly concerned
29 with Suburban’s manipulation of payroll and labor data. We find
30 this to be too granular (a tenth of a percent) at this time given the
31 comparatively large adjustment above for parent costs allocated to

⁶⁶ Ibid, p. 17 (emphasis added).

1 all entities and we therefore decline to make another minor
 2 adjustment at this time. We again warn Suburban that it must be
 3 reasonable in its calculations and consistent in its data in the
 4 next general rate case.⁶⁷

5 Table-10 below shows how Suburban used the three-factor methodology to
 6 calculate a 49.50% allocation rate for the Utility Group’s costs applicable to Suburban by
 7 removing the 9 service contracts from the cost allocation calculations.

8 **Table-10: Suburban’s 3-Factor Cost Allocations for Utility Group without Service**
 9 **Contracts**

COMPUTATION OF ALLOCATION PERCENT									
For Utility Group without Service Contracts									
Company	Direct Operating Expense		Payroll		End of Year Gross Plant		PROPOSED ALLOCATION %		
	Recorded 2015		Recorded 2015		Recorded 2015		Total	Average	
	Amount, \$	Percent	Amount, \$	Percent	Number	Percent	Percent	(Percent)	
ALLOCATION FACTORS									
Suburban Water Systems	35,636,123	53.3%	8,257,287	49.3%	252,399,351	45.9%	148.5%	49.5%	
Texas Utilities									
Monarch Utilities	14,026,966	21.0%	4,543,571	27.1%	129,782,085	23.6%	71.7%	23.9%	
Windermere	4,820,825	7.2%	1,419,718	8.5%	52,489,631	9.5%	25.2%	8.4%	
Hornsby Bend Ops	2,606,754	3.9%	484,853	2.9%	30,978,549	5.6%	12.4%	4.1%	
Diamond	672,321	1.0%	182,027	1.1%	6,809,529	1.2%	3.3%	1.1%	
Water Services Inc.	1,307,477	2.0%	416,778	2.5%	8,941,256	1.6%	6.1%	2.0%	
Huntington	61,605	0.1%	18,386	0.1%	715,383	0.1%	0.3%	0.1%	
Inverness	133,712	0.2%	24,562	0.1%	1,811,669	0.3%	0.6%	0.2%	
Mid-Tex	197,768	0.3%	22,758	0.1%	3,246,081	0.6%	1.0%	0.3%	
SW Utilities	28,573	0.0%	9,780	0.1%	111,359	0.0%	0.1%	0.0%	
Tenkiller	331,692	0.5%	170,104	1.0%	1,065,965	0.2%	1.7%	0.6%	
Metro H2O	1,562,726	2.3%	129,332	0.8%	1,101,838	0.2%	3.3%	1.1%	
Total for Texas Utilities		38.5%		44.3%		42.9%			
Southeast Utilities									
Riverview Wastewater	2,599,589	3.9%	580,375	3.5%	35,473,842	6.4%	13.8%	4.6%	
North Shelby & Other	2,685,407	4.0%	414,198	2.5%	24,103,576	4.4%	10.9%	3.6%	
North County Water	137,723	0.2%	62,993	0.4%	1,355,780	0.2%	0.8%	0.3%	
Total for Southeast Utilities		8.1%		6.4%		11.00%			
TOTAL	66,809,259	100.0%	16,736,719	100.0%	550,385,893	100.0%	300.0%	100.0%	

10
 11 Notice that under the affiliate Southeast “Contracts” are removed (see shaded row
 12 in Table-10 above) as compared to the Table-7 for Southwest’s cost allocation where the
 13 “contracts” were included within the cost allocation calculations under Southeast

⁶⁷ Ibid, p. 18 (emphasis added).

1 Utilities. This removal of the 9 service contracts effectively reduces the allocation rates
2 for Southeast Utilities and thus shifts the Utility Group’s costs toward Suburban. For
3 example, under the “Direct Operating Expense” factor, the allocation factor for Southeast
4 decreases from 14.4% (as shown in Table-7) to 8.1% as shown in Table-10. Similarly,
5 under the “Payroll” factor, the allocation rate for Southeast decreases from 16.8% (as
6 shown in Table-7) to 6.4% as shown in Table-10.

7 The removal of service contracts has the opposite effect on Suburban where
8 allocation rates increase. For example, the allocation rate for Suburban increased from
9 49.7% (See Table-7) to 53.3% as shown in Table-10 for the “Direct Operating Expense”
10 factor. Similarly, the allocation rate for Suburban increased from 43.8% (see Table-7) to
11 49.3% as shown in Table-10 for the “Payroll” factor. Therefore, removing the service
12 contacts for the purpose of the Utility Group’s cost allocation is not warranted and it
13 unfairly shifts the Utility Group’s costs toward Suburban. The more appropriate
14 approach is to include service contracts in the cost allocations along with the proxy
15 values of gross plant as shown in Table-9 above where Suburban’s overall allocation rate
16 is 44.1%.

17 Suburban’s estimate for the Utility Group’s operating expense for Test Year 2018
18 is \$1,270,370. Therefore, cost allocations for Suburban at 49.5% are \$628,833,⁶⁸
19 whereas based on a 44.1% allocation rate that includes the impact of service contracts
20 and of the gross plant (by proxy), Suburban’s cost allocations would only be \$560,233⁶⁹
21 – a difference of \$68,600.

22 The most harmful and serious aspect of Suburban’s cost allocation factors for the
23 Utility Group’s cost allocation is the fact that Suburban strays from its previous
24 settlement with ORA under D.14-12-038. According to the settlement, Suburban agreed

⁶⁸ \$628,833 = (\$1,270,370 x 49.5%).

⁶⁹ \$560,233 = (\$1,270,370 x 44.1%).

