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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MEMORANDUM

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

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

ORA’s Legal Counsels for this case are Selina Shek and Tovah Trimming.
A. INTRODUCTION

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

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

Parent Company Background

In 1975 Southwest, then a regulated utility, requested the Commission’s authority to purchase Suburban, also a regulated utility, in its Application, (“A.”) 55655. In the Application, Southwest sought the Commission’s permission to purchase Suburban and consolidate its regulated operations in California. The Commission approved the transaction in Decision, (“D.”) 84466; however, the Commission did not authorize Southwest to be a holding or a parent company. Since then, Southwest has transformed itself into a parent company and Suburban has become a subsidiary regulated by the Commission. Therefore, unlike most other Class-A water utilities that have received Commission approval to establish a parent or holding company organizational structure, Suburban never operated under any formal Affiliate Transaction Rules (“ATRs”).
It was not until 2007, upon the request of Office of Ratepayer Advocates ("ORA") (then the Division of Ratepayer Advocates, or DRA), that the Commission ordered Suburban to formally file an application to establish a holding company structure (A.09-07-015). This application was subsequently dismissed without prejudice in D.10-05-001 due to the fact that the Commission opened an industry-wide rulemaking proceeding to establish generic ATRs for water and sewer utilities that have a parent or a holding company structure, Rulemaking ("R.") 09-04-012. On October 14, 2010, the Commission issued D.10-10-019 in R.09-04-012, which established industry-wide ATRs on Class-A water utilities including Suburban.

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

Currently, the various subsidiaries of Southwest are grouped under two major business segments: Southeast Utilities and Texas Utilities. These two business segments have numerous water systems in the states of Alabama and Texas that they own, operate, and manage.² Southeast Utilities has nine service contracts with various local cities and municipalities to operate and manage their respective water and wastewater systems. It is 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).
Southwest’s cost allocations. The history of these contentions is briefly discussed in the Southwest’s Cost Allocations section below.

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

B. SUMMARY OF RECOMMENDATIONS

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

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

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

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Ratepayers should not be required to fund these positions because Suburban has not provided adequate support to justify their need.

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

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

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C. DISCUSSION

1. Parent Company’s Expenses

   a. Executive Compensation

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

   Table-2: Southwest Executive Pay as of 2015

   **Table-2: Southwest Executive Pay as of 2015**

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

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2. Suburban’s Responses to AMX-006 and AMX-008.
There are several shortcomings in Southwest’s compensation philosophy.

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

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

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\[^8\] Jocelyn Padilla’s Prepared Testimony, p. 3, lines 14-20.

\[^9\] A.10-04-009; D.10-09-012.

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

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

\section*{ii. Southwest’s Executives are Not Managing a Publicly Traded Company}

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

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

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

\text{13} Golden State Water Company (A.14-07-006) and San Gabriel Valley Water Company (A.16-01-002).}
company to certify their company’s annual/quarterly report for accuracy, which exposes them to the risk of civil and criminal enforcement action.\textsuperscript{14} No such regulatory requirements exist for the officers of private companies. Therefore, it is unreasonable to compare salaries between the two classifications of companies as compensation reflects different levels of responsibility and risk.

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

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

\texttt{The Southwest Water Company’s policy and philosophy regarding compensation is to:}

\texttt{... Promote a pay for performance compensation philosophy that will attract and retain talented and experienced individuals to achieve the company’s strategic performance goals.}\textsuperscript{15}

However, it fails to explain what the company’s strategic performance goals are. During discovery, Suburban admitted that the \texttt{only} strategic performance goal of Southwest is Earning Before Interest, Taxes, Depreciation, and Amortization ("EBITDA").\textsuperscript{16}

The popular financial site Investopedia defines EBITDA as follows:

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

\textsuperscript{14} SEC Release No. 34-46079.

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

\textsuperscript{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.
debt capital and its tax effects by adding back interest and taxes to earnings.

…

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

EBITDA first came into common use with leveraged buyouts in the 1980s, when it was used to indicate the ability of a company to service debt.\(^\text{17}\)

Investopedia explains the drawbacks of EBITDA as follows:

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

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


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

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

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

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

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

Suburban’s response to ORA’s Data Request AMX-003, 1(e).
strategic performance goal for Southwest’s executives is increasing EBITDA, which is purely a profitability goal that inherently competes with the general performance goals desirable for ratepayers such as safety, reliability, quality, and affordability.

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

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

Not only are these executives paid above the 50th percentile, they also receive performance rewards in addition to their total compensation. For example, based on Suburban’s response to ORA Data Request, AMX-003, question 3(c), Importantly, Suburban was unable to support the basis for the compensation level of above the 50th percentile and did not provide the details of the “exceptional performance” categorization to demonstrate the merit of the executives’ reward pay. For example, Suburban’s response to ORA Data Request AMX-003,

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21 Pfizer Inc.: $48,851/$146.80 = 332.77 times. The Coca Cola Company: $44,294/$146.80 = 301.73 times.
question 5(a) claimed that the practice of paying above the 50th percentile is “widely accepted market methodology is rooted in the practice of using the market median as a proxy for the targeted market rate.” However, Suburban failed to provide any documentary support for this claim.

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

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

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

Suburban claims that Southwest’s executives are Suburban Response to ORA Data Request AMX-003, 3(c) and 5(a).

See Attachment B.
In addition, Suburban claims that various executives were paid performance incentives in 2015. 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. 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.

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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).
Table-3 shows numerous discrepancies between what Suburban reported to ORA during discovery and what Suburban’s workpapers state. As demonstrated by these inconsistencies, Suburban’s workpapers and testimony are unreliable.

In addition to the identified discrepancies, there are several issues with Southwest’s executive compensation. First, it seems illogical that although executives were paid above the 50th percentile their short-term incentives were reduced.

