Docket:	:	A.16-07-002
Exhibit Number	:	ORA - ____
Commissioner	:	M. Picker
Administrative Law Judge	:	S. Park
ORA Witness	:	Julia Ende

ORA
OFFICE OF RATEPAYER ADVOCATES

REPORT AND RECOMMENDATIONS ON PAYROLL AND BENEFITS, REGULATORY EXPENSES, SPECIAL REQUESTS #2 & #15

PUBLIC VERSION

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MEMORANDUM

The requests and data presented by California American Water (Cal Am) in Application (A.) A.16-07-002 were examined in order to provide the Commission with recommendations that represent the interests of ratepayers for safe and reliable service at lowest cost. Suzie Rose is ORA's project lead for the proceeding. Richard Rauschmeier is ORA's oversight supervisor. Paul Angelopulo and Kerriann Sheppard are ORA's legal counsel.

Although every effort was made to comprehensively review, analyze and provide the Commission with recommendations on each ratemaking and policy aspect presented in the application, the absence from ORA's testimony of any particular issue does not necessarily constitute its endorsement or acceptance of the underlying request, methodology, or policy position related to that issue.

I. Payroll Expenses

A. INTRODUCTION

This Chapter summarizes ORA's analysis and recommendations for payroll expenses for Cal Am's districts and GO for Test Year 2018. ORA analyzed Cal Am's testimony, supporting workpapers, responses to data requests and methods of estimating payroll expense. The discussion presented herein focuses on adjustments to Cal Am's estimates. The resulting adjusted estimates are reflected in ORA's Results of Operations (RO) tables.

B. SUMMARY OF RECOMMENDATIONS

The table below presents a summary of Test Year 2018 total expensed payroll estimates.

Comparison of Total Expensed Payroll Estimate – Test Year 2018

Cal Am Request	ORA Recommendation	Cal Am> ORA
$ 22,610,458	$19,413,281	$3,197,177

C. DISCUSSION

The main components of Cal Am's payroll expenses include labor (base salaries), overtime, Annual Performance Plan (APP, also referred to as the Annual Incentive Plan), Long Term Incentive Pay (LTIP) in the form of restricted stock units and stock options, and severance pay. The main reasons for the difference between ORA and Cal Am's estimates are: the differing base years used to forecast labor, the differing methodologies used to calculate APP expense, and differing labor inflation factors.

1. Labor

To project labor costs, Cal Am uses an estimate of 2016 salaries by position as its base year and compounds these salaries by union-negotiated wage increases and inflation factors to arrive at its Test Year 2018 request.[1] Cal Am escalates non-union salaries by 3.5% in 2017,

[1] Testimony of Todd Pray, at p. 6.

3.2% in 2018 and 2.94% in 2019, while union employees are escalated 2.25-2.5% annually in accordance with union contract provisions.[2]

ORA begins its forecast for TY 2018 by using 2015 actual salary data provided by Cal Am. This methodology provides a more reliable baseline than the utility-provided 2016 estimates or budgets. Actual 2015 data presents the opportunity to view labor expense under the most accurate circumstances. Since the Commission previously authorized Cal Am an amount of TY 2015 labor expense in rates,[3] in 2015 Cal Am had an incentive to control its labor costs. This is because if Cal Am spends more than the authorized labor budget, Cal Am would not receive recovery for the excess in rates. Ratepayers should be afforded the expectation that this type of cost-control will be maintained. Using 2015 salary data as a baseline for labor satisfies this expectation, and provides a reasonable amount of labor expense in rates consistent with Cal Am's provision of safe and reliable service. Further, Cal Am's proposal inappropriately assumes no vacancies. Using recorded information reflects actual vacancy levels.

To illustrate the difference between using a budgeted amount and an actual historical amount as a base year, workpapers provided by Cal Am demonstrate that Cal Am's total 2016 labor forecast is $21,326,261, which is a 12% increase over the 2015 actual expense amount of $19,101,910.

Table 1-1: Recorded and Requested Expensed Labor[4]

	Recorded $					**Cal Am Estimated $**		
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**TY 2018**
Labor	17,694,305	18,036,220	18,751,172	19,007,867	19,101,910	21,326,261	21,976,459	22,610,458
% Change		2%	4%	1%	0%	12%	3%	3%

Labor expenses are most accurately and reasonably projected by beginning with a base year of 2015 actual recorded labor expense. As described above, Cal Am proposes different wage escalation factors for union and non-union employees. To escalate 2015 expenses to TY 2018, a single escalation factor should be applied to all employees, rather than a higher factor for

[2] Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab INP - Labor Benefits.

[3] D.15-04-007, Attachment A, at p. 55.

[4] Cal Am workpaper ALL_CH04_O&M_RO_Labor, tab Summary of Costs - Detail WS9.

non-union employees. An examination of recorded payroll expenses reveals salaries for the highest compensated employees have increased at a faster rate than the lowest compensated employees. One measure of this wage gap is shown by comparing the percentage of overall labor costs attributed to the top and bottom 5% of employees. In 2010, the recorded payroll of the top 5% of employees was 3.65 times the payroll of the bottom 5% of employees.[5] Under Cal Am's proposal for 2016, that multiple would increase to 4.42.[6] Escalating both union and non-union salaries at 2.5% per year is preferable to Cal Am's proposal, because using the same rate for union and non-union employees will ensure the wage gap does not grow relative to recorded 2015 labor expenses. Further, using a 2.5% escalation rate for all employees is consistent with the settlement agreement adopted in the previous GRC, which authorized a 2.5% escalation rate for all employees.[7]

The Commission should adopt a methodology that uses 2015 recorded labor expense as the base year, escalated annually by the highest union-negotiated wage increase, 2.5%, for all employees. This method is superior to Cal Am's methodology because 1) using recorded costs as a base year is more reflective of actual costs than the utility-provided 2016 estimates that Cal Am utilizes; 2) it helps to ensure the wage gap does not grow significantly relative to recorded 2015 labor expenses; and 3) it is consistent with the settlement that was adopted by the Commission in the last GRC.

2. Long Term Executive Incentive Compensation

For Test Year 2018, Cal Am seeks to recover a total of $227,850 from California ratepayers for expenses related to long-term incentive pay. Cal Am's Long Term Incentive Plan (LTIP) program consists of Restricted Stock Units (RSU) and Performance Stock Units (PSU). Cal Am estimated expenses include $167,430 for RSUs and $60,431 for PSUs for Test Year 2018.

Cal Am's workpapers, recent Commission decisions, and Service Company's 2013 Equity Award Brochure demonstrate that 50% of the forecasted PSU expense allocation can

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[5] A.10-07-007, EXP-200 workpapers.

[6] Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab Current Employees WS-A-1.

[7] D.15-04-007, Attachment A – Amended Partial Settlement Agreement, p. 55.

justifiably be funded by ratepayers, while the total remaining Long Term Incentive Compensation should be funded by shareholders.

