Docket:	:	A.07-01-009 et al.
Exhibit Number	:	
Commissioner	:	Dian Grueneich
Admin. Law Judge	:	Regina DeAngelis
DRA Project Mgr.	:	Victor Chan
	:	

DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION

REPORT ON THE RESULTS OF OPERATIONS OF GOLDEN STATE WATER COMPANY Region I BAY POINT DISTRICT for Test Year 2008 and Escalation Years 2009 and 2010 Application 07-01-010 In Consolidated Proceeding A.07-01-009 et al.

San Francisco, California
May 14, 2007

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MEMORANDUM

In this Report, the Division of Ratepayer Advocates (DRA) of the California Public Utilities Commission (Commission) presents its analyses, findings, and recommendations regarding the Bay Point District in Region 1 of the Golden State Water Company (GSWC). The general rate case (GRC) application for the Bay Point District, A. 07-01-010, was consolidated with other GRC applications for Districts in Region I, into a single docket, A. 07-01-009 et al. Unless otherwise indicated, this Report pertains only to the Bay Point District.

For the Bay Point District, GSWC is requesting Commission authorization to increase in 2008 the present rates charged for water service by $492,400, an increase of 8.57% over present rates; in 2009 by $122,500, an increase of 1.94%; and in 2010 by $160,000, an increase of 2.47%.

The qualifications of the DRA witnesses sponsoring this Report, are set forth in attached Appendix B. The DRA Project Coordinator for this and the other Reports in A. 07-01-009 et al. is Victor Chan, and the DRA's Legal Counsel is Cleveland Lee.

EXECUTIVE SUMMARY

I. INTRODUCTION

On January 5, 2007, the Golden State Water Company (GSWC) filed A. 07-01-009 et al., requesting authorization to increase in 2008 the current rates charged for water service in the Bay Point District by $492,400, an increase of 8.57% over present rates; in 2009 by $122,500, an increase of 1.94%; and in 2010 by $160,000, an increase of 2.47%. For Test Year 2008 and 2009, GSWC requests a return on equity of 11.25% and a return on rate base of 9.41%.

II. SUMMARY OF RECOMMENDATION

This Report constitutes DRA's prepared direct testimony for the Bay Point District in the consolidated GRC proceeding, A.07-01-009 et al., which includes A. 07-01-010. Based on Staff's analyses, reviews, and findings of A. 07-01-010, DRA recommends for the Bay Point District in the Test Year 2008 an overall revenue requirement of $5,760,000, an overall increase of $13,000 or 0.23% of present rate for the Bay Point District ratepayers, as shown in the table below entitled "Summary of Earnings for the Bay Point District"

Summary of Earnings for the Bay Point District

Test Year 2008

DRA Present	GSWC Present	DRA Recommended	GSWC's Request
$5,747,000	$5,747,000	$5,760,000	$6,303,300

An overview of DRA's key recommendations by Chapters is presented as follows:

1. Chapter 2- Customer, Consumption and Operating Revenue

DRA's and GSWC's updated estimates are the same for the average number of customers, water consumption, and operating revenues. For the Test

Year 2008, the estimated total average number of customers is 4,996 customers, and the total water consumption 1,241,203 Ccf. At GSWC's present and proposed rates, the calculated operating revenues for the Test Year 2008 are $5,747,000 and $6,303,300, respectively.

2. Chapter 3-Expenses (O&M, A&G)

DRA recommends $3,444,400 in operating expenses for Test Year 2008 but GSWC's proposes $3,723,500. DRA's estimate is $279,100 lower than GSWC's proposal because of the Parties' use of different escalation factors, assumptions, and methodologies to forecast these future expenses.

3. Chapter 4-Plant In Service

GSWC requests plant additions of $1,228,800 for 2007, $1,189,500 for Test Year 2008, and $1,187,000 for Test Year 2009. On the other hand, DRA recommends plant additions of $842,300 in 2007, $885,500 in Test Year 2008, and $638,000 in Test Year 2009.

Further, DRA will present recommendations concerning GSWC's partnership with engineering firm CH2MHill, GSWC's Overhead Rate, and GSWC's planned and unplanned project Contingency adder**.**

4. Chapter 5- Depreciation Expenses and Reserve

Differences between DRA's and GSWC's depreciation and reserve estimates are due to the disparities between GSWC's requested plant additions and DRA's recommended plant additions for the Test Years 2008 and 2009. GSWC requests depreciation of $8,609,400 in Test Year 2008 and $9,463,600 in Test Year 2009. DRA recommends $8,622,600 in Test Year 2008 and $9,466,200 in Test Year 2009. These differences are analyzed in Chapter 4, "Utility Plant Additions."