Second, Suburban asserts that the CEO was paid below the 50th percentile.
but a closer look at the Mercer Survey reveals that Suburban compared the CEO’s compensation with the mean of the 50th percentile while it used the median of 50th percentile for all other executives. Use of the mean to calculate the CEO’s compensation resulted in a value of ***BEGIN CONFIDENTIAL***

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Suburban fails to explain why it took a different approach for the CEO’s compensation than it did for the other executives’ compensation.

vi. Suburban’s Ratepayers are Already Paying a Sizeable Expense for Executive Oversight that Generates Direct Ratepayer Benefits

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

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

As evident from the Table-4 above, Suburban’s captive ratepayers are already paying high costs for the executives who are directly involved in the day-to-day operations of Suburban and who apparently have balanced performance goals that benefit both the shareholders and the ratepayers. Suburban’s ratepayers should not be burdened by an additional cost of approximately $1 million\(^{30}\) 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.
executives whose sole performance goal is to increase profits for shareholders and who
are also paid based on an incommensurable market average.

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

1) The Commission exclude Southwest’s executive compensation from the allocation to
Suburban’s ratepayers because Southwest’s executives have exorbitant compensation
and do not add value to Suburban’s ratepayers who already fund approximately $1.7
million cost for Suburban’s top executives.

2) If the Commission authorizes Suburban to allocate Southwest’s executive
compensation, it should calculate the allocation based on the 25th percentile level of
the Mercer Survey, and not the 50th percentile which is grossly skewed due to the
presence of large international companies. The 25th percentile is not skewed because
it would more likely exclude the executive compensation for the relatively large
global companies. Table-5 below shows executive compensation at the 25th percentile
level as of 2014. These compensation values should then be escalated to 2018 values
by using Commission’s traditional CPI-labor escalation factors.

3) The Commission should order Suburban to align Southwest’s executive compensation
with the interest of ratepayers so that a balance is created between serving the
shareholders and the captive ratepayers.

4) The Commission should order Suburban to formulate a more realistic and comparable
group of utility companies based on gross revenue for the purpose of benchmarking
Southwest’s executive compensation under ORA’s supervision.
Table-5: Southwest’s Executive Compensation for Ratemaking Purposes Based on 25% Percentile of the Mercer Survey

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2. Parent Company’s Information Technology Capital Projects

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

Table-6: Southwest’s IT Projects - 2018 through 2019\(^\text{31}\)

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

\(^{31}\) Based on the data presented by Suburban (Workpapers, File: GRC 2017-A.17-01-xxx, Tab: Parent Co. RB).
The cost data in Table-6 above shows the breakdown of costs for hardware, software, external labor, and internal labor. The internal labor cost consists of regular labor expenses that are capitalized and subsequently removed from Southwest’s operating and administration expenses. However, what Table-6 does not show, and what is important for assessing this request, is Southwest’s previous IT projects which have not been successful at providing benefits to ratepayers or even the Company.

a. Southwest’s Prior IT projects

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

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

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

... Evaluated the company’s existing information systems, including billing, general ledger, accounts payable, purchasing, budgeting, job costing, payroll and HR management;

... Interviewed key staff members to collect data, conduct a needs assessment, and identify strengths and weaknesses;

... Prepared a comparative analysis of current system capabilities with industry best practices;

... Prepared a Business Systems Assessment Report that

- summarized all of the above,
- documented the advantages and risks associated with replacing or maintaining the company’s current systems,
- identified alternatives along with budget-level cost estimates,
- determined the level of IT support needed for each alternative, and
- recommended a preferred alternative.35

Spending $22.13 million on an IT project that only produced a list of IT 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).
providing for the benefit of Suburban and Suburban’s ratepayers. Suburban’s ratepayers should not have to pay for Southwest’s potential poor oversight of another expensive IT project that could end up useless given Southwest’s recent management failure. No IT project should be authorized without a robust need analysis and effective project management guarantees.

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

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

He further states that Southwest has been using an older version of SAP:

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***END CONFIDENTIAL***

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

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

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

Because Mr. Farney acknowledges that the new system will require “fixes” and that “fixes” are the root of the need for the requested upgrade, it appears that in a few years Southwest will be back to square one and will be demanding yet another upgrade based on argument that ***BEGIN CONFIDENTIAL*** 40

***END CONFIDENTIAL*** 40

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

***END CONFIDENTIAL*** 41

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38 Suburban Response to ORA Data Request AMX-001, 1 (e).
39 Suburban Response to ORA Data Request AMX-001, 1 (e).
41 Ibid.
Further diminishing confidence in the potential success of Southwest’s requested IT project and Southwest’s management of such a project, is the fact that in 2011 Southwest decided to run ***BEGIN CONFIDENTIAL***.

Southwest claims that the ***BEGIN CONFIDENTIAL*** provides a number of benefits to the organization and our customers. In terms of cost avoidance, this technology upgrade will add to our hardened and state of the art data center (with backup and redundancy) provide extremely high reliability in terms of system availability.

It is unclear why these advantages were not fully evaluated in 2011 when Southwest was just emerging from its $22.13 million failed IT project. One can only hope that Southwest has learned some lessons from its failed $22.13 million IT project.

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

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***END CONFIDENTIAL***

These

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Suburban Response to ORA’s Data Request AMX-001, 1(f).
facts help establish that Southwest is not in the best position to spearhead its current IT project. Suburban’s ratepayers deserve reliable management and the Commission should not allow any funds in rates for IT projects without adequate checks and balances in place.