American Water's 2013 Equity Award brochure clearly states the incentive compensation purpose ("[The incentive compensation] promotes the achievement of the company's long-term, strategic business objectives"), as well as the company's mission, ("[a]s a publicly-held company, American Water has a responsibility to its shareholders to drive long-term success and increase the value of American Water stock.").[8] Also, the Equity Award brochure does not make a single mention of "customers" or "ratepayers." Stock options and RSUs both represent Long Term Incentive compensation that provides no discernible benefit to ratepayers, and as such, shareholders, and not ratepayers, should fully fund stock options and RSU expense.

a) Performance Stock Units (PSUs)

American Water's 2013 Equity Award brochure states that 30% of the total Equity Award is from PSUs that are measured by internal performance goals.[9] ORA analyzed this section for evidence that these internal performance goals provide incentives that benefit ratepayers. According to the Equity Award Brochure, the 30% PSU allocation award is determined by meeting internal performance goals that are measured 50% toward compounded earnings per share (EPS) growth and 50% toward operational efficiency goals.[10] Because the operational efficiency goal is an incentive that promotes control of operations and maintenance expense as compared to revenues, 50% of the 30% PSU portion of the Equity Award, approximately 15% of the total Equity Award, may result in a benefit to ratepayers.

b) Regulatory Background of Incentive Compensation

In its past five GRCs, Cal Am's incentive compensation has either been removed or reduced by Decision or through settlement. These Cal Am GRC decisions include D.03-02-030,

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[8] American Water Works Company, Inc. 2013 Equity Award Brochure for Employees, p. 1.

[9] *Ibid.*

[10] *Ibid.*

D.06-11-050, D.09-07-021, D.12-06-016, and D.15-04-007, each of which resulted in either removal or reduction of Cal Am's requested incentive compensation.[11]

In the recent Golden State Water Company decision, the Commission considered and clarified its position regarding long term compensation such as stock options:

> With regard to the Commission's past treatment of long term compensation, our review of the decisions show that the Commission has generally disallowed long term incentive compensation. Although many companies offer long term compensation plans, this does not necessarily mean that ratepayers should have to pay for the costs of funding such programs. In considering whether such costs are reasonable, we find that the benefit of this type of compensation plan clearly benefits officers and shareholders if the value of the stock goes up. Since this stock-based compensation is tied to financial performance over a period of time, it clearly demonstrates that a premium is being placed on the companies' financial performance. In addition, the officers who will receive the stock-based compensation are already highly compensated through their base pay, the STIP, and other incentives.[12]

A recent San Diego Gas & Electric GRC decision reached a similar conclusion: "…long term compensation is stock-based compensation, which is tied to the financial performance of Sempra, and which benefits shareholders rather than ratepayers. For that reason, it is reasonable to disallow all ratepayer funding of Corporate Center's allocation of the costs of the long term incentive plan to SDG&E and SoCalGas."[13] In addition, a similar decision was reached during Southern California Edison's recent GRC.[14] ORA concurs with the Commission's stated position that long term incentive plans benefit shareholders and thus only recommends ratepayer funding for the 15% of the budgeted amount for the PSU portion, a ratio which best aligns resulting ratepayer benefits with the incentives and beneficiaries of the long term incentive plan goals. The Commission should adopt ORA's recommended LTIP expense of $30,216 for Test Year 2018.

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[11] D.03-02-030, p. 25, D.06-11-050, p. 30, D.09-07-021, p. 100, D.12-06-016, p. 9, D.15-04-007 Attachment A, p. 55.

[12] D.16-12-067, at pp. 104-105.

[13] D.13-05-010, at p. 832.

[14] D.12-11-051, at p. 451.

3. Annual Performance Plan

The Annual Performance Plan (APP)[15] is a program that provides eligible employees an opportunity to earn cash incentives equivalent to a certain percentage of an employee's base salary. Each employee's annual award is based on the company achieving certain objectives and the employee's personal performance.[16] The table below presents Cal Am's recorded and requested APP expenses.

Table 1-2: Recorded and Requested Expensed Annual Performance Plan[17]

	Recorded $					Cal Am Estimated $		
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Test Year 2018**
APP	2,022,463	1,710,814	1,522,638	1,473,112	1,802,668	1,638,326	1,693,342	1,747,662
% Change		-15%	-11%	-3%	22%	-9%	3%	3%

Similar to Cal Am's LTIP, 50% of the APP award pool funding is tied to the goal of corporate financial performance. [BEGIN CONFIDENTIAL] [redacted] [END CONFIDENTIAL] This results in a recommended TY 2018 APP expense of $873,831.

[15] The name of the plan was changed from Annual Incentive Plan (AIP) to Annual Performance Plan in 2016. See Cal Am's response to data request ORA DR JE6-012, Q.4.a.

[16] American Water Works Company Proxy Proxy Statement dated March 27, 2015, at p. 29.

[17] Cal Am workpaper ALL_CH04_O&M_RO_Labor, tab Summary of Costs - Detail WS9.

[redacted]

4. Severance

Cal Am's estimate for CAW Corporate severance expenses uses an inflation-adjusted five-year average as the base year and applies ORA ECOS inflation factors to arrive at a Test Year estimate of $114,941.[19] As shown in the table below, Cal Am's severance expenses fluctuate significantly year to year.

Table 1-3: Recorded and Requested CAW Corporate Severance Expense

	Recorded $					Cal Am Estimated $		
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Test Year 2018**
	332,661	92,399	10,188	84,645	8,922	108,322	111,334	114,941
% Change		-72%	-89%	731%	-89%	1114%	2.78%	3.24%

While variance year to year is expected, the 2011 recorded expense is an outlier and therefore should be excluded from the five year average. The 2011 recorded expense can be considered an outlier as it is greater than one standard deviation above the 2011-2015 mean. Cal Am provided no testimony to justify the use of ratepayer funding for severance packages. If the Commission does allow severance expense to be included in the revenue requirement, it is more appropriate to utilize the five-year inflation adjusted average, excluding 2011 as an outlier, resulting in a TY 2018 severance expense of $53,294.

D. CONCLUSION

The Commission should adopt ORA's payroll expense estimates. The Commission should:

1) Use 2015 recorded payroll to provide a verifiable cost basis from which to escalate for inflation, that represents an actual period of time when Cal Am had a strong incentive to control costs,
2) Escalate non-union salaries by 2.5% per year,
3) Reduce incentive plan expenses to align incentives with the beneficiaries, and

[19] Workpaper ALL_CH04_O&M_RO_Labor, tab Escalated Costs WS5.

4) Reduce severance expenses to exclude years with outlier data.

II. Employee Benefits

A. INTRODUCTION

This chapter presents ORA's analysis and estimates for company-wide benefit expenses in Account 795. The discussion presented herein focuses on adjustments to Cal Am's estimates. The resulting adjusted estimates are reflected in ORA's Results of Operations (RO) tables.

B. SUMMARY OF RECOMMENDATIONS

2018 Expense Adjustment	Cal Am Request	ORA Recommendation	Cal Am > ORA
Reduction in Pension Plan	$3,110,800	$1,777,600	$1,333,200
Removal of Stock Purchase Plan	$51,922	$0	$51,922
Reduction in Group Health Insurance	$3,697,450	$2,592,300	$1,105,150

C. DISCUSSION

Expenses in "Account 795 – Employee Benefits expense" include costs associated with the 401(k) plan, Defined Compensation Plan, Employee Stock Purchase Plan, pension costs, group health insurance (including medical, dental, and vision), and retiree health care costs. Cal Am calculates the costs company-wide and then allocates those to the districts and General Office.[20]

1. Pension Plan Funding

For Test Year 2018 Cal Am is requesting $3,110,800 for pension expense costs related to California district and General Office employees. According to Cal Am, this amount is derived from a formula that takes consultant Towers Watson's actuarial conclusions performed on behalf of all of American Water and allocates a portion to Cal Am. The percentage allocated to Cal Am

[20] Cal Am workpaper ALL_CH04_O&M_WP_Labor.

is based on the actual 2015 allocation, which was 5.05%.[21] Cal Am has a balancing account that tracks the difference between recorded and adopted pension costs. A discussion of the balance in the Pension Balancing Account can be found in the Testimony of Roy Keowen.