1 that its parent company Southwest “*will work diligently to divest itself of its remaining*
2 *operations service contracts. If Southwest is unable to divest itself of these remaining*
3 *contracts by the next rate case, it will in its next application provide end-user figure and*
4 *the plant values of those systems under each contract.*”⁷⁰ However, in this current GRC,
5 Suburban once again failed to provide the end-user data or the gross plant data for the
6 systems its affiliate Southeast Utilities serves under the 9 remaining service contracts.
7 Suburban claims that Southeast Utilities Managing Director and Lead Engineer have
8 made concerted efforts to obtain these values from the contracting parties, but the
9 contracting parties rebuffed these attempts or were simply not responsive as they have no
10 requirement to provide the requested information.⁷¹ However, when ORA inquired about
11 the support for these concerted efforts of Southeast Utilities’ Managing Director and
12 Lead Engineer, Suburban failed to produce any support in the form of, for example,
13 emails exchanges or meeting minutes. Suburban simply responded: “*No meeting*
14 *minutes, correspondence or emails exist. Efforts to obtain data were severely thwarted*
15 *because of the proprietary nature of the assets as well as their early vintage.*”⁷² This is
16 simply unacceptable; not only did Suburban fail to divest the remaining service contracts,
17 it also failed to provide the end-users and gross plant data. Suburban also failed to
18 support its claims that it exercised due diligence in divesting the remaining service
19 contracts and obtaining the required information. The Commission should not give any
20 weight to Suburban’s claim that its efforts to obtain data were severely thwarted because
21 of the proprietary nature of the assets. Suburban was aware of these difficulties and facts
22 when it entered into the settlement with ORA, which was subsequently adopted in D.14-
23 12-038.

⁷⁰ D.14-12-038, Attachment 1 (Settlement Document), pp. 31-32 (emphasis added).

⁷¹ Walter Bench’s Prepared Testimony, p. 40, lines 12-19.

⁷² Suburban’s Response to ORA’s Data Request AMX-005, Q-1(a) (emphasis added).

1 In addition, under the settlement per D.14-12-038, “*parties agreed to calculate the*
2 *Utility Group allocation factor using the same three-factor allocation agreed upon for*
3 *parent company costs, including the traditional calculation of gross plant, and to keep*
4 *the eleven contracts in the calculations for the Utility Group.*”⁷³ However, Suburban
5 once again not only excludes the gross plant but also removes the eleven (now 9) service
6 contracts for the calculations of the Utility Group allocations.

7 This is in direct contradiction to the Commission’s earlier directives under
8 D.12-04-009 that specifically warned Suburban not to exclude these service contracts
9 when calculating Utility Group’s allocations and use reasonable and consistent data. The
10 Commission stated, “*We again warn Suburban that it must be reasonable in its*
11 *calculations and consistent in its data in the next general rate case.*” Here, unfortunately
12 Suburban again has presented inconsistent data for its cost allocations and disregarded the
13 Commission’s warnings on its improper actions on cost allocations.

14 Suburban’s clear disregard of its obligation under the Commission approved
15 settlement agreement is a blatant disregard of a Commission mandate and a dismissive
16 attitude towards its obligations to ORA. Further, Suburban’s unexplained divergence
17 from the approach taken in that settlement to include service contracts is not only
18 unreasonable, it directly contradicts the Commission’s warning about doing so.

19 An effective cost allocation methodology consistently measures the amount of the
20 work or activity involved with various subsidiaries. Using inconsistent measures would
21 skew the cost allocations. The service contracts are an integral part of the activities
22 Southeast performs, and thus removing these contracts will skew allocations toward other
23 affiliates like Suburban. The Commission should instruct Suburban to use a consistent
24 set of cost allocation factors for both Southwest and Utility Group costs.

⁷³ D.14-12-038, Attachment 1 (Settlement Document), pp. 31-32 (emphasis added).

1 **5. Utility Group’s Costs**

2 Suburban requests \$1,270,370 in Test Year 2018 for Administrative & General
 3 (“A&G”) expenses for its Utility Group. Suburban then proposes to allocate the A&G
 4 expenses using the three-factor cost allocation methodology. ORA in contrast
 5 recommends \$751,295 in Test Year 2018.

6 **a. Utility Group A&G Expenses Increased Dramatically**

7 The Utility Group’s expenses increased dramatically since the last recorded year
 8 2015. A&G costs were \$675,966 in 2015 and now Suburban’s forecast is at \$1,270,370
 9 for 2018, which is an increase of 87.93%. Table-11 below shows the Utility Group’s
 10 A&G costs over the past five years (2011-2015) and Suburban’s forecasts for the four
 11 years (2016-2019). Please note Suburban has not provided the 2016 cost data and thus
 12 the data for 2016 is based on the forecast amounts included in Suburban’s workpapers.

13 **Table-11: Utility Group A&G expenses over past 5 years and 4 future years**

Description	Recorded Year					Estimated Year		Test Year	
	2011	2012	2013	2014	2015	2016	2017	2018	2019
UTILITY GROUP EXPENSES									
<u>ADMINISTRATIVE AND GENERAL EXPENSES</u>									
Payroll and Benefits	\$317,578	\$485,543	\$565,306	\$598,513	\$582,132	\$ 849,157	\$1,062,415	\$1,107,235	\$1,134,113
General & Administrative Expense	37,571	37,047	51,381	50,953	48,397	82,423	84,254	86,070	87,941
Other Expenses	45,672	52,377	50,586	61,573	45,436	72,571	74,820	77,065	79,408
Total	\$400,821	\$574,966	\$667,274	\$711,039	\$675,966	\$1,004,151	\$1,221,489	\$1,270,370	\$1,301,461
Year-to-year Percentage Change		43.45%	16.05%	6.56%	-4.93%	48.55%	21.64%	4.00%	2.45%
Test Year-2018 Percentage increase over the last recorded year-2015								87.93%	