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

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

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

The Southwest IT function has realized the following accomplishments and achievements in the last three years:

The new telecommunications wide area network (WAN) that utilizes a modern Multiprotocol Label Switching (MPLS) provides a high performance network that optimizes data traffic and avoids latency and slow response time. The average network availability for the La Mirada customer call center increased from approximately 98.68% in early 2014 to an average of 99.83% (each 1% =1.6 hours of downtime) for the year 2015 which mean increased availability of agents and system that provides customer service. In addition, IT configured network redundancy for each of

43 See generally Jeff Farney Prepared Testimony.
the three Suburban locations so that in the event of a network outage
due to fiber cut, etc. the redundant connection will automatically
kick in and sustain operations until the primary is restored.

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

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

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

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

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

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

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

... installed an SAP utility named Governance Risk and
Compliance which provides automation to track, manage, and
mitigate segregation of duties to control risk of fraud and
accounting errors and eliminate numerous manual processes
in Procurement, IT and Finance.
... implemented banking automation enhancements in the
treasury department for Automated Clearing House (ACH)
and Credit Card transactions that include automated clearing
reconciliation and electronic bank statement processing.  

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

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

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

In addition to the clear contradictions between the testimony of Walter Bench and
Jeff Farney, ***BEGIN CONFIDENTIAL***

Contrary to Mr. Farney’s assertions, Mr. Bench’s Prepared Testimony (as
reproduced and highlighted above) claims that these modules, namely ***BEGIN
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44 Walter Bench Prepared Testimony, pp. 30-33 (original emphasis omitted and emphasis added).
46 Jeff Farney Prepared Testimony, p. 11, lines 2-8.
were already implemented three years ago. This apparent inconsistency gives rise to the concerns that Southwest and Suburban maybe attempting to recover the past IT costs (other than Project Cornerstone-Oracle) in future rates from the ratepayers. The current request should only be recovered in rates based on prospective Test Year estimates. Mr. Bench is clearly claiming that these various IT modules were not only functional as of 2015, they are deemed stable, reliable, and sufficient to provide a platform for Southwest’s future growth.

Suburban provides no convincing support that its current IT costs are different than those spent in the various modules that were working fine, at least in 2015.

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

Mr. Bench corroborated Mr. Farney’s testimony by testifying that these modules were up and running in 2015. Thus, there is a valid concern whether the entire cost of $5.4 million or portion of which was already spent between the period of 2011 and 2015.

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

ORA also raised concerns during the discovery phase regarding the recovery of the $22.13 million past cost. Per the assigned Administrative Law Judge’s (“ALJ’s”) direction, Suburban submitted an official declaration on April 3, 2017 claiming that its
current $5.4 million IT request has nothing to do with the $22.13 million costs spent up until 2009 for its previous IT project.47

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

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

Suburban is directed here to track Project Cornerstone costs in a memorandum account. However, we find that the matter is premature, and will not authorize Suburban to utilize the Advice Letter process at this time to recover those costs. Instead, Suburban and DRA are directed to meet and confer informally on this issue prior to the filing of any request to recover these costs. The parties may meet/confer themselves, or request a mediation conference through the Commission’s ADR program. If the parties agree, Suburban may file a request to recover these costs through an Advice Letter. If no agreement is reached, Suburban shall file a formal application for that purpose.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).
Suburban claims that it did not establish the memorandum account ordered by D.09-03-007 because Southwest and Suburban have not requested recovery of any of the costs associated with Project Cornerstone. However, the fact remains that neither ORA nor the Commission have performed an independent evaluation to ascertain whether Suburban’s current claims are factual. Suburban’s failure to establish the memorandum account and its inability to show any tangible IT assets against the $22.13 million investment raises great concerns about whether Suburban ratepayers inappropriately shouldered some of these costs. ORA cannot verify Suburban’s claims.

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

Based on foregoing discussion and facts it is recommended that:

1) The Commission should deny Suburban’s current request to include Southwest’s IT capital projects in Suburban’s ratebase.

2) The Commission should order an immediate third-party IT audit for Suburban’s parent, Southwest, to ensure that Suburban ratepayers are not subsidizing unnecessary and past costs. ORA should be authorized to supervise the third-party IT auditor to ensure that ratepayers’ interests are protected and overall quality is maintained.

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

3. Southwest’s Cost Allocations

a. Background

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

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

**Indirect Allocations**

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

1. Direct operating expenses, excluding uncollectibles, general expenses, depreciation and taxes.  
2. Gross Plant.  
3. Number of employees (using direct operating payroll, excluding general office payroll, as the best measure of this component).
4. Number of customers (subscribers of telephone). Historically, Suburban has misused the Commission’s Four-Factor Allocation Method described above to calculate allocation rates by shifting unreasonably high parent company costs toward its ratepayers. For example, starting in 2002, Suburban unreasonably applied the Number of Customers factor to divert its parent company’s costs toward Suburban by simply undercounting the number of customers its other affiliates served under private contracts. The undercounting of Number of Customers served by other affiliates effectively would have shifted allocation weight toward Suburban where the Number of Customers is relatively higher. However, the Commission disallowed Suburban’s application of the Number of Customers factor and ordered Suburban to use only three factors instead by dropping the Number of Customer factor. This subsequently did not allow the parent company’s cost allocations toward Suburban to increase unreasonably.

Thus, Suburban’s witness Walter Bench’s Prepared Testimony is factually incorrect when he claims that prior to 2013, the Commission ordered Suburban to use the four-factor method to allocate indirect costs which was consistent with the procedures set forth in the Commission’s memo “Allocation of Administrative and General Expenses and Common Utility Plant,” dated July 26, 1956.

Similarly, in its GRC application, A.11-02-002, decided in D.12-04-009, the Commission ordered Suburban to use only two factors since the Commission did not find 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.
Thus, the statement in Walter Bench’s Prepared Testimony claiming that the two-factor methodology resulted from a settlement per D.12-04-009 is incorrect because the proceeding was litigated and decided by the Commission. Suburban also applied for a rehearing on the matter, but the Commission denied Suburban’s request.