As shown in Table 2-1 below, recorded pension costs have decreased in each of the last three years. However, Cal Am estimates an increase in pension expenses of 73% in 2016, 24% in 2017 and 41% in 2018.

Table 2-1: Recorded and Requested Pension Expense [22]

	Recorded $					**Cal Am Estimated $**		
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**Test Year 2018**
Pension	2,678,626	3,798,243	2,832,725	1,362,905	1,024,814	1,777,600	2,211,900	3,110,800
% Change		42%	-25%	-52%	-25%	73%	24%	41%

Cal Am's pension expense estimates are based on numerous assumptions, including plan participation and investment returns. The further out in the future the expenses are projected, the more speculative the estimates become. Still, Cal Am has failed to explain why pension expenses are projected to increase by over 200% in the test year as compared to the last recorded year. ORA notes that the actuarial estimates cited by Cal Am in support of its application are from a report dated October 2015. The declining trend in pension costs has resulted in recorded expenses significantly under the authorized levels. According to Cal Am, the over collection in the pension balancing account in 2015 was almost $4 million.[23] Given the recent decline in pension costs, estimates should reflect recorded costs. Thus, pension expenses are more accurately estimated by utilizing Cal Am's actuarial projected 2016 pension expense estimate of $1,777,600 in each year of this GRC. This estimate is based on the most recently available data and is similar to the 2013-2015 average recorded pension expense. As discussed in Roy

[21] Testimony of Todd Pray, p. 12 and Cal Am's response to data request ORA JE6-002, Q.1.

[22] Cal Am's response to data request ORA JE6-002 Q.1 and Q.2.

[23] Cal Am's response data request ORA RK2-005.3 Q.1.

Keowen's testimony, ORA recommends continuation of the Pension Cost Balancing Account which will capture differences between authorized and actual pension expenses. ORA also recommends that Cal Am incorporate the following language in its Pension Balancing Account preliminary statement to ensure consistency in accounting practices:

1. To the extent that Cal Am increased pension costs in an escalation year filing, that increase should also be applied to the "adopted" pension costs for the purposes of calculating the difference between adopted and actual pension costs; and
2. In calculating "actual" pension costs, Cal Am should apply the capitalization ratios that were used for the adopted pension costs for Test Year 2018.

2. Stock Purchase Plan Funding

Cal Am provides employees the opportunity to purchase common shares of American Water (AWK) stock at a 10% discount off the New York Stock Exchange (NYSE) price, through after-tax payroll deductions. Full and part-time employees are eligible.[24] Cal Am's Test Year estimate in Table 2-2 below is based on budgeted amounts and not based on actual participation or recorded costs.

Table 2-2: Employee Stock Purchase Plan (ESPP) Expenses[25]

	Recorded (amounts escalated)					**Estimated**
	2011	**2012**	**2013**	**2014**	**2015**	**Test Year 2018**
ESPP	$19,583	$22,634	$24,946	$29,461	$33,627	$51,922
% Increase		16%	10%	18%	14%	54%

ORA disagrees with inclusion of the cost associated with ESPP in the revenue requirement for the same reasons discussed above in the Executive Incentive section regarding Long Term Incentive Plans. As described in this Report, Cal Am employees receive compensation above base salary in the form of 401(k) matching, defined contribution or defined

[24] Cal Am's response to data request ORA JE6-004, Q.3.

[25] Workpaper ALL_CH04_O&M_RO, tab Sum Costs Before GO Alloc WS9A.

benefit plans, and annual performance plan bonuses. Additional compensation in the form of subsidized stock purchases does not confer any benefit on ratepayers and should instead be funded by shareholders. The Commission should therefore not authorize this expense to be funded by ratepayers for TY 2018.

3. Group Insurance

Cal Am requests group medical insurance expense increases over its 2016 estimated expense of 9.5% in 2017 and 8.4% in 2018.[26] The result of applying these compounded increases yields a forecasted TY 2018 net group medical expense for Cal Am employees of $3,697,450.[27] ORA recommends utilizing 2015 recorded costs as the base year, with annual increases of 3.1% in 2016, 4.5% in 2017, and 5.0% in 2018. This methodology yields a TY 2018 expense of $2,592,300, which is $1,105,150 less than Cal Am's request. This difference is due to the choice of base year and the methodologies used to calculate group medical insurance inflation, as described further below.

a) Forecasting Methodologies

As stated in the testimony of Todd Pray, to forecast the group medical insurance expense, Cal Am began with an estimate of 2016 claims costs provided by actuary consultant Aon Hewitt.[28] Cal Am escalated the 2016 estimated costs by escalation factors provided by consultant Towers Watson. The factors are 9.5% in 2017 and 8.4% in 2018 to arrive at the Test Year estimate.[29] The costs include medical, dental, vision care and employee assistance program.[30]

As the basis for its request, Cal Am used an *estimate* of 2016 claims instead of the recorded 2015 *actual* costs. Cal Am then escalates these costs as described above. In support of its requested annual group medical insurance percentage increases, Cal Am provides the

[26] Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab INP - Labor Benefits.

[27] Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab Sum Labor - Benefit $ WS-A-10.

[28] Testimony of Todd Pray, at p. 26.

[29] Testimony of Jeffrey Linam, page 11; Testimony of Stuart Alden, pp. 8-9; and Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab INP - Labor Benefits.

[30] Cal Am workpaper ALL_CH04_O&M_WP_Labor, tab Y_Grp Ins Data WS-C.

testimony of actuary Stuart Alden from consultancy Towers Watson. Alden's testimony mirrors the testimony provided in the last GRC, often word for word. It cites a survey entitled "2016 Emerging Trends in Health Care (Towers Watson Survey)" stating "…we found that the average projected 2016 trend (before reflecting the impact of any plan changes or employee contributions) for the surveyed employers was 6.0%." Alden then extrapolates this 6% to 2017 and 2018 and adds a 1-4% annual premium due to additional costs related to the Patient Protection and Affordable Care Act (PPACA) and prescription drug costs, and arrives at 7-10% estimated annual increases for 2017 and 2018. The inflation factors used in Cal Am's workpapers are 9.5% in 2017 and 8.4% in 2018. Cal Am does not provide an explanation how the specific factors were derived from the range of 7-10% described in testimony.

Cal Am's methodology used to forecast its medical insurance expense increases is flawed. The support Cal Am uses to justify these inflation rates is identical to that used in the last GRC. However, Cal Am's recorded insurance costs have decreased in each of the last four years.[31] Additionally, a report released on Cal Am consultant Towers Watson's website entitled "The New Health Care Imperative" states, "Health trend increases (employer costs after plan changes) fell to a 15-year low of 4.1% in 2013 and are expected to average 4.4% for 2014."[32] A report from Cal Am's other healthcare consultant Aon Hewitt released 11/12/2015 entitled "2015 records lowest U.S. Health Care Cost Increase in Nearly 20 years" shows the rate increase in 2015 was 3.2% and predicts rates will increase by 4.1% in 2016. [33]

As discussed in the previous section, a more accurate methodology for forecasting Group Insurance Expense for TY 2018 uses recorded data for 2015 as a base year and applies annual inflation increases to this amount for years 2016, 2017, and TY 2018. In general, ECOS rates are used to calculate inflation, but for group insurance the Commission should use the Health Insurance inflation factors specific to this expense from Information Handling Services Global Insight's (IHS) Employment Cost Index from October 2016. The Commission routinely relies on economic data prepared by IHS Global Insight to ascertain the level of inflation. IHS

[31] ALL_CH04_O&M_WP_Labor, tab Y_Grp Ins Data WS-C.