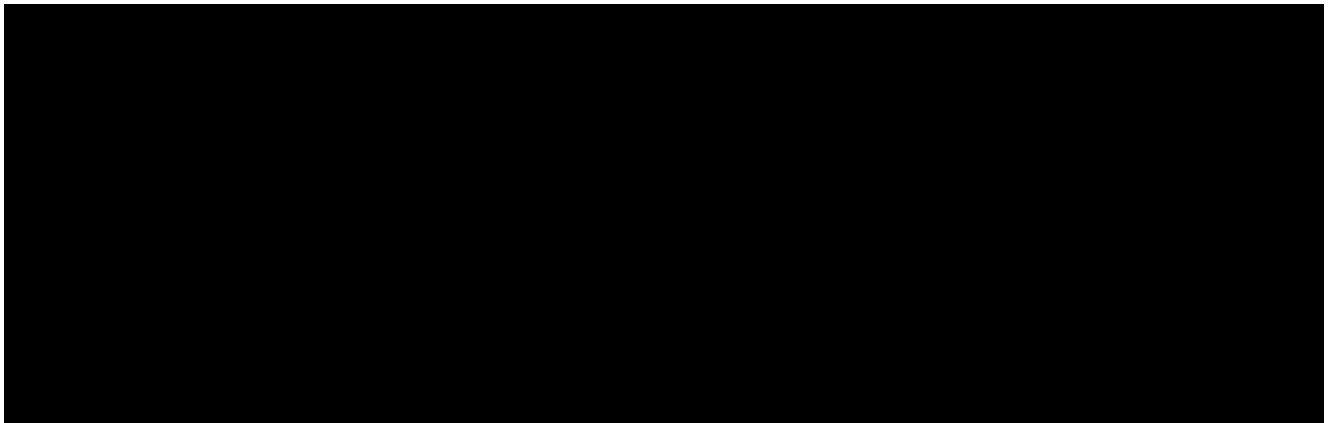
14
 15 Expenses increased substantially since 2015 in the payroll and benefit categories.
 16 However, Suburban did not include much detail about this massive payroll increase. In
 17 fact, Suburban only included one page of testimony to substantiate Utility Group

1 expenses.⁷⁴ Additionally, descriptions for the new positions contradicted what was
2 presented in the workpapers.

3 Table-12 below shows the details of Utility Group's regular payroll during 2014-
4 2018.⁷⁵

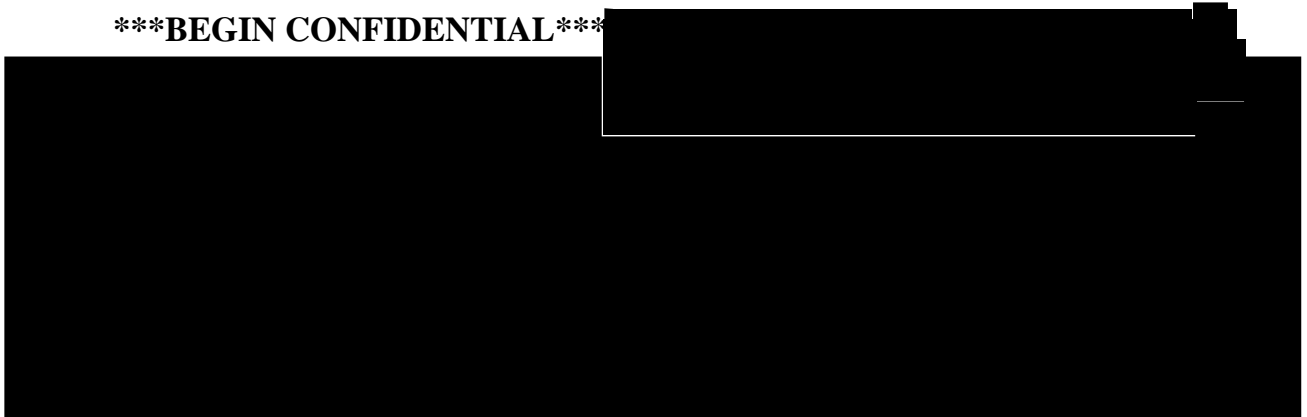
5 **Table-12: Utility Group Regular Payroll over the period 2014-2018**

6 *****BEGIN CONFIDENTIAL*****



7
8 *****END CONFIDENTIAL*****

9 *****BEGIN CONFIDENTIAL*****



⁷⁴ Suburban's Results of Operations for Test Years Ending December 31, 2018 and 2019, and Attrition Year 2020, pp. 5-5 and 5-6. See Attachment-F.

⁷⁵ The regular payroll data for the period 2014-2016 is based on Suburban's response to ORA's data request AMX-10. The regular payroll data for the period 2017-2018 was based on Suburban's workpapers: File:2016-2019 UG Expenses-GRC, Tab: Confidential.

1 [REDACTED]

2 [REDACTED] ***END CONFIDENTIAL ***

3 **b. Utility Group’s Salary Increases Have No Support**

4 In addition, the Utility Group’s employee salaries have increased substantially in
5 Suburban’s estimates for 2016. Suburban then uses this as a basis to estimate Test Year
6 2018 expenses. Suburban does not offer any explanation or justifications for this
7 unwarranted increase in the staff salaries in 2016. For example, the following table
8 shows the year-to-year increases for regular payroll of selected Utility Group employees.
9 Notice the spike in 2016:

10 **Table-13: Utility Group’s Employees Inexplicable Salary Spikes in 2016**

11 ***BEGIN CONFIDENTIAL***

12 [REDACTED]

13 ***END CONFIDENTIAL***

14 In short, Suburban’s application does not explain or support these higher payroll
15 expenses in its prepared testimonies but instead included them in its workpapers making
16 it difficult for ORA to discover. Suburban’s lack of substantiation for this increase is not
17 consistent with Public Utility Code, Section 454(a): “*that no utility should change rates*
18 *except upon showing that the new rates are justified.*” It is Suburban’s burden to make a
19 showing for its new rates.

20 **c. Suburban Provides Inadequate Support for its New Hires**

21 Suburban added three positions to its Utility Group in 2016: 1) Director
22 Regulatory Affairs; 2) Manager Regulatory Affairs; and 3) Regulatory Analyst.

1 Suburban’s workpapers show that the position of Regulatory Analyst ***BEGIN

2 CONFIDENTIAL*** [REDACTED]

3 [REDACTED]

4 ***END CONFIDENTIAL ***

5 Suburban has not demonstrated that this Regulatory Analyst position is new or
6 why the Utility Group needed this position filled. Suburban did not fill this position
7 during any of 2015, and therefore shows the Utility Group did not really need this
8 position otherwise it would have not left vacant for the entire 2015.

9 Suburban also does not provide any specific justifications for the other two new
10 hires: ***BEGIN CONFIDENTIAL*** [REDACTED]

11 [REDACTED]

12 [REDACTED] ***END CONFIDENTIAL ***⁷⁶ Therefore, it is highly
13 unreasonable to add such a substantial amount without adequate justifications for the new
14 positions. For example, Suburban does not present any work-load studies to show that
15 the current or future work-load is overwhelming and the new positions are justified—
16 there is simply no such information. Thus Suburban fails to make an adequate showing
17 pursuant to Public Utility Code, Section 454(a) for the new rates.