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

- If Southwest is unable to divest itself of the remaining service contracts by next general rate case, it will in its next application provide end-user figures and the plant values of those systems under each contract.
- To calculate the Utility Group allocation factor using the same three-factor allocation agreed upon for parent company cost, including the traditional calculation of gross plant, and to keep the eleven contracts in the calculations.

b. Current Three-Factor Allocations

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

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Walter Bench’s Prepared Testimony, p. 38, lines 24-27.
D.13-12-030, pp. 5-8.
D.14-12-038, Settlement Document, pp. 31-32.
Suburban failed to provide the needed gross plant and end-users (Number of Customers) information under these service contracts and also excluded the remaining 9 service contracts for the purpose of assessing Utility Group’s allocations. This information, some of which Suburban agreed to provide in the last GRC settlement, would have enabled the Commission to apply its intended Four-Factor Allocation Method. Instead, Suburban applies cost allocations in this GRC to unreasonably shift cost to its captive ratepayers. Suburban flagrantly disregards the Commission’s directive to provide the end-user figures and the plant values for its service contracts and deviates from the reasonable approach to include the remaining service contracts for the calculation of Utility Group’s allocations—an approach both ORA and Suburban agreed to in settlement per D.14-12-038 in the last GRC (A.14-02-004). Notably, that approach was also in-line with the Commission’ earlier directives on the same issues per D.12-04-009 where the Commission warned Suburban that “it must be reasonable in its calculations and consistent in its data in the next general rate case.”

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

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

\[59\] D.12-04-009, p. 18 (emphasis added).
from Suburban’s workpapers indicating that gross plant values were missing for the 9 contracts.

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Direct Operating Expense Recorded 2015</th>
<th>Payroll Recorded 2015</th>
<th>End of Year Gross Plant Recorded 2015</th>
<th>PROPOSED ALLOCATION % Total</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount, $</td>
<td>Percent</td>
<td>Amount, $</td>
<td>Percent</td>
<td>Amount, $</td>
</tr>
<tr>
<td>Suburban Water Systems</td>
<td>35,636,123</td>
<td>49.7%</td>
<td>8,257,287</td>
<td>43.8%</td>
<td>252,399,351</td>
</tr>
<tr>
<td>Texas Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monarch Utilities</td>
<td>14,026,966</td>
<td>19.5%</td>
<td>4,543,571</td>
<td>24.1%</td>
<td>129,782,085</td>
</tr>
<tr>
<td>Windermere</td>
<td>4,820,825</td>
<td>6.7%</td>
<td>1,419,718</td>
<td>7.5%</td>
<td>52,489,631</td>
</tr>
<tr>
<td>Hornsby Bend Ops</td>
<td>2,606,754</td>
<td>3.6%</td>
<td>484,853</td>
<td>2.6%</td>
<td>30,978,549</td>
</tr>
<tr>
<td>Diamond</td>
<td>672,321</td>
<td>0.9%</td>
<td>182,027</td>
<td>1.0%</td>
<td>6,809,529</td>
</tr>
<tr>
<td>Water Services Inc.</td>
<td>1,307,477</td>
<td>1.8%</td>
<td>416,778</td>
<td>2.2%</td>
<td>8,941,256</td>
</tr>
<tr>
<td>Huntington</td>
<td>61,605</td>
<td>0.1%</td>
<td>18,386</td>
<td>0.1%</td>
<td>715,383</td>
</tr>
<tr>
<td>Inverness</td>
<td>133,712</td>
<td>0.2%</td>
<td>24,562</td>
<td>0.1%</td>
<td>1,811,669</td>
</tr>
<tr>
<td>Mid-Tex</td>
<td>197,768</td>
<td>0.3%</td>
<td>22,758</td>
<td>0.1%</td>
<td>3,246,081</td>
</tr>
<tr>
<td>SW Utilities</td>
<td>28,573</td>
<td>0.0%</td>
<td>9,780</td>
<td>0.1%</td>
<td>111,359</td>
</tr>
<tr>
<td>Tenkiller</td>
<td>331,692</td>
<td>0.5%</td>
<td>170,104</td>
<td>0.9%</td>
<td>1,065,965</td>
</tr>
<tr>
<td>Metro H2O</td>
<td>1,562,726</td>
<td>2.2%</td>
<td>129,332</td>
<td>0.7%</td>
<td>1,101,838</td>
</tr>
<tr>
<td>Total for Texas Utilities</td>
<td>35.8%</td>
<td>39.4%</td>
<td>42.9%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southeast Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Riverview Wastewater</td>
<td>2,599,589</td>
<td>3.6%</td>
<td>580,375</td>
<td>3.1%</td>
<td>35,473,842</td>
</tr>
<tr>
<td>North Shelby &amp; Other</td>
<td>2,685,407</td>
<td>3.7%</td>
<td>414,198</td>
<td>2.2%</td>
<td>24,103,576</td>
</tr>
<tr>
<td>North County Water</td>
<td>137,723</td>
<td>0.2%</td>
<td>62,993</td>
<td>0.3%</td>
<td>1,355,780</td>
</tr>
<tr>
<td>Contracts</td>
<td>4,961,115</td>
<td>6.9%</td>
<td>2,114,871</td>
<td>11.2%</td>
<td>0</td>
</tr>
<tr>
<td>Total for Southeast Utilities</td>
<td>14.4%</td>
<td>16.8%</td>
<td>11.0%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notice that under the factor “End of Year Gross Plant-Recorded 2015” value used of the gross plant is “0” for the contracts (See shaded row in Table-7 above). Therefore, based on this erroneous assumption and elimination of gross plant for the service contracts, this results in a 45.9% cost allocation of Suburban’s parent company toward Suburban under the gross plant factor. Later, Suburban applies the 45.9% allocation rate under the gross plant factor to calculate the weighted overall allocation of 46.5% for Suburban for all three factors. Similarly, the cost allocations for the other two subsidiaries under gross plant factor are 42.90% and 11.00% (See shaded cells in Table-7 above) for Texas Utilities and Southeast Utilities, respectively.
Therefore, the absence of the gross plant values under the 9 service contracts skews the gross plant factor rates toward other subsidiaries including Suburban. To remedy this deficiency, ORA created a reasonable proxy for the gross plant values for the 9 service contracts. Please note that it is Suburban’s burden to adequately support its rate increase request, but here ORA is forced to remedy this deficiency or else harm Suburban’s ratepayers.