[32] https://www.towerswatson.com/en-US/Insights/IC-Types/Survey-Research-Results/2014/05/full-report-towers-watson-nbgh-2013-2014-employer-survey-on-purchasing-value-in-health-care

[33] http://ir.aon.com/about-aon/investor-relations/investor-news/news-release-details/2015/2015-Records-Lowest-US-Health-Care-Cost-Increases-in-Nearly-20-years/default.aspx

inflation factors are preferable because they originate from a purely non-partisan source. [BEGIN CONFIDENTIAL] [redacted] [END CONFIDENTIAL]. These health care inflation factors are higher than the Consumer Price Index (CPI) inflation factors listed in ORA's Escalation Memo that incorporates projections prepared by IHS, and are significantly lower than the assumed inflation requested by Cal Am.

D. CONCLUSION

ORA makes several recommendations regarding Cal Am's request for employee benefit expenses. The Commission should not authorize Cal Am's requested ESPP expense as it does not provide ratepayer benefit. Further, the Commission should adopt ORA's recommended expenses for pension and group insurance because they provide a more accurate estimate for TY 2018.

III. Special Request #2 – Group Insurance Balancing Account

A. INTRODUCTION

This chapter presents ORA's analysis and recommendation on Special Request #2. In Special Request #2, Cal Am requests authorization to establish a balancing account for group health insurance expenses based on the changes in the company portion of the cost per employee. Cal Am's makes the following assertions in support of its request:[34]

1. Group insurance coverage is expected to experience premium increases in the range of 7% to 10% on an annual basis.

2. American Water will again renegotiate the group insurance coverage with vendors – both to consider new vendors and determine the magnitude of coverage in the plan, in 2017, prior to the Test Year in this case.

B. SUMMARY OF RECOMMENDATIONS

ORA does not agree with Cal Am on the need for a balancing account to cover increases in group insurance expenses for the following reasons, each of which is discussed in more detail below.

1. Group Health Insurance is expected to increase in the range of only 3.1% - 5.0% for the period 2016-2019, not 7% - 10% as Cal Am claims. The moderate increases in health insurance, as projected by IHS Global Insight and public estimates from the company's own consultants, are unlikely to be as high as Cal Am predicts.

2. With the protection offered by a balancing account, there is no incentive for Cal Am to negotiate for the most affordable insurance coverage alternative upon renewal in 2017.

C. DISCUSSION

Cal Am predicts group insurance to increase in the range of 7% -10%. ORA disagrees with these percentages, as IHS data for October 2016 shows health insurance increases forecasted in the range of 3.1% - 5.0% for the period 2016 to 2018. IHS is one of the sources of information for Estimates of Non-Labor and Wage Escalation Rates and Compensation per Hour published by ORA's ECOS and Water Branches. Using the trend forecasted by IHS Global

[34] Testimony of Stuart Alden, at pp. 8-9.

Insight, group insurance expense is expected to fluctuate at a moderate level and not as erratically as Cal Am predicts. Thus, there is no need for a balancing account.

With the protection of a balancing account, Cal Am will not have an incentive to negotiate for the most reasonable alternative when it chooses its next group insurance provider in 2017. Cal Am could choose the most expensive provider available, or pursue the most expensive available coverage, and ratepayers would pay the full amount of the associated cost increases through recovery of the balancing account. Instead of adopting greater cost-sharing for health coverage amongst employees, consistent with the general trends in private sector health coverage, Cal Am could pursue the opposite with little to no financial repercussion.

D. CONCLUSION

There is no basis to grant Cal Am’s request for a Group Insurance Balancing Account. Cal Am does not justify its arguments for the creation of a Balancing Account, and further investigation shows its arguments to be lacking in merit. The Commission should deny Special Request #2.

IV. Special Request #15 – Treatment of Pension and Other Post-Employment Benefits

A. INTRODUCTION

This chapter presents ORA's analysis and recommendation on Special Request #15. In Special Request #15, Cal Am requests to use the pension and Other Post-Employment Benefits (OPEB) expenses projected by its actuary in the step rate calculations for 2019 and 2020.[35] ORA's recommendations are based on analysis of Cal Am's testimony, workpapers, responses to data requests, and previous Commission rulings.

B. SUMMARY OF RECOMMENDATIONS

ORA recommends the Commission should reject this request for the following reasons:

1. Cal Am's pension forecast overestimates actual costs.
2. The request deviates from established Commission practice and makes step increase filings needlessly complex.
3. Using a lower estimate in the Test Year compared to the attrition and escalation year obscures the full impact on rates.

C. DISCUSSION

Cal Am's actuary projects different pension and OPEB expense amounts for each of the three years of the GRC cycle. Instead of averaging these numbers to determine the Test Year 2018 estimate, this request would result in the use of different retirement benefits expenses for each year of the rate case.

As justification for this request, Cal Am states it is using the actual forecast as a way to reduce rate impact in the test year. Cal Am goes on to assert because the step rate filings only allow costs to increase by inflation, if the costs are higher than inflation the mismatch in the

[35] Testimony of Todd Pray, at pp. 12-13.

Company's revenue stream could result in a cash flow deficit.[36] According to Cal Am, a cash flow deficit would require additional financing of debt which would increase customers' rates.

There is no evidence Cal Am has faced a cash flow deficit as a result of pension funding obligations. Rather, as discussed in Chapter 2 of this Report, during the current rate case, the authorized pension expenses Cal Am is recovering in rates exceeds the actual pension expenses. According to data request responses, the over-collection in the pension balancing account in 2015 was almost $4 million.[37] Cal Am's actuary forecasts pension expenses for this rate case that significantly exceed recorded costs in the last five years. ORA recommends a lower pension expense estimate and therefore, it would be inappropriate to authorize the pension and OPEB forecast Cal Am requests in this special request.

Additionally, Cal Am's request deviates from established Commission practice. D.04-06-018 and subsequent D.07-05-062 (the "Rate Case Plan") provides for "one test year and two escalation years program for expenses."[38] In Special Request #15, Cal Am requests the Commission to establish "authorized" amounts for pension and OPEB expenses for 2019 and 2020 (in additional to TY 2018), essentially establishing three test years for these expenses. This is not only contrary to the Rate Case Plan, it also creates unnecessary complexity and additional work for Commission staff in the step rate filings.

Of further concern, allowing Cal Am to use a lower expense amount in the test year and authorizing a higher amount for future years is misleading to ratepayers. This obscures the true impact on rates of the expenses requested in this GRC application.

Lastly, Cal Am has a balancing account specifically to accommodate differences between authorized and actual pension expenses, should the amounts increase from the TY 2018 authorized amount.

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[36] Testimony of Todd Pray, at pp. 12-13.

[37] Cal Am's response data request ORA RK2-005.3 Q.1.

[38] D.04-06-018 at Appendix p.15.

D. CONCLUSION

ORA reviewed Cal Am's Special Request #15 and found no basis for the requested treatment of pension and OPEB expenses. Cal Am's request 1) reflects needlessly inflated pension and OPEB expense, 2) is contrary to the Rate Case Plan, 3) creates unnecessary complexity in the company's step rate filings, and 4) obscures the full impact of pension and OPEB expenses on rates. Consequently, the Commission should deny Special Request #15.