18 **d. Suburban Lacks Support for Increased Utility Group Expenses Based on**
19 **New Hires**

20 The new positions not only increase the Utility Group’s payroll and benefit
21 expenses, which are ultimately allocated to Suburban’s ratepayers, but Suburban also
22 increases other A&G expenses based on these new hires. Here again, Suburban offers
23 minimal written testimony, essentially a few paragraphs, and fails to provide actual
24 justifications. For example, a closer look of Suburban’s workpapers reveals that the other
25 expense categories such as Travel & Entertainment, Subscription, Office Supply,

⁷⁶ Suburban’s workpaper, File:2016-2019 UG Expenses-GRC, Tab: Confidential.

1 Printing/Communication, Telecommunication, Training & Seminars and Professional
2 Dues increased based on these new hires by adding 2/3 and 1/3 of the expenses to that of
3 the expense levels in 2015. Apparently, Suburban thinks adding these new positions will
4 increase various operating expenses proportionately by 2/3 and 1/3.

5 For example, Suburban bases its Test Year 2018 estimates on the expense level in
6 2017 and 2016. Suburban obtained 2016 estimates based on recorded 2015 expenses, but
7 then added *additional 2/3 and 1/3 of 2015 expenses* on top of the inflated expenses.
8 However, Suburban provides no justifications for why it presumes these various cost
9 categories to increase by additional 2/3 and 1/3 of the inflated costs. For example,
10 Suburban estimates that Travel & Entertainment expenses will increase by 2/3 without
11 justifying how these new hires can result in exactly an increase of 2/3 more costs. There
12 are simply no justifications to support the additional 2/3 of the costs.

13 The Commission should not require Suburban's ratepayers to pay for Suburban's
14 forecasted increase in expenses tied to the new hires at the Utility Group. The
15 Commission should use recorded 2014 expenses and escalate to Test Year 2018. This
16 will result in total Utility Group's allocable costs of \$751,295 and allocation to Suburban
17 in the amount of \$331,321 for Test Year 2018.

18 **6. Health and Medical Insurance**

19 Suburban carries its health and dental insurance at Southwest's level and allocates
20 the premiums based on employee headcounts to the various subsidiaries including
21 Suburban. More specifically, Suburban uses the Per Employee Per Month ("PEPM")
22 value to allocate these medical costs. Based on its own historical renewal costs and a
23 survey based on Kaiser Family Foundation's study, Suburban estimates a PEPM
24 premium cost per employee of \$1,369.77 and \$63.29 for its medical insurance and dental

1 insurance, respectively.⁷⁷ Suburban then estimates that its PEPM for medical insurance
2 will increase by 4% annually and its dental insurance will increase annually at 1% in the
3 future. Based on these assumptions, Suburban estimates the PEPM rate for 2018 per
4 employee will be \$1,540.80 and \$65.21 for medical insurance and dental insurance,
5 respectively.

6 Suburban’s estimates for its medical and dental insurances appear reasonable.
7 However, for medical and dental insurance, escalation beyond the Test Year 2018 should
8 only be limited to the Consumer Price Index-Urban (“CPI-U”) escalation rates per the
9 Commission’s Rate Case Plan, D.04-06-018 and D.07-05-062. The applicable CPI-U
10 inflation rates as of June 2016 are 1.0% for 2019 and 2020.

11 **7. Employee Healthcare Balancing Account**

12 Suburban requests replacing its existing Employee Healthcare Balancing Account
13 (“EHBA”) with a new EHBA that would remove the Commission’s restriction that only
14 allows Suburban to recover 85% of its actual healthcare costs in excess of the adopted
15 costs in rates

16 The Commission in D.14-12-048 approved a settlement requiring the existing
17 restriction on Suburban’s EHBA in which Suburban would refund 100% of the difference
18 between actual costs below its adopted costs and would only recover 85% of actual costs
19 in excess of its adopted cost. Nothing significant has happened since that would warrant
20 a change in the existing restriction.

21 The purpose of the 85% recovery restriction of its actual healthcare cost in excess
22 of forecasted cost was to incentivize Suburban to be vigilant in acquiring its healthcare
23 insurance and search for the best possible premiums. The kind of EHBA Suburban
24 requests will not only effectively remove this incentive, which will not serve the interests

⁷⁷ Suburban’s workpapers, File: GRC 2017-A.17-01-xxx, Tab: Expenses Support.

1 of captive ratepayers, but it will also reduce the financial risk for the shareholders at the
2 expense of increasing financial responsibilities of its ratepayers.

3 Granting Suburban's request would decrease its business risk further, and the
4 Commission is not under any obligation to guarantee Suburban to earn a specific rate of
5 return. If the Commission reduced Suburban's financial risk, it should also reduce
6 Suburban's authorized Cost of Capital. A utility with lower risk should receive a lower
7 return.

8 Based on the foregoing discussions and facts, the Commission should require
9 Suburban to retain its existing Employee Healthcare Balancing Account for 2018-2020.
10 If the Commission reduces Suburban's financial risk, it should also reduce Suburban's
11 authorized Cost of Capital.

12 **8. Various Property and Casualty Lines of Insurance**

13 Suburban has quite a few Property and Casualty insurances such as workers'
14 compensation, auto liability insurance, general liability insurance, umbrella insurance,
15 property insurance, legal liability insurance, pollution legal liability insurance, director
16 and officers insurance, crime coverage, fiduciary liability insurance, employment
17 practices liability insurance, technology liability insurance, and cyber and technology
18 liability insurance at its parent company Southwest's level. Suburban forecasts a total
19 premium including its broker fee to be \$1,413,763 for 2015. These costs are then
20 escalated based on CPI-U inflation to Test Year 2018.

21 Suburban then allocates the various property and casualty insurance costs from
22 Southwest to various subsidiaries including Suburban based on several allocation criteria.
23 For example, workers' compensation insurance is allocated based on the total payroll,
24 general liability insurance is allocated based on budgeted revenues, etc. ORA does not
25 object to Suburban's insurance requests.