The proxy is based on the relationship between the Payroll factors to the Gross Plant factors for the other companies Southeast Utilities managed and operated. For example, Table-7 above shows that Suburban’s affiliate, Southeast Utilities operates and manages three other entities, namely: Riverview Wastewater, North Shelby and Others, and North County Water. The Gross Plant values of these three entities can be expressed as a payroll multiplier calculated by dividing their respective gross plant values by their respective payroll values. Table-8 below shows values of Payroll Multiplier of 61 times, 58 times and 22 times for Riverview Wastewater, North Shelby and Others, and North County Water, respectively, with an average Payroll Multiplier of 47 times.

Table-8: Southeast: Gross Plant as a Multiplier of Payroll

<table>
<thead>
<tr>
<th>Payroll Multiplier</th>
<th>Payroll Ending Gross Plant</th>
<th>End of Year Gross Plant</th>
<th>Payroll Multiplier</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Recorded 2015</td>
<td>Recorded 2015</td>
<td>Amount, $</td>
</tr>
<tr>
<td><strong>Southeast Utilities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Riverview Wastewater</td>
<td>$580,375</td>
<td>$35,473,842</td>
<td></td>
</tr>
<tr>
<td>North Shelby &amp; Other</td>
<td>$414,198</td>
<td>$24,103,576</td>
<td></td>
</tr>
<tr>
<td>North County Water</td>
<td>$62,993</td>
<td>$1,355,780</td>
<td></td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Therefore, because Suburban reported the payroll value for the 9 service contracts as $2,114,871, the missing Gross Plant value for the 9 contracts based on this average Payroll Multiplier of 47 can be calculated as $99,398,936.

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

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Direct Operating Expense Recorded 2015 Amount, $</th>
<th>Percent</th>
<th>Payroll Recorded 2015 Amount, $</th>
<th>Percent</th>
<th>End of Year Gross Plant Recorded 2015 Amount, $</th>
<th>Percent</th>
<th>PROPOSED ALLOCATION % Total Percent</th>
<th>Average (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALLOCATION FACTORS</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Suburban Water Systems</td>
<td>35,636,123</td>
<td>49.7%</td>
<td>8,257,287</td>
<td>43.8%</td>
<td>252,399,351</td>
<td>38.8%</td>
<td>132.3%</td>
<td>44.1%</td>
</tr>
<tr>
<td>Texas Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monarch Utilities</td>
<td>14,026,966</td>
<td>19.5%</td>
<td>4,543,571</td>
<td>24.1%</td>
<td>129,782,085</td>
<td>20.0%</td>
<td>63.6%</td>
<td>21.2%</td>
</tr>
<tr>
<td>Windermere</td>
<td>4,820,825</td>
<td>6.7%</td>
<td>1,419,718</td>
<td>7.5%</td>
<td>52,489,631</td>
<td>8.1%</td>
<td>22.3%</td>
<td>7.4%</td>
</tr>
<tr>
<td>Hornsby Bend Ops</td>
<td>2,606,754</td>
<td>3.6%</td>
<td>484,853</td>
<td>2.6%</td>
<td>30,978,549</td>
<td>4.8%</td>
<td>11.0%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Diamond</td>
<td>672,321</td>
<td>0.9%</td>
<td>182,027</td>
<td>1.0%</td>
<td>6,809,529</td>
<td>1.0%</td>
<td>2.9%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Water Services Inc.</td>
<td>1,307,477</td>
<td>1.8%</td>
<td>416,778</td>
<td>2.2%</td>
<td>8,941,256</td>
<td>1.4%</td>
<td>5.4%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Huntington</td>
<td>61,605</td>
<td>0.1%</td>
<td>18,386</td>
<td>0.1%</td>
<td>715,383</td>
<td>0.1%</td>
<td>0.3%</td>
<td>0.1%</td>
</tr>
<tr>
<td>Inverness</td>
<td>133,712</td>
<td>0.2%</td>
<td>24,562</td>
<td>0.1%</td>
<td>1,811,669</td>
<td>0.3%</td>
<td>0.6%</td>
<td>0.2%</td>
</tr>
<tr>
<td>Mid-Tex</td>
<td>197,768</td>
<td>0.3%</td>
<td>22,758</td>
<td>0.1%</td>
<td>3,246,081</td>
<td>0.5%</td>
<td>0.9%</td>
<td>0.3%</td>
</tr>
<tr>
<td>SW Utilities</td>
<td>28,573</td>
<td>0.0%</td>
<td>9,780</td>
<td>0.1%</td>
<td>111,359</td>
<td>0.0%</td>
<td>0.1%</td>
<td>0.0%</td>
</tr>
<tr>
<td>Tenkiller</td>
<td>331,692</td>
<td>0.5%</td>
<td>170,104</td>
<td>0.9%</td>
<td>1,065,965</td>
<td>0.2%</td>
<td>1.6%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Metro H2O</td>
<td>1,562,726</td>
<td>2.2%</td>
<td>129,332</td>
<td>0.7%</td>
<td>1,101,838</td>
<td>0.2%</td>
<td>3.1%</td>
<td>1.0%</td>
</tr>
<tr>
<td>Total for Texas Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>71,770,374</td>
<td>100.0%</td>
<td>18,851,590</td>
<td>100.0%</td>
<td>649,784,829</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