V. Regulatory Expenses

A. INTRODUCTION

This Chapter summarizes ORA's analysis and recommendations for regulatory expenses for Cal Am's districts and GO for Test Year 2018. ORA analyzed Cal Am's testimony, supporting workpapers, and responses to data requests. The discussion presented herein focuses on adjustments to Cal Am's estimates. The resulting adjusted estimates are reflected in ORA's Results of Operations (RO) tables.

B. SUMMARY OF RECOMMENDATIONS

Key recommendations include:

1) Reduce rate consultants expense;
2) Reduce outside attorneys' fees;
3) Remove duplicative witness training expense;
4) Remove cost of capital expense; and
5) Remove compensation study expense

C. DISCUSSION

Account 797 – Regulatory Commission Expenses (also referred to herein as rate case expenses) includes amounts for legal services, printing and mailing, and consulting expenses incurred by a utility during the processing of required General Rate Case and Cost-of-Capital applications. Cal Am is requesting a total regulatory expense amount of $3,559,073 to be recovered from ratepayers over the course of the 2018-2020 GRC cycle.[39] ORA recommends a regulatory expense of $1,274,323, which is $2,284,750 less than Cal Am's requested amount. The difference between Cal Am's request and ORA's recommendation is attributable to: 1) consideration of the appropriateness of Cal Am's rate consultants and legal expenses; 2) removal of expenses for: witness training, cost of capital proceeding, and a compensation study.

In Special Request #9, Cal Am proposes to recover rate case expenses over 27 months instead of 36 months starting in October of Test Year 2018 with the remaining amount recovered equally in the escalation and attrition years. This results in Cal Am requesting a total of

[39] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp.

$395,453 for regulatory expenses for TY 2018.[40] ORA recommends evenly recovering rate case expenses over the three year rate case cycle, resulting in $424,774 for TY 2018, $29,321 more than Cal Am. The Scoping Memo issued October 17, 2016 excludes Special Request #9 from this proceeding, stating, "The general rate case covers a 3-year period. Therefore, it is appropriate for the rate case expense to be spread out over a 3-year period rather than over a shorter 27-month period."[41] For a more accurate comparison of TY 2018 estimates for regulatory expenses, evenly recovering Cal Am's requested regulatory expense over three years would have resulted in Cal Am requesting $1,186,358 in TY 2018, while ORA is recommending $424,774 in TY 2018, a difference of $761,584.

1. Comparative Analysis with other Class A Water Utilities

To put Cal Am's request into perspective, ORA performed a comparative analysis of the amounts requested in GRC proceedings by the four largest Class A Water Utilities, including Cal Am's request. The requested amount is divided by the number of active service connections to arrive at an average dollar amount per service connection. The results are summarized in Table 4-1 below:

[40] *Ibid.*

[41] A.16-07-002 Assigned Commissioner's Scoping Memo And Ruling dated October 17, 2016, p. 5.

Table 4-1: Comparison of Rate Case Expense Between Four Largest Class A Water Utilities

Class A Water Utility	Proceeding	TY	(TY) Amount Request	Total # of Service Connections	Dollar amount per Service Connection
Golden State Water	A.14-07-006	2016	$653,606[42]	242,605	2.69[43]
San Jose Water	A.15-01-002	2016	$341,000[44]	218,935	1.56
Cal Water	A.15-07-015	2017	$197,000[45]	423,599	0.47
California American	A.16-07-002	2018	$1,186,358[46]	174,451	6.80
Average $ Amount Per Service Connection for Three Largest Class A Water IOUs:					1.57

Table 4-1 shows that the dollar amount of rate case expense per service connection. Cal Am is requesting four times more than the average amount requested by the three largest Class A Water Utilities. Cal Am's request amounts to $6.80 per service connection while the average among the three largest Class A Water Utilities is $1.57. This comparison provides strong evidence that Cal Am's regulatory expense request of $3,559,073 is excessive. The recommendations below address the excess more specifically.

2. Rate Consultants

Cal Am estimates rate consultant expenses of $632,500 for the GRC cycle. This represents a 162% increase in rate consultant expenses over the last authorized amount of $241,140. Cal Am's workpaper provides the names, rates and quantity of labor for each of the

[42] Golden State's request in A.14-07-006 includes the duplicative costs for both the 2014 and 2017 rate cases after the company was authorized to move from recovering rate case expenses on a deferred to prospective basis. Using the amount requested for the 2017 rate case and excluding duplicative costs for the 2014 GRC is appropriate for comparison. See A.14-07-006 Prepared Testimony of Hilda Wahhab, p. 19.

[43] A.14-07-006, Workpaper GO-SOE 14, tab 797 Rate Case Expense.

[44] A.15-01-002, Workpaper CH-09, Tab WP 9-08.

[45] A.15-07-017, WP6B8 Acct 797.

[46] As discussed above, Cal Am's application requested $395,453 for rate case expenses in Test Year 2018. This was the result of a methodology that back-weighted recovery of rate case expenses in the escalation and attrition years. The special request to use this alternate methodology was excluded from this proceeding; therefore, the table reflects a Test Year amount assuming even distribution of rate case expenses over three years.

proposed consultants. ORA requested more information regarding how the estimates were developed and the nature of the work, and developed the below recommendations based on Cal Am's responses.

a) Dave Stephenson and Lisbeth Hether

Cal Am budgets $308,000 to contract with two former employees. First, Cal Am estimates $235,000 for labor and travel for consultant Dave Stephenson.[47] Mr. Stephenson retired as Director of Rates for Cal Am in 2015. Cal Am provides the following justification for its expense request: "Mr. Stephenson assists California American Water in all aspects of the general rate case including policy and testimony support, regulatory research, support to discovery requests, MDRs, working papers, direct and rebuttal testimony, support in settlement, hearings, briefs and responses to proposed decisions. Mr. Stephenson has provided key support in the development of the new Results of Operation ("RO") model that has been provided in this rate case and will be involved in consulting on future updates to that model."[48] Second, Cal Am estimates $73,000 for labor and travel for Lisbeth Hether, a former Cal Am financial analyst who retired in 2015.[49] Cal Am asserts that Ms. Hether supports the analysis of O&M costs and has experience with accounting and financial systems.[50]

The list of duties for both these consultants describes precisely the same responsibilities as Cal Am's nine full-time staff in its Rates Department. Payroll dollars are budgeted to Cal Am for performance of these activities. Cal Am is attempting to secure additional dollars to do the same work already being done by its nine-person Rates Department and provided for in the payroll budget. The company has not decreased its requested payroll expense to account for outsourcing functions that were previously completed in-house. Any assistance provided to train new employees as part of the transition should be complete, or under any scenario finished well before Test Year 2018. Therefore, the Commission should not authorize Cal Am's $308,000

[47] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 116-Rate Consultants.

[48] Cal Am Response to ORA DR JE6-003, Q.1.a.

[49] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 116-Rate Consultants.