1 **9. Suburban’s Non-Cooperative Behavior and Non-Compliance with**
2 **Commission Decisions**

3 Suburban has a history of frustrating the discovery process, and unfortunately,
4 despite Commission direction to “re-examine it[s] regulatory relationship with [ORA]
5 and establish a more cooperative attitude,” Suburban was extremely uncooperative in this
6 GRC.⁷⁸ Specifically, Suburban (1) repeatedly did not provide the data specifically
7 requested by ORA’s data requests, (2) requested several extensions to respond to data
8 requests, some of which included routine requests where the information had already
9 been compiled for the purpose of testimony development, (3) ignored ORA’s rejection of
10 requested extensions, (4) and in one instance refused to informally communicate with
11 ORA on follow up questions related to Suburban’s data request responses.

12 Collectively, these discovery issues demonstrate Suburban’s impediment of the
13 discovery process and “highlight a continual tension in rate cases: the limited time
14 available to [ORA] and the disincentive for the utility to cooperate.”⁷⁹ Ratepayers are
15 harmed when ORA cannot obtain the information necessary to conduct a thorough
16 analysis of a utility’s application to ensure the utility is requesting reasonable rate
17 increases. This may be especially true for parent company allocations where “incomplete
18 and inconsistent, and therefore unreasonable” data would result in ratepayers shouldering
19 “general costs incurred to benefit *multiple entities*.”⁸⁰ Although these complaints
20 primarily involve discovery related to parent company allocations, other discovery
21 problems arose in this proceeding. For example, Suburban’s refused to engage
22 informally with ORA over the phone to discuss its request for new positions. Suburban
23 had previously allowed one such meeting but refused to grant additional meetings

⁷⁸ See D.12-04-009, p. 22.

⁷⁹ See D.12-04-009, p. 20.

⁸⁰ See D.12-04-009, p. 11 (emphasis added).

1 because it was concerned its witnesses required counsel. Suburban insisted that it would
2 be more productive if ORA would submit its questions entirely in writing.⁸¹

3 **a. Suburban’s Discovery Non-compliance with D.12-04-009**

4 The most egregious aspect of Suburban’s non-cooperative behavior was that it had
5 been directed by the Commission in the past to establish a more cooperative working
6 relationship with ORA, but Suburban has not obeyed the Commission’s orders. For
7 example, in D.12-04-009, the Commission duly noted Suburban’s non-cooperative
8 behavior toward ORA and specifically ordered Suburban to adopt a more cooperative
9 attitude:

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

- 13 1) failed to fully support its application as required by the water rate case
14 plan;
15 2) failed to “facilitate Informal Communications” in order to create a better
16 understanding of the position of the parties and to avoid and resolve
17 discovery disputes and eliminate unnecessary litigation;” and
18 3) failed to provide DRA access to its affiliates’ relevant books and
19 records.

20 These allegations were first raised in DRA’s direct testimony (Ex. DRA-1
21 at 8-65 – 8-68.) DRA proposes a fine of \$10,250 for each of the three
22 allegations. DRA equates this to a fine imposed on another company in
23 D.07-05-062.

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

⁸¹ Suburban’s email response on March 30, 2017 by Bob Kelly to ORA’s Victor Chan upon request for additional meeting.

1 We will not impose any fine at this time.
2 (Emphasis Added)

3 Despite the Commission’s directive, Suburban continued to display the
4 uncooperative behavior condemned in D.12-04-009, including failing to fully respond to
5 ORA’s data requests despite repeated requests for clarification. For example, despite
6 ORA’s attempts to informally resolve deficiencies in Suburban’s responses to ORA Data
7 Request AMX-002 through oral communications (phone calls), Suburban refused to
8 respond using this more efficient method and instead required formal, written follow-up
9 data requests to resolve the outstanding issues. Frustrated with its inability to obtain the
10 information through informal means and considering that AMX-002 was not the only
11 discovery issue at hand, ORA, in the spirit of cooperation, agreed to Suburban’s
12 unreasonable request to submit subsequent follow-up written data requests for AMX-002.

13 In addition, instead of continuing to work with ORA on the unanswered portions
14 of AMX-002, whether orally or in follow up data requests, Suburban unilaterally decided
15 that its responses to AMX-002 were sufficient despite repeated attempts by ORA to show
16 the contrary.⁸² Moreover, when ORA did send the subsequent data requests regarding
17 Suburban’s initial responses to AMX-002 as being deficient, Suburban simply ignored
18 the due date (March 7, 2017). On March 15, 2017, Suburban simply responded that its
19 initial responses were not deficient.⁸³

20 In a final attempt, however, to obtain information necessary to verify Suburban’s
21 previous deficient responses to AMX-002 and therefore justify ratepayers bearing a
22 portion of these expenses, ORA raised the remaining issues to ALJ Houck during a Status
23 Conference held on March 27, 2017.

⁸² Attachment-G (Email communication with Suburban regarding AMX-002).

⁸³ Attachment-H (Email correspondences with Suburban regarding AMX-002).

1 The ALJ instructed the parties to submit a written description of discovery issues
2 related to the Office of Ratepayer Advocate’s Data Request AMX-002, item 4(e). And
3 later, after several emails and telephone conversations about when ORA could expect
4 Suburban’s response, on April 7, 2017, Suburban submitted its updated response to
5 AMX-002, 4(e)—almost two months after ORA initially issued its data request, AXM-
6 002, 4(e) on February 3, 2017.⁸⁴

7 Unfortunately, ORA determined the information Suburban provided on April 7,
8 2017 still lacked adequate explanation for what ORA requested, namely, the supporting
9 documentation from Suburban does not verify that a particular legal invoice was actually
10 directly charged to a particular subsidiary because the documentation does not link the
11 accounting entry to a specific subsidiary. The booking transactional records do not
12 include a subsidiary’s account number, name, or other identifying information. Suburban
13 was manually linking its accounting records to the various subsidiaries.

14 Suburban later claimed that the information provided on April 7, 2017 was all it
15 had and that it did not have further support. Thus, ORA determined the ALJ would not
16 be able to provide further guidance or pressure to Suburban for additional information,
17 and the best route would be to address these continued problems in obtaining information
18 in its ORA testimony instead.

19 Thus, in order to protect ratepayers from potentially inaccurate information, ORA
20 can only conclude that Southwest and Suburban are not accurately booking legal fees
21 costs to ensure that Suburban’s ratepayers are not subsidizing costs for Southwest or its
22 other corporate entities.