COMPUTATION OF ALLOCATION PERCENT
For Southwest with Gross Plant for Service Contracts

47 x (Payroll for 9 contracts) = 47 x ($2,114,871) = $99,398,936.
4. Utility Group Cost Allocations

a. Background

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

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

For example, Suburban claims that certain characteristics of these service contracts distinguish them from being regulated utilities. Southeast contracts are with the contracting parties only. There is no extension of this contractual arrangement to actual customers. Customers remain the customers of the contracting parties. Similarly, 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.
contracting party facilities, ownership or otherwise. Plant and equipment remain the sole property and ultimate responsibility of the contracting parties. Southeast has contracted only to operate and maintain these facilities.  

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

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

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

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64 Walter Bench’s Prepared Testimony, pp. 42-43.
65 D.12-04-009, pp. 16-17 (emphasis added).
used are greater in value. The Commission understood this fundamental principle of cost allocation and thus clearly noted the following:

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

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

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

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

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66 Ibid, p. 17 (emphasis added).
all entities and we therefore decline to make another minor adjustment at this time. **We again warn Suburban that it must be reasonable in its calculations and consistent in its data in the next general rate case.**

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

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

<table>
<thead>
<tr>
<th>Company</th>
<th>Direct Operating Expense</th>
<th>Payroll</th>
<th>End of Year Gross Plant</th>
<th>PROPOSED ALLOCATION %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount, $</td>
<td>Percent</td>
<td>Amount, $</td>
<td>Percent</td>
</tr>
<tr>
<td>Suburban Water Systems</td>
<td>35,636,123</td>
<td>53.3%</td>
<td>8,257,287</td>
<td>49.3%</td>
</tr>
<tr>
<td>Texas Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monarch Utilities</td>
<td>14,026,966</td>
<td>21.0%</td>
<td>4,543,571</td>
<td>27.1%</td>
</tr>
<tr>
<td>Windermere</td>
<td>4,820,825</td>
<td>7.2%</td>
<td>1,419,718</td>
<td>8.5%</td>
</tr>
<tr>
<td>Hornsby Bend Ops</td>
<td>2,606,754</td>
<td>3.9%</td>
<td>484,853</td>
<td>2.9%</td>
</tr>
<tr>
<td>Diamond</td>
<td>672,321</td>
<td>1.0%</td>
<td>182,027</td>
<td>1.1%</td>
</tr>
<tr>
<td>Water Services Inc.</td>
<td>1,307,477</td>
<td>2.0%</td>
<td>416,778</td>
<td>2.5%</td>
</tr>
<tr>
<td>Huntington</td>
<td>61,605</td>
<td>0.1%</td>
<td>18,386</td>
<td>0.1%</td>
</tr>
<tr>
<td>Inverness</td>
<td>133,712</td>
<td>0.2%</td>
<td>24,562</td>
<td>0.1%</td>
</tr>
<tr>
<td>Mid-Tex</td>
<td>197,768</td>
<td>0.3%</td>
<td>22,758</td>
<td>0.1%</td>
</tr>
<tr>
<td>SW Utilities</td>
<td>28,573</td>
<td>0.0%</td>
<td>9,780</td>
<td>0.1%</td>
</tr>
<tr>
<td>Tenkiller</td>
<td>331,692</td>
<td>0.5%</td>
<td>170,104</td>
<td>1.0%</td>
</tr>
<tr>
<td>Metro H2O</td>
<td>1,562,726</td>
<td>2.3%</td>
<td>129,332</td>
<td>0.8%</td>
</tr>
<tr>
<td>Total for Texas Utilities</td>
<td>38.5%</td>
<td>44.3%</td>
<td>42.9%</td>
<td></td>
</tr>
<tr>
<td>Southeast Utilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Riverview Wastewater</td>
<td>2,599,589</td>
<td>3.9%</td>
<td>580,375</td>
<td>3.5%</td>
</tr>
<tr>
<td>North Shelby &amp; Other</td>
<td>2,685,407</td>
<td>4.0%</td>
<td>414,198</td>
<td>2.5%</td>
</tr>
<tr>
<td>North County Water</td>
<td>137,723</td>
<td>0.2%</td>
<td>62,993</td>
<td>0.4%</td>
</tr>
<tr>
<td>Total for Southeast Utilities</td>
<td>8.1%</td>
<td>6.4%</td>
<td>11.00%</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>66,809,259</td>
<td>100.0%</td>
<td>16,736,719</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

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

67 Ibid, p. 18 (emphasis added).
Utilities. This removal of the 9 service contracts effectively reduces the allocation rates for Southeast Utilities and thus shifts the Utility Group’s costs toward Suburban. For example, under the “Direct Operating Expense” factor, the allocation factor for Southeast decreases from 14.4% (as shown in Table-7) to 8.1% as shown in Table-10. Similarly, under the “Payroll” factor, the allocation rate for Southeast decreases from 16.8% (as shown in Table-7) to 6.4% as shown in Table-10.

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

Suburban’s estimate for the Utility Group’s operating expense for Test Year 2018 is $1,270,370. Therefore, cost allocations for Suburban at 49.5% are $628,833,\(^{68}\) whereas based on a 44.1% allocation rate that includes the impact of service contracts and of the gross plant (by proxy), Suburban’s cost allocations would only be $560,233\(^{69}\) – a difference of $68,600.