[50] Cal Am Response to ORA DR JE6-003, Q.3.a.

request for the rate consultants discussed above. This adjustment is reflected in ORA's Results of Operations (RO) tables.

b) Anne Watson

Cal Am estimates $108,000 for consultant Anne Watson, developed by estimating 18 months of service at a monthly rate of $6,000.[51] According to Cal Am, Ms. Watson is a former Commission ALJ and offers "support to California American Water in testimony development and review, review of policy positions and the level of evidence and support needed in California American Water's filings before the Commission related to the general rate case."[52] ORA requested all invoices from Anne Watson between 2012 and November 2016. Cal Am provided invoices dated between August 2013 and May 2014 totaling $66,000, about half of the request in this rate case. No invoices were provided for the last two and a half years, including the period covering the preparation for this rate case filing, meaning Ms. Watson is no longer being paid to provide service to Cal Am.[53] Also at issue is Cal Am's practice of contracting with a consultant on retainer, as Cal Am has done with Ms. Watson. The only description of services on Ms. Watson's invoices is "Professional Fees." Ms. Watson's invoices provide so little detail that it is impossible to determine whether she performed any services that benefitted ratepayers, or whether Ms. Watson performed services that only serve American Water corporate interest. Given the lack of support for this consultant's service and the lack of evidence the expenses are expected to continue, the Commission should disallow $108,000 from the rate consultants estimate for Ms. Watson.

c) Ken Parris

Cal Am includes an estimated $35,000 expense for consultant Ken Parris.[54] In response to ORA's data request for information, Cal Am described Mr. Parris' role as "an experienced data analyst and statistician who supports the analysis of revenues, bill days, revenue modeling

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[51] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 116-Rate Consultants.

[52] Cal Am's response to data request ORA JE6-003 Q.6.a.

[53] Cal Am's response to data request ORA JE6-006.2 Q.1.b.

[54] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 116-Rate Consultants.

and rate design. Mr. Parris has experience with large data files and analysis."[55] ORA requested and reviewed Cal Am's invoices from Mr. Parris to date. The invoices provided totaled $5,720, significantly lower than Cal Am's $35,000 estimate. The invoices provided cover the first half of the rate case proceeding. ORA is aware that Mr. Parris could incur additional expenses for work as the second half of this proceeding progresses and therefore recommends a budget of $10,000, twice what has been incurred in the first nine months of the case, as a reasonable total GRC expense in the forecast.

d) Utility Consulting Group

Cal Am requests $96,500 for consultant Utility Consulting Group (UCG). UCG was hired to develop Cal Am's new Results of Operations (RO) model. This cost was of a one-time nature as the RO model has been completed and implemented for use in the current proceeding. Cal Am staff have been trained and are familiar with the model and no justification has been provided for the continuation of these expenses into the next rate case. The Commission should not allow $96,500 for UCG expenses in the rate consultant estimate.

3. Legal Expense

Cal Am arrives at its legal expense estimate by starting with the $1,242,845 settlement amount in the last case. Cal Am then inflates this amount by 5.9% to arrive at an estimate for the 2016 GRC of $1,316,173.[56]

As with many of the other components of Cal Am's requested regulatory expenses, Cal Am's requested amount for TY 2018 legal fees are based on estimates and previously authorized amounts, not recorded costs. ORA considered several factors in developing its recommendation, including recorded outside counsel expenses, as well as Cal Am's in-house legal staffing capacity.

a) Recorded Outside Counsel Costs

In order to evaluate Cal Am's estimate of legal fees, ORA requested all 2013 GRC-related legal invoices. After objections, Cal Am eventually provided heavily redacted invoices

[55] Cal Am's response to data request ORA JE6-003 Q.4.a.

[56] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 118-Legal.

dated between August 2012 and February 2016, purportedly related to the previous GRC. The total billed in the invoices for the 2013 GRC was $344,277.[57] This amount includes over $21,000 for expense charges, including document production, meals, and online legal research services. The total billed hours were approximately 700. Cal Am's request in this case exceeds the amount spent in the previous GRC by $971,896.

ORA's data request asked the company to provide a detailed list of which of these invoices pertain to the Rule 1.1 violation issued in A.13-07-002.[58] As part of the previous GRC, the Commission imposed sanctions on Cal Am for violation of Rule 1.1 of the Commission's Rules of Practice and Procedure.[59] Cal Am opposed the decision and filed an application for rehearing, which the Commission denied.[60] Cal Am's data request response failed to identify which invoices related to Rule 1.1.

As part of its review of legal invoices, ORA noted all entries with Rule 1.1 in the description. However, Cal Am's redactions made it difficult to identify with certainty all entries related to Rule 1.1. A connection to Rule 1.1 for some of the redacted entries could be reasonably inferred based on the description and comparison to the timeline of filings (e.g. a reference to the Order to Show Cause hearing or a charge to "analyze ORA motion" in November 2013). As a result of its review, ORA conservatively estimates $200,000 of the approximately $344,000 is related to Rule 1.1 defense. Of the 700 billed hours recorded in the invoices, 415 hours are in the months related to Rule 1.1 services, leaving 285 in the remaining months. See Attachment 2: Cal Am 2013 GRC Legal Invoices Analysis, which summarizes charges on the invoices provided.

Cal Am incurred the Rule 1.1-related expense because of a material misstatement in its application before the Commission.[61] It is inappropriate to include costs related to the Rule 1.1 proceeding in a forecast and compensate the company, at the expense of ratepayers, for a serious offense against Commission policy. Allowing such expenses would in essence charge ratepayers

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[57] Cal Am's response to data request ORA DR JE6-007, Q.1.a.

[58] A.1607002 JE6-003, Q.9.a.i.

[59] D.15-04-008.

[60] D.16-01-025.

[61] D.15-04-008, at p. 27.

for Cal Am's costs associated with misleading regulators. Further, Rule 1.1 violations are not expected to recur, and therefore the costs associated with defending such violations should not reasonably be included in any prospective forecast.

Review of Cal Am's retention agreements and invoices revealed another concern regarding overall legal expenses. The charges on Cal Am's legal invoices are primarily billed by attorney Lori Ann Dolquiest at the law firm Nossaman (previously with the law firm Manatt). Ms. Dolquiest charges a "discounted" rate between $567-578/hour. Retention agreements and invoices state this is a 15% discount from her regular rate.[62] The Commission has previously ruled on the reasonableness of outside attorneys' hourly rates. Resolution (Reso.) W-4961 noted, "In D.09-05-011, the Commission approved an hourly rate for attorneys […] as $290 and $330 in 2007 and 2008 respectively."[63] DWA staff recommended an attorney fee of $350/hour be used for the water utility Park Water Company.[64] Decision 15-10-025 issued in 2015 approved DWA's recommendation.[65]

As in the Park Water Company (Park) case at issue in Reso.W-4961 and D.15-10-025, Cal Am did not make an assessment of reasonableness of the rates charged by its legal counsel by comparing them with hourly rates charged by attorneys with comparable experience. Cal Am's outside counsel were selected based on the prior relationship representing Cal Am in regulatory matters. An hourly rate of $350, as recommended in D.15-10-025, should be adjusted for inflation and utilized in calculating Cal Am's outside attorneys' fees. For TY 2018, this results in a rate of $385/hr.

b) In-house attorney staffing level

A review of Cal Am's in-house legal staffing level further supports the adoption of a lower outside legal budget than past rate cases. In Cal Am's previous GRC, the Commission authorized a new in-house attorney position for regulatory affairs for Cal Am.[66] Cal Am

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[62] Cal Am's response to data request ORA JE6-007, Q.1.a.

[63] Resolution W-4961, p. 7.

[64] *Ibid.*

[65] D.15-10-025, p. 12-13.