23 The result of Suburban’s uncooperative approach to AMX-002 and the related
24 follow-up data request was a lengthy and time-consuming process that still did not
25 produce some of the specific information ORA requested.

⁸⁴ Attachment-I (Copy of ORA’s initial data request, AMX-002, 4(e)).

1 ORA already is under a very tight deadline to serve its testimony, and any delays
2 in receiving the information it seeks from a utility makes ORA’s job all the harder.

3 In addition, as discussed in details above under Section-4: Utility Group Cost
4 Allocations of this report, Suburban also violates the spirit and mandate of D.12-04-009
5 when it ignores the Commission’s warning to use consistent data for its Utility Group’s
6 cost allocation. D.12-04-009 states:

7 There is a second allocation of costs within the utility group which is
8 allocated on a four-factor by Suburban only to the affiliated utilities, i.e., it
9 excludes the 547 unaffiliated entities serviced under a contract by the parent
10 company. In its opening brief DRA (at 25 – 29) summarizes its analysis of
11 the allocation proposed by Suburban which is a 50.9% rate for Suburban
12 whereas DRA recalculates the rate to be 50.8%. DRA is mainly concerned
13 with Suburban’s manipulation of payroll and labor data. We find this to be
14 too granular (a tenth of a percent) at this time given the comparatively large
15 adjustment above for parent costs allocated to all entities and we
16 therefore decline to make another minor adjustment at this time. We again
17 warn Suburban that it must be reasonable in its calculations and consistent
18 in its data in the next general rate case.⁸⁵

19 Table-10 above shows how Suburban used the three-factor methodology to
20 calculate a 49.50% allocation rate for the Utility Group’s cost for Suburban by removing
21 the 9 service contracts from the cost allocation calculations. As discussed earlier,
22 removal of 9 service contracts increases cost allocations for Suburban and thus reflect
23 Suburban’s willful manipulation of the cost allocation of Utility Group’s expenses
24 despite the Commission’s clear warning not to do so.

25 **b. Suburban’s Discovery Non-Compliance with D.04-06-018**

26 In addition Suburban’s non-cooperative behavior during this GRC has been
27 especially egregious given the fact that the Commission per D.04-06-018 has clear
28 instructions to facilitate “*informal communications*” between the applicant and ORA:

⁸⁵ D.12-04-009, p. 18 (emphasis added).

1 Informal communications between applicant and ORA are encouraged at all
2 stages of the proceedings, including the PA review period, in order to
3 facilitate understanding by the parties of their respective positions, to avoid
4 or resolve discovery disputes, and to avoid unnecessary litigation.⁸⁶

5 As discussed earlier, Suburban’s repeated failure to work cooperatively with the
6 Commission’s staff should be taken seriously since this behavior undermines the
7 Commission’s regulatory authority. The Commission’s Public Utility Code, Section 309,
8 5(e) supports ORA’s authority to request any information that it deems necessary to
9 perform its review of reasonableness of a regulated utility’s rate increase request:

10 The division (ORA) may compel the production or disclosure of any
11 information it deems necessary to perform its duties from any entity
12 regulated by the Commission, provided that any objections to any request
13 for information shall be decided in writing by the assigned commissioner
14 or by the president of the commission, if there is no assigned
15 commissioner.⁸⁷

16 It is amply clear that Suburban was put on notice per D.12-04-009 to “*re-examine*
17 *its regulatory relationship with DRA and establish a more cooperative attitude*”.
18 Unfortunately, Suburban’s actions here have deteriorated even further by refusing to
19 engage in informal communications with ORA pursuant to D.04-06-018 as well. Recall
20 that Suburban unilaterally decided that its responses to one of ORA’s data requests,
21 AMX-002 were sufficient besides repeated attempts by ORA to show the contrary and
22 that Suburban refused to engage in informal oral communications with ORA’s staff and
23 insisted that any subsequent follow up request regarding AMX-002 should be in writing.
24 In addition, Suburban also refused to engage informally with ORA over the phone to
25 discuss its request of new positions.⁸⁸

⁸⁶ D.04-06-018, Appendix, Rate Case Plan for Class A Water Utilities, p. 3 (emphasis added).

⁸⁷ California Public Utilities Code, Section 309.5(e).

⁸⁸ Suburban’s email response on March 30, 2017 by Bob Kelly to ORA’s Victor Chan upon request for additional meeting.

1 Compounding Suburban’s refusal to informally resolve AMX-002 issues,
2 Suburban also unilaterally gave itself extensions of time to respond to Data Requests
3 without ORA approval, thus delaying ORA’s discovery efforts. Moreover, Suburban
4 repeatedly ignored ORA’s position that ORA will not approve extensions for its data
5 request responses without Suburban providing reasons for the need for such extensions, a
6 reasonable approach that comports with the spirit of the Commission’s Discovery
7 Custom and Practice Guidelines. Collectively, Suburban’s behavior frustrates the
8 discovery process and impedes ORA from obtaining necessary information to analyze the
9 reasonableness of Suburban’s GRC requests.

10 Attachment-J shows copies of various email correspondences between ORA and
11 Suburban regarding several time extensions Suburban requested for various ORA’s data
12 requests. As demonstrated in the emails, ORA denied these time extensions citing: 1) the
13 inadequate and unsupported reasons Suburban provided to support its time extensions
14 and 2) the limited time ORA has for its discovery and preparation for its report.⁸⁹ Where
15 appropriate, ORA on the other hand, did its best to accommodate Suburban where
16 Suburban was able to provide reasonable support for its request for extensions. For
17 example, in case of ORA’s Data Request, AMX-007, in the spirit of accommodation,
18 ORA replaced its original data request so that Suburban could easily provide the
19 information.⁹⁰ Suburban has not reciprocated with such cooperation.

20 **c. Suburban’s Non-Compliance with its Last Rate Case D.14-12-038**

21 Another flagrant example of Suburban’s non-compliance with the Commission’s
22 decisions is its renegeing responsibility under a settlement the Commission approved
23 under D.14-12-038. As discussed earlier under Section 4 of this Report, Suburban

⁸⁹ Attachment-J (Copies of various email correspondences between ORA and Suburban regarding several time extensions Suburban has requested).

⁹⁰ Attachment-K (Copies of email correspondences between ORA and Suburban showing ORA’s efforts to accommodate Suburban’s time extension request).