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

20 D.14-12-038, Attachment 1 (Settlement Document), pp. 31-32 (emphasis added).
22 Suburban’s Response to ORA’s Data Request AMX-005, Q-1(a) (emphasis added).
In addition, under the settlement per D.14-12-038, “parties agreed to calculate the Utility Group allocation factor using the same three-factor allocation agreed upon for parent company costs, including the traditional calculation of gross plant, and to keep the eleven contracts in the calculations for the Utility Group.” However, Suburban once again not only excludes the gross plant but also removes the eleven (now 9) service contracts for the calculations of the Utility Group allocations.

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

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

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

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21 D.14-12-038, Attachment 1 (Settlement Document), pp. 31-32 (emphasis added).
5. Utility Group’s Costs

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

a. Utility Group A&G Expenses Increased Dramatically

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

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

<table>
<thead>
<tr>
<th>Description</th>
<th>Recorded Year</th>
<th>Estimated Year</th>
<th>Test Year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>UTILITY GROUP EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ADMINISTRATIVE AND GENERAL EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll and Benefits</td>
<td>$317,578</td>
<td>$485,543</td>
<td>$565,306</td>
</tr>
<tr>
<td>General &amp; Administrative Expense</td>
<td>$37,571</td>
<td>$37,047</td>
<td>$51,381</td>
</tr>
<tr>
<td>Other Expenses</td>
<td>$45,672</td>
<td>$52,377</td>
<td>$50,586</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$400,821</td>
<td>$574,966</td>
<td>$667,274</td>
</tr>
<tr>
<td>Year-to-year Percentage Change</td>
<td>43.45%</td>
<td>16.05%</td>
<td>6.56%</td>
</tr>
<tr>
<td>Test Year-2018 Percentage increase over the last recorded year-2015</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Expenses increased substantially since 2015 in the payroll and benefit categories. However, Suburban did not include much detail about this massive payroll increase. In fact, Suburban only included one page of testimony to substantiate Utility Group
expenses. Additionally, descriptions for the new positions contradicted what was presented in the workpapers.

Table-12 below shows the details of Utility Group’s regular payroll during 2014-2018.

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

***BEGIN CONFIDENTIAL***

***END CONFIDENTIAL***

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

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

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

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

c. Suburban Provides Inadequate Support for its New Hires

Suburban added three positions to its Utility Group in 2016: 1) Director Regulatory Affairs; 2) Manager Regulatory Affairs; and 3) Regulatory Analyst.
Suburban’s workpapers show that the position of Regulatory Analyst ***BEGIN CONFIDENTIAL*** is new or why the Utility Group needed this position filled. Suburban did not fill this position during any of 2015, and therefore shows the Utility Group did not really need this position otherwise it would have not left vacant for the entire 2015.

Suburban also does not provide any specific justifications for the other two new hires: ***BEGIN CONFIDENTIAL*** Therefore, it is highly unreasonable to add such a substantial amount without adequate justifications for the new positions. For example, Suburban does not present any work-load studies to show that the current or future work-load is overwhelming and the new positions are justified—there is simply no such information. Thus Suburban fails to make an adequate showing pursuant to Public Utility Code, Section 454(a) for the new rates.

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

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

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

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

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

### 6. Health and Medical Insurance

Suburban carries its health and dental insurance at Southwest’s level and allocates the premiums based on employee headcounts to the various subsidiaries including Suburban. More specifically, Suburban uses the Per Employee Per Month ("PEPM") value to allocate these medical costs. Based on its own historical renewal costs and a survey based on Kaiser Family Foundation’s study, Suburban estimates a PEPM premium cost per employee of $1,369.77 and $63.29 for its medical insurance and dental
Suburban then estimates that its PEPM for medical insurance will increase by 4% annually and its dental insurance will increase annually at 1% in the future. Based on these assumptions, Suburban estimates the PEPM rate for 2018 per employee will be $1,540.80 and $65.21 for medical insurance and dental insurance, respectively.

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

7. **Employee Healthcare Balancing Account**

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

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

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

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

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

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

8. Various Property and Casualty Lines of Insurance

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

Suburban then allocates the various property and casualty insurance costs from Southwest to various subsidiaries including Suburban based on several allocation criteria. For example, workers’ compensation insurance is allocated based on the total payroll, general liability insurance is allocated based on budgeted revenues, etc. ORA does not object to Suburban’s insurance requests.
9. Suburban’s Non-Cooperative Behavior and Non-Compliance with Commission Decisions

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

Collectively, these discovery issues demonstrate Suburban’s impediment of the discovery process and “highlight a continual tension in rate cases: the limited time available to [ORA] and the disincentive for the utility to cooperate.” 79 Ratepayers are harmed when ORA cannot obtain the information necessary to conduct a thorough analysis of a utility’s application to ensure the utility is requesting reasonable rate increases. This may be especially true for parent company allocations where “incomplete and inconsistent, and therefore unreasonable” data would result in ratepayers shouldering “general costs incurred to benefit multiple entities.” 80 Although these complaints primarily involve discovery related to parent company allocations, other discovery problems arose in this proceeding. For example, Suburban’s refused to engage informally with ORA over the phone to discuss its request for new positions. Suburban 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).
because it was concerned its witnesses required counsel. Suburban insisted that it would be more productive if ORA would submit its questions entirely in writing.81

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

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

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

1) failed to fully support its application as required by the water rate case plan;

2) failed to “facilitate Informal Communications” in order to create a better understanding of the position of the parties and to avoid and resolve discovery disputes and eliminate unnecessary litigation;” and

3) failed to provide DRA access to its affiliates’ relevant books and records.