[66] D.15-04-007, Attachment A – Amended Partial Settlement Agreement, p. 60.

currently has three attorneys and a paralegal in its regulatory department, in addition to three attorneys in its operations department. Cal Am's legal expenses are discussed in the protest of intervenors Mark West Area Community Services Committee and the California Water Rights Association (Mark West et al). The protest discusses Cal Am's history of representation in past proceedings, noting the relationship between Cal Am's in-house and outside counsel, as well as the increasing number of attorneys working on Cal Am proceedings.[67] Given the resources of Cal Am's law office in San Francisco, the protest recommends outside attorney expenses be borne by shareholders and not ratepayers.

ORA agrees with Mark West et al that Cal Am has been unable to demonstrate that the legal expenses and services of outside counsel were necessary or used in the most efficient and cost-effective manner. According to invoices, Cal Am's outside counsel performs work related to normal regulatory activities. Cal Am did not provide justification or documentation showing these activities are outside of the scope of what should be completed by the utility's own regulatory counsel, where dollars are budgeted to perform these functions. Costs of this nature are budgeted by the Commission as part of the authorized payroll expenses. As such, approval of a budget in excess of a million dollars as requested by Cal Am would amount to double recovery and should not be approved.

Based on this evaluation, ORA recommends a legal budget based on lower allowable billable hours and a lower hourly rate than Cal Am's request. ORA bases its forecast of outside legal expenses on the 285 hours incurred in the last GRC unrelated to Rule 1.1 at the $350 hourly rate previously authorized by the Commission, and adjusts for inflation to Test Year 2018 to arrive at $110,000. See below for calculation:

[67] A.16-07-002 Protest of Mark West Area Community Services Committee and the California Water Rights Association, pp. 9-11.

Figure 3-1: Outside Legal Expense

	2015	2016	2017		2018
Base Year Hourly Rate	$ 350				
Inflation Factors[68]		2.60%	3.50%		3.90%
Inflation Adjusted Hourly Rate		$ 359	$ 372		$ 386
ORA proposed billable hours				x	285
Test Year Proposed Legal Expense					**$110,057**
$386 (Inflation-adjusted hourly billing rate) x **285** (billable hours) = **$110,057**					

4. Witness Training

Cal Am requests a budget for witness training of $52,165.[69] This amount is developed based on two full weeks of training at an attorney hourly rate of $652.07 ($652.07/hour x 40 hours x 2 weeks = $52,165).

Cal Am's GRC application includes prepared testimony from twelve witnesses. Of those twelve witnesses, nine state in the introduction to their testimony that they have experience testifying in front of the Commission.[70] The remaining three witnesses do not state whether or not they have testified in front of a regulatory body, but one is a long-tenured employee and the other two consultants describe their extensive professional background.[71] This suggests Cal Am's requested budget is needlessly inflated. Additionally, ORA's review of outside attorney's expenses detailed above revealed witness training expenses included in the 2013 GRC-related legal invoices. Witness training costs are therefore already included in the legal expenses estimate, and to add it as a separate line item, as Cal Am does, amounts to double recovery. The Commission should remove the $52,165 witness training costs from the regulatory expense forecast.

[68] May 2016 ECOS Compensation Per Hour Memo.

[69] Cal Am workpaper ALL_CH04_O&M_WP_Reg Exp, tab 122-Witness Training.

[70] Sherrene Chew, Jeffrey Dana, Edward Grubb, Jeffrey Linam, Stephanie Locke, Todd Pray, Eric Sabolsice, Mark Schubert, Richard Svindland.

[71] Stuart Alden, Robert Mustich, and Patrick Pilz.

5. Cost of Capital Proceeding

Rate Case Plan D.07-05-062 outlined a schedule for cost of capital applications on a triennial basis beginning in 2008. The four largest Class A utilities (Joint Parties) were at that time next scheduled to file in 2014 for proposed costs of capital for the three-year period beginning January 1, 2015. In 2014 the Joint Parties applied for and the Commission granted a year-long extension. In 2015 and 2016 the Commission granted the Joint Parties' additional one-year requests to postpone the filing. On December 2, 2016 the Joint Parties sent a letter to the Commission's Executive Director requesting a delay of the 2017 cost of capital filings one additional year until March 31, 2018. The letter provides two primary rationales in support of the delay:[72]

1. The resources of the Commission and utilities are strained dealing with numerous other proceedings, including multiple Order Instituting Rulemakings (OIRs), as well as drought response.
2. The economic environment has not changed significantly to necessitate the cost of capital adjustment.

The Joint Parties state the conditions cited in this letter are likely to continue "for the foreseeable future." There is little reason to expect the utilities will not continue to request deferrals on the same basis. If the latest request for extension is granted, the next cost of capital proceeding will not take place during the current rate case cycle. Additionally, Cal Am is currently collecting in rates the $188,811 authorized for this expense as part of the last GRC.[73] Given the delays, there are no recently recorded costs for this expense that can be reviewed for reasonableness. Cal Am should not be permitted to collect more in rates than it is spending. Due to the continued delays and uncertainty of whether the cost of capital filing will actually take place during the next GRC, ORA excludes the cost from the forecast. The necessity of this expense should be re-evaluated in the next GRC.

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[72] Letter from California-American Water Company, California Water Service Company, Golden State Water Company, San Jose Water Company to Executive Director Tim Sullivan, dated December 2, 2016.

[73] Cal Am workpaper "ALL_CH04_O&M_WP_Reg Exp" tab "Summary."

6. Compensation Study

Cal Am requests $200,000 for a compensation study. ORA reviewed the retention agreement and invoices for the previous study provided by Cal Am's compensation consultant Towers Watson. Unlike the invoices from outside legal counsel, the consultant invoices provided show vague descriptions of the work with no detail regarding the breakdown of days and hours worked, or hourly rates.[74] For example, invoice 152340180387 is a bill for $23,176.20 with the description "Fees for Services Rendered in May 2014 related to CAW Rate Case Support." Insufficient information inhibits ORA's ability to meaningfully evaluate whether this is an appropriate use of ratepayer funds.

ORA further questioned Cal Am concerning the need for and frequency of this expense and received the following response, in part:

"California American Water was initially directed to submit a total compensation study as part of its 2012 general rate case. In addition, I am aware that ORA criticized Golden State Water Company in its previous general rate case that it did not provide a compensation study as part of its application. I also believe that ORA similarly criticized California Water Service Company."[75]

Although Cal Am failed to provide any citations, ORA reviewed filings from the referenced cases. ORA could not find a Commission decision directing Cal Am to complete a $200,000 compensation study every three years. Cal Am either misinterprets or misrepresents ORA's testimony in the Golden State Water Company (GSWC) and California Water Service Company proceedings. In the previous GSWC GRC, ORA testimony noted that GSWC relies on a study from 1990 as part of its compensation determination.[76] In its opening brief, ORA recommended GSWC be ordered to work jointly with ORA to develop a methodology for selecting an appropriate peer group and forecasting method for executive compensation.[77] ORA's recommendation for a joint effort to develop a peer group stemmed from specific concerns about inappropriate peer group selection by consultants. These recommendations do

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[74] Cal Am DR Response JE6_003 Q021B Attachment 1_Redacted.

[75] Cal Am Response to ORA DR JE6-006 Q.3.b.

[76] A.14-07-006 ORA's Report on Labor and Pension & Benefits, p. 16.

[77] A.14-07-006 ORA's Opening Brief, p. 158.

not support Cal Am's request for a compensation study based on criteria developed by consultants.