1 wrongfully reneged on its obligation under the official settlement that required Suburban
2 would work diligently to divest all of its remaining service contracts, but in the event it
3 failed to divest then to provide Number of Customer figures and the Gross Plant values of
4 the systems under each contract.⁹¹ However, in this rate case application Suburban failed
5 on both accounts. Not only Suburban failed to divest the remaining service contracts, it
6 also failed to provide the end-users and gross plant data for the systems served under
7 these service contracts. In addition, Suburban also failed to support its claims that it has
8 exercised due diligence in either divesting the remaining service contracts or in obtaining
9 the required information. In addition, the second agreed upon term under the Settlement
10 Agreement, although not binding on Suburban here, Suburban did not provide any
11 explanation and simply removed the 9 service contracts from Utility Group’s cost
12 allocation calculation despite the Commission’s warning under D.12-04-009 in the
13 previous GRC (A.11-02-002) that it “*must be reasonable in its calculations and*
14 *consistent in its data in the next general rate case.*”⁹²

15 Suburban’s clear disregard of its obligation and a Commission warning
16 demonstrates a serious problem that the Commission should address.

17 ORA determined Suburban violated the following various Commission Decisions
18 and requests that the Commission consider whether a penalty should be imposed:

- 19 1) Suburban failed to “*facilitate Informal Communications*” in order to create a
20 better understanding of the position of the parties and to avoid and resolve
21 discovery disputes and eliminate unnecessary litigation” per D.04-06-018;
- 22 2) Suburban failed to “*re-examine its regulatory relationship with ORA and*
23 *establish a more cooperative attitude*” per D.12-04-009; and

⁹¹ D.14-12-038, Settlement Document, pp. 31-32.

⁹² D.12-04-009, p. 18 (emphasis added).

1 3) Suburban reneged on its obligations per its Settlement under D.14-12-038 with
2 ORA.

3 Thus, the Commission may want to consider the following Public Utilities Code
4 sections, which provide authority to the Commission to punish utilities for violating
5 Commission Decisions:

6 § 2107. Any public utility which violates or fails to comply with any
7 provision of the Constitution of this state or of this part, **or which fails or**
8 **neglects to comply with any part or provision of any order, decision,**
9 **decree, rule, direction, demand, or requirement of the commission,** in a
10 case in which a penalty has not otherwise been provided, is subject to
11 penalty of not less than five hundred dollars (\$500), nor more than twenty
12 thousand dollars (\$20,000) for each offense.⁹³

13
14 § 2110. Every public utility and every officer, agent, or employee of any
15 public utility, who violates or fails to comply, or who procures, aid, or abets
16 any violation by any public utility of any provision of the Constitution of
17 this state or of this part, **or who fails to comply with any part of any**
18 **order, decision, rule, direction, demand, or requirement of the**
19 **commission,** or who procures, aids, or abets any public utility in such
20 violation or noncompliance in a case in which a penalty has not otherwise
21 been provided, is guilty of a misdemeanor and is punishable by a fine not
22 exceeding one thousand dollars (\$1,000), or by imprisonment in a county
23 jail not exceeding one year, or both such fine and imprisonment.⁹⁴

24 **10. Suburban Fails to Justify and Support Direct Legal Fee Charges**

25 Suburban’s testimony does not support allocating legal fees from its parent
26 company to its affiliates, including Suburban. ORA’s data request AMX-002, 4(e) dated
27 2/3/17 sought to request information on these allocations. Suburban’s witness Walter
28 Bench in his prepared testimony includes an Attachment-2 (page 3 of 5) that is supposed

⁹³ California Public Utilities Code, Section 2107 (emphasis added).

⁹⁴ California Public Utilities Code, Section 2110 (emphasis added).

1 to show corporate level legal invoicing and legal invoicing attributable only to general
2 corporate matters.⁹⁵

3 Attachment-2 (page 3 of 5) reveals that as of 2015 there were at least four
4 subsidiaries listed: Western Utilities, Texas Utilities, Texas Services, and Southeast
5 Utilities along with Southwest as “Corporate.”⁹⁶ Suburban later explained that the
6 “Western Utilities” is in fact “Suburban” and “Texas Services” no longer exists.

7 ORA noticed that the total amount of \$1,374,946.43 as shown in total row at the
8 end of the table does not add up to \$1,374,946.43, but to \$1,388,777.10 instead. On
9 February 3, 2017, ORA issued its Data Request AMX-002, 4(e) requesting that if these
10 expenses are directly charged, please provide the supporting documents to show the
11 direct charges for these various business segments. On February 10, 2017, Suburban
12 partially responded to AMX-002, 4(e), and submitted a revised version of its original
13 Attachment-2 (page 3 of 5), showing the total row adding to \$1,388,777.10. However, as
14 for as supporting documents for direct charges were concerned, Suburban responded that
15 it would be providing the supporting documents by February 17, 2017.⁹⁷

16 On February 17, 2017, Suburban provided copies of its accounting records along
17 with yet another revision of its original Attachmnet-2 (page 3 of 5). This time around,
18 Suburban adjusted the total legal fee amount from \$1,388,777.10 to \$1,250,640.83
19 without any explanation.⁹⁸ It was not until February 28, 2017 that Suburban finally
20 explained this revision:

21 Response on February 10, 2017 was provided to correct the summation in
22 the column “TOTAL” from \$1,374,946.43 to \$1,388,777.13.

⁹⁵ Walter Bench’s Prepared Testimony, p. 12, lines 19-22

⁹⁶ See Attachment-L.

⁹⁷ See Attachment-M.

⁹⁸ See Attachment-N.