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

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

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81 Suburban’s email response on March 30, 2017 by Bob Kelly to ORA’s Victor Chan upon request for additional meeting.
We will not impose any fine at this time.  
(Emphasis Added)

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

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

In a final attempt, however, to obtain information necessary to verify Suburban’s previous deficient responses to AMX-002 and therefore justify ratepayers bearing a portion of these expenses, ORA raised the remaining issues to ALJ Houck during a Status 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).
The ALJ instructed the parties to submit a written description of discovery issues related to the Office of Ratepayer Advocate’s Data Request AMX-002, item 4(e). And later, after several emails and telephone conversations about when ORA could expect Suburban’s response, on April 7, 2017, Suburban submitted its updated response to AMX-002, 4(e)—almost two months after ORA initially issued its data request, AMX-002, 4(e) on February 3, 2017.\textsuperscript{84}

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

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

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

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

\textsuperscript{84} Attachment-I (Copy of ORA’s initial data request, AMX-002, 4(e)).
ORA already is under a very tight deadline to serve its testimony, and any delays in receiving the information it seeks from a utility makes ORA’s job all the harder.

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

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

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

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

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

85 D.12-04-009, p. 18 (emphasis added).
Informal communications between applicant and ORA are encouraged at all stages of the proceedings, including the PA review period, in order to facilitate understanding by the parties of their respective positions, to avoid or resolve discovery disputes, and to avoid unnecessary litigation.\footnote{D.04-06-018, Appendix, Rate Case Plan for Class A Water Utilities, p. 3 (emphasis added).}

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

The division (ORA) may compel the production or disclosure of any information it deems necessary to perform its duties from any entity regulated by the Commission, provided that any objections to any request for information shall be decided in writing by the assigned commissioner or by the president of the commission, if there is no assigned commissioner.\footnote{California Public Utilities Code, Section 309.5(e).}

It is amply clear that Suburban was put on notice per D.12-04-009 to “\textit{re-examine its regulatory relationship with DRA and establish a more cooperative attitude}”. Unfortunately, Suburban’s actions here have deteriorated even further by refusing to engage in informal communications with ORA pursuant to D.04-06-018 as well. Recall that Suburban unilaterally decided that its responses to one of ORA’s data requests, AMX-002 were sufficient besides repeated attempts by ORA to show the contrary and that Suburban refused to engage in informal oral communications with ORA’s staff and insisted that any subsequent follow up request regarding AMX-002 should be in writing. In addition, Suburban also refused to engage informally with ORA over the phone to discuss its request of new positions.\footnote{Suburban’s email response on March 30, 2017 by Bob Kelly to ORA’s Victor Chan upon request for additional meeting.}
Compounding Suburban’s refusal to informally resolve AMX-002 issues, Suburban also unilaterally gave itself extensions of time to respond to Data Requests without ORA approval, thus delaying ORA’s discovery efforts. Moreover, Suburban repeatedly ignored ORA’s position that ORA will not approve extensions for its data request responses without Suburban providing reasons for the need for such extensions, a reasonable approach that comports with the spirit of the Commission’s Discovery Custom and Practice Guidelines. Collectively, Suburban’s behavior frustrates the discovery process and impedes ORA from obtaining necessary information to analyze the reasonableness of Suburban’s GRC requests.

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

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

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

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

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

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

1) Suburban failed to “facilitate Informal Communications” in order to create a
better understanding of the position of the parties and to avoid and resolve
discovery disputes and eliminate unnecessary litigation” per D.04-06-018;

2) Suburban failed to “re-examine its regulatory relationship with ORA and
establish a more cooperative attitude” per D.12-04-009; and

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91 D.14-12-038, Settlement Document, pp. 31-32.
92 D.12-04-009, p. 18 (emphasis added).
3) Suburban reneged on its obligations per its Settlement under D.14-12-038 with ORA.

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

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

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

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

Suburban’s testimony does not support allocating legal fees from its parent company to its affiliates, including Suburban. ORA’s data request AMX-002, 4(e) dated 2/3/17 sought to request information on these allocations. Suburban’s witness Walter 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).
to show corporate level legal invoicing and legal invoicing attributable only to general
corporate matters.\textsuperscript{95}

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

ORA noticed that the total amount of $1,374,946.43 as shown in total row at the
end of the table does not add up to $1,374,946.43, but to $1,388,777.10 instead. On
February 3, 2017, ORA issued its Data Request AMX-002, 4(e) requesting that if these
expenses are directly charged, please provide the supporting documents to show the
direct charges for these various business segments. On February 10, 2017, Suburban
partially responded to AMX-002, 4(e), and submitted a revised version of its original
Attachment-2 (page 3 of 5), showing the total row adding to $1,388,777.10. However, as
for as supporting documents for direct charges were concerned, Suburban responded that
it would be providing the supporting documents by February 17, 2017.\textsuperscript{97}

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

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

\textsuperscript{95}饿 Walter Bench’s Prepared Testimony, p. 12, lines 19-22
\textsuperscript{96}饿 See Attachment-L.
\textsuperscript{97}饿 See Attachment-M.
\textsuperscript{98}饿 See Attachment-N.
Response on February 17, 2017 provided a further correction to $1,250,640.83. This correction was based on further analysis using the vendor names, and supporting documents were provided to support the further revised amounts.\textsuperscript{99}

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

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

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

\textsuperscript{99} See Attachment-O (Suburban response to ORA’s deficiency of AMX-002) (emphasis added).
\textsuperscript{100} See Attachment-N.
\textsuperscript{101} See Attachment-G.
\textsuperscript{102} See Attachment-P.
records does not provide adequate documentation that these records actually presented a
direct charge from the parent company to a specific subsidiary.

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

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

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

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

103 See Attachment-Q.
D. CONCLUSION

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

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

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