Furthermore, contrary to Cal Am's "belief," ORA's testimony on labor and benefits in the previous California Water Service Company makes no criticism, and flatly no mention, of a failure to complete a compensation study.[78] This is an inappropriate comparison in view of the circumstances of this proceeding. Nothing in the Golden State or Cal Water cases resembles support for a costly, recurring compensation study for Cal Am.

Cal Am's assertion that the surveys are completed for ORA and the Commission is unsupported. Towers Watson considers the survey sources proprietary and did not provide the data to Cal Am, therefore the underlying data is not provided for ORA analysis.[79] Without the ability to evaluate the source data for accuracy, the surveys are of minimal value. Even if the surveys accurately report compensation for regulated entities, it is highly unlikely that the data distinguishes between the amount of compensation provided to employees and the amount authorized for recovery in rates. Often the Commission excludes portions of compensation, including bonuses and executive incentive pay, as described in Chapter 2 of this Report. The surveys as provided in the last two GRCs do not provide information relevant to ORA and should not be continued.

Cal Am offered no evidence the surveys were used to make changes to the Company's compensation package. The 2013 and 2016 GRC compensation studies are substantially similar in language, conclusions and recommendations. Cal Am has provided no support for once again hiring an outside consultant to validate or change Cal Am's compensation policy. Evaluation of Cal Am's compensation package does not necessitate a $200,000 study every three years and ORA removes this request from the forecast.

D. CONCLUSION

For the reasons outlined above, ORA recommends a total amount for regulatory expense of $1,274,323, amounting to $424,774 in Test Year 2018. ORA arrived at this estimate by removing Cal Am's increased outside consultant expense because it is unwarranted and Cal Am

[78] A.15-07-015 ORA's Report on Payroll and Benefits.

[79] Testimony of Robert Mustich, at p. Appendix G-2.

has the internal resources to meet these obligations. ORA also reduces Cal Am's estimated legal fees to reflect the actual amount of substantiated labor incurred in the previous GRC at a Commission approved hourly rate. ORA further removes the cost of capital proceeding expense to reflect that no costs were incurred in the previous rate case, and any costs that may be incurred in future cost of capital proceedings have already been funded by ratepayers. Adopting these adjustments result in $2.43 per service connection for rate case expenses for TY 2018.[80] While still higher than the average rate case expense of $1.57/per service connection for the three largest Class A Water Utilities shown in Table 4-1, these adjustments to Cal Am's proposed expense budget should provide the necessary incentives to bring Cal Am closer in line to its peer utilities, on a cost-per-service connection basis.

[80] $424,774 proposed TY 2018 expense / 174,451 service connections = $2.43 per connection.

Attachment 1: Witness Qualifications

QUALIFICATIONS AND PREPARED TESTIMONY OF JULIA ENDE

Q.1 Please state your name and business address.

A.1 My name is Julia Ende and my business address is 505 Van Ness Avenue, San Francisco, California 94102.

Q.2 By whom are you employed and in what capacity?

A.2 I am a Public Utilities Regulatory Analyst in the Water Branch of the Office of Ratepayer Advocates.

Q.3 Briefly describe your pertinent educational background.

A.3 I received a Bachelor of Science Degree in Policy & Management from Carnegie Mellon University.

Q.4 Briefly describe your professional experience.

A.4 In October 2013 I joined the Water Branch of the Commission's Office of Ratepayer Advocates as a Public Utilities Regulatory Analyst. My work has focused on General Rate Case proceedings and I previously testified before the Commission on conservation and WRAM/MCBA issues. Prior to joining ORA, I worked at a law firm, taking part in negotiations between public agencies/non-profits and labor unions. My work also involved analyzing budget and class and comparability data and drafting proposals and full-text Memoranda of Understanding.

Q.5 What is your responsibility in this proceeding?

A.5 I am responsible for testimony on payroll and benefits, A&G Other expenses, regulatory expenses, and special request #2.

Q.6 Does that conclude your direct testimony?

A.6 Yes, at this time.

Attachment 2: Cal Am 2013 GRC Legal Invoices Analysis

Invoice #	Bill Date	Service Date Thru	Service Charges	Hours	Expense Charges	TOTAL (Service + Expense Charges)
219782	9/24/2012	8/31/2012			$ 309	$ 309
222449	10/16/2012	9/31/2012			$ 23	$ 23
225977	11/12/2012	10/31/2012	$ 1,559	23		$ 1,559
227506	12/4/2012	11/30/2012	$ 852	1		$ 852
241035	4/17/2013	3/31/2013	$ 520	1		$ 520
244129	5/20/2013	4/30/2013	$ 3,766	20	$ 83	$ 3,849
247711	6/25/2013	5/31/2013	$ 1,505	8	$ 178	$ 1,683
250016	7/17/2013	6/30/2013	$ 1,855	10	$ 1,336	$ 3,191
253616	8/23/2013	7/31/2013	$ 788	2		$ 788
256682	9/24/2013	8/31/2013	$ 205	1		$ 205
258162	10/9/2013	9/30/2013	$ 298	1	$ 5	$ 302
262976	11/15/2013	10/31/2013	$ 1,096	2	$ 18	$ 1,114
264024	12/11/2013	11/30/2013	$ 33,384	68	$ 206	$ 33,591
268921	1/24/2014	12/31/2013	$ 17,076	33	$ 4,810	$ 21,886
271835	2/24/2024	1/31/2014	$ 15,295	29	$ 274	$ 15,569
274859	3/24/2014	2/28/2014	$ 9,737	20	$ 406	$ 10,143
277315	4/15/2014	3/31/2014	$ 51,442	106	$ 110	$ 51,552
280998	5/23/2014	4/30/2014	$ 737	1	$ 1,623	$ 2,360
283929	6/19/2014	5/31/2014	$ 10,722	20	$ 371	$ 11,093
286975	7/23/2014	6/30/2014	$ 50,281	106	$ 3,929	$ 54,210
289632	8/19/2014	7/31/2014	$ 15,159	29	$ 1,840	$ 17,000
292768	9/19/2014	8/31/2014	$ 9,739	21	$ 474	$ 10,213
294809	10/10/2014	9/30/2014	$ 2,290	4	$ 1,661	$ 3,951
299566	11/17/2014	10/31/2014	$ 10,231	23		$ 10,231
302429	12/10/2014	11/30/2014	$ 1,618	3	$ 248	$ 1,866
305429	1/23/2015	12/23/2014	$ 58	0		$ 58
308843	2/27/2015	1/31/2015	$ 259	1		$ 259
314485	4/30/2015	3/31/2015	$ 45,986	91	$ 37	$ 46,023
317247	5/21/2015	4/30/2015	$ 15,184	26	$ 2,462	$ 17,646
320262	6/18/2015	5/31/2015	$ 15,968	36	$ 234	$ 16,202
323574	7/23/2015	6/30/2015			$ 873	$ 873
326975	8/25/2015	7/31/2015			$ 114	$ 114
336220	11/10/2015	10/31/2015	$ 1,994	8		$ 1,994
447520	12/21/2015	11/30/2015	$ 1,740	3		$ 1,740
344620	2/4/2016	1/31/2016	$ 1,301	2		$ 1,301
449547	2/18/2016	12/31/2015			$ 10	$ 10
TOTAL FROM 2013 GRC						$ 344,277

Legal invoice summary from data provided in Cal Am's Response to ORA JE6-007, Q.1.a.
Highlighting indicates months where legal services related to Rule 1.1 violation issued in A.13-07-002.