1 Response on February 17, 2017 provided a further correction to
2 \$1,250,640.83. **This correction was based on further analysis using the**
3 **vendor names, and supporting documents were provided to support**
4 **the further revised amounts.**⁹⁹

5 The supporting documents do not include names of any subsidiaries or any code
6 numbers or account numbers in these accounting records, which could establish the fact
7 that legal fee expenses were actually directly charged to a specific subsidiary in
8 question.¹⁰⁰

9 Since then, ORA has indicated to Suburban on more than one occasion that its
10 response to AMX-002, 4(e) dated February 17, 2017 was deficient. However, Suburban
11 kept claiming that its response was not deficient and at the same time refused to engage
12 with ORA in an informal discussion.¹⁰¹ It was not until March 23, 2017 that ORA
13 alerted Suburban that it planned to raise Suburban's deficient responses to AMX-002,
14 4(e) at the March 27, 2017 status conference, and on Friday, March 24, 2017, at 7:19
15 p.m., Suburban submitted an email response to ORA's follow up questions to item 4(e),
16 which included an attachment. In the attachment, Suburban manually wrote reference
17 numbers in Walter Bench's testimony to match the direct charges to the law firm
18 invoices.¹⁰²

19 This supporting documentation from Suburban, however, does not verify that a
20 particular legal invoice was actually directly charged to a particular subsidiary because
21 the documentation does not directly link a charge to a subsidiary as the accounting
22 records do not includes a subsidiary's account number, name, or other identifying
23 information. Therefore, manual matching of the invoice amounts to that of accounting

⁹⁹ See Attachment-O (Suburban response to ORA's deficiency of AMX-002) (emphasis added).

¹⁰⁰ See Attachment-N.

¹⁰¹ See Attachment-G.

¹⁰² See Attachment-P.

1 records does not provide adequate documentation that these records actually presented a
2 direct charge from the parent company to a specific subsidiary.

3 Suburban's final response dated April 7, 2017 was largely the same as its previous
4 response on March 24, 2017; it still included hand-written matching of invoice amounts
5 to that of Walter Bench's Prepared Testimony, Attachment-2 (page 3 of 5).

6 Suburban's response on April 7, 2017 added little value to establish that these
7 various legal expenses are directly charged from the parent company to the specific
8 subsidiaries including Suburban. The information Suburban provided on April 7, 2017
9 still lacks the explanations ORA requested. Suburban still did not verify that a particular
10 legal invoice was actually directly charged to a particular subsidiary because the
11 documentation does not link a charge to a specific subsidiary. In addition, the booking
12 transactional records still did not include a subsidiary's account number, name, or other
13 identifying information. Suburban is manually linking its accounting records to the
14 various subsidiaries.¹⁰³

15 Suburban's brief (half-line) descriptions of legal invoices in some instances do
16 explain the link between a specific subsidiary and legal expenses, but the transaction data
17 and actual booking of these legal fees to specific subsidiaries still were not included. For
18 example accounting records show a column "Posting Date," but do not show where and
19 to which subsidiary the transaction was posted. Therefore, it is not clear that Southwest
20 and Suburban are accurately booking costs to ensure that Suburban's ratepayers are not
21 subsidizing costs for Southwest or its other corporate entities.

22 The Commission should not allow Suburban's ratepayers to be responsible for
23 these unsupported direct legal charges for ratemaking purposes.

¹⁰³ See Attachment-Q.

1 **D. CONCLUSION**

2 ORA makes several recommendations regarding Suburban’s request for its parent
3 company, Southwest, and the Utility Group’s cost allocations. For example, ORA
4 recommends that the Commission should approve an overall allocable cost of Southwest
5 in the amount of \$10,544,072 and a subsequent cost allocation to Suburban of \$4,649,936
6 at the allocation rate of 44.1%. For the Utility Group’s cost allocations, ORA
7 recommends that the Commission should approve an overall allocable cost of \$751,295
8 and a subsequent cost allocation to Suburban in the amount of \$331,321 at the allocation
9 rate of 44.1%.

10 In addition, ORA also recommends that the Commission should not allow any IT
11 capital expenses without a robust need analysis and a showing of competent project
12 management. ORA also finds that Suburban’s medical and dental insurance escalations
13 factors should be reverted back to the conventional labor escalation rates per the 2004
14 Rate Case Plan adopted in D.04-06-018. ORA recommends that the Commission should
15 require Suburban to retain its existing Employee Healthcare Balancing Account for 2018-
16 2020 and any such request that is aimed at reducing the utility’s regulatory risk should be
17 reviewed during the Cost of Capital proceedings so that the inherent risk and return
18 relationship is adequately evaluated. Finally, ORA requests that the Commission
19 consider whether a penalty should be imposed on Suburban for its non-compliance with
20 several Commission Decisions and non-cooperative behavior that has grossly
21 undermined the Commission’s regulatory oversight.

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**REPORT ON THE SOUTHWEST WATER COMPANY
ALLOCATION TO SUBURBAN WATER SYSTEMS
LIST OF ATTACHMENTS**

Attachment	Description	Note on Confidential Information
A	Southwest Organization Chart	Not Confidential
B	3/31/17 Response to AMX-02 #1b	Confidential
C	Mercer's survey excerpts	Confidential
D	Email from Mr. Joel Reiker, Vice President of Regulatory Affairs, San Gabriel Valley Water Company to ORA's Analyst, Mr. Mehboob Aslam	Not Confidential
E	Amended declaration of Robert L. Kelly on behalf of Suburban Water Systems in response to Office of Ratepayer Advocates Data Request AMX-006	Not Confidential
F	Excerpt of Suburban's Results of Operations, Page 5-5 and 5-6	Not Confidential
G	Email communications with Suburban regarding AMX-002	Not Confidential
H	Email correspondence with Suburban regarding AMX-002	Not Confidential
I	Copy of ORA's initial data request AMX-002, 4(e)	Not Confidential
J	Copies of various email correspondences between ORA and Suburban regarding several time extensions Suburban has requested	Not Confidential
K	Copies of email correspondences between ORA and Suburban showing ORA's efforts to accommodate Suburban's time extension request.	Not Confidential
L	Copy of Attachment-2 (page 3 of 5), Walter Bench's prepared testimony.	Confidential
M	Dated February 10, 2017, Suburban's partial response to ORA's data request AMX-002	Table on last page is Confidential; remainder is not.
N	Dated February 17, 2017, Suburban's partial response to ORA's data request AMX-002, items 1, 4(c), 4(e), 5(b), 5(e), and 6(c) supporting documents.	Confidential
O	Dated February 28, 2017, Suburban response to ORA's data request AMX-002, items 1, 4(c), 4(e), 5(e), and 6(c).	Not Confidential
P	Dated March 24, 2017, Suburban's response to ORA's data request AMX-002, item 4(e).	Confidential
Q	Dated April 7, 2017, Suburban's additional information regarding ORA's data request AMX-002, Question 4(e).	Confidential

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