5. Chapter 6-Rate Base

GSWC requests a rate base of $11,658,600 for Test Year 2008 and $12,066,900 for Test Year 2009; DRA recommends $11,038,700 for Test Year 2008 and $11,036,500 for Test Year 2009. The Parties' disagreements regarding rate base are based on their divergent views of plant additions.

6. Chapter 7-Taxes

For both State and Federal income taxes as shown in Table 7-1, DRA estimates higher income taxes than GSWC has calculated. The Parties' have different estimates of revenue requirement, expenses, rate base, and other tax issues.

7. Chapter 8-Policy Issues

Based on DRA's review of water quality records provided by GSWC and the California Department of Health Services' (DHS) history of GSWC compliance in the Bay Point District, GSWC has been in compliance with the DHS drinking water standards from 2004 to 2006. The Commission's Public Advisor also reports that Bay Point customers have found GSWC's water generally satisfactory.

8. Chapter 9-Rate Design

GSWC's rate design is consistent with the method set forth in Commission Decision (D.) 86-05-064. Approximately 50% of fixed costs are recovered through the service charge, and the remaining costs through a single block commodity rate.

9. Chapter 10- Escalation Years

DRA estimates $5,856,000 and $5,933,000 as the revenue requirements for the Escalation Years 2009 and 2010, respectively, as compared with GSWC's same estimates, respectively, of $6,423,100 and $6,576,900.

List of Chapters and the Sponsoring DRA Witness

Chapter Number	Description	Witness
-	Executive Summary	Victor Chan
1	Summary of Earnings	Victor Chan
2	Customer, Consumption, Operating Revenue	Victor Moon
3	Expenses (O&M, A&G)	Eric Matsuoka
4	Plants in Service	Patricia Esule
5	Depreciated and Amortization Expenses	Patricia Esule
6	Rate Base	Patricia Esule
7	Taxes	Eric Matsuoka
8	Rate Design	Victor Moon
9	Policy Issues	Victor Chan
10	Escalations Years	Victor Chan
	Appendix A (Escalation Factors)	
	Appendix B (Qualifications and Prepared Testimony)	

CHAPTER 1: SUMMARY OF EARNINGS

A. Introduction

This Chapter provides DRA's recommendations in response to GSWC's general rate increase requests for the Test Year 2008 and the Escalation Years 2009 and 2010.

B. Summary of Recommendations

At Table 1-1, "Summary of Earnings," at the end of this Chapter, DRA compares for the Test Year 2008 its recommended and GSWC's requested revenues, expenses, taxes, and rate base.

C. Discussion

The total revenues requested by GSWC are as follow:

Year	Amount of Increase	Percent
Test Year 2008	$492,400	8.57%
Escalation Year 2009	$122,500	1.94%
Escalation Year 2010	$160,000	2.47%

GSWC estimates that its proposed rates will produce revenues providing the following returns for Test Year 2008:

Test Year	Return on Rate base	Return on Equity
2008	9.41%	11.25%

D. Conclusion

DRA recommends a revenue increase for Test Year 2008 as follows (the Escalation Years 2009 and 2010 are discussed in Chapter 10):

Test Year	Amount of Increase	Percent
2008	$13,000	0.23%

The last general rate increase for GSWC was authorized by D. 05-05-025 in A.04-08-042, resulting in a rate of return on rate base of 7.34% in 2005 and 7.42% in 2006. In this Report, DRA used the most recent rates requested by Advice Letter (AL) 1220-W and authorized as effective on January 1, 2007.

A comparison of DRA's and GSWC's estimates for rate of return on rate base for the Test Year 2008 at the present rate is shown below:

	Rate of Return		
	2008		
	DRA	GSWC	Diff
Present Rates	8.73%	6.77%	1.96%

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TABLE 1-1				
Region I- Bay Point				
SUMMARY OF EARNINGS				
Test Year 2008				
	DRA	Utility	DRA	Utility
Item	Present	Present	Recommended	Requested
	(A)	(B)	(C)	(D)
	(Dollars in Thousands)			
Operating Revenues	5,747.0	5,747.0	5,760.0	6,303.3
Total Revenue	5,747.0	5,747.0	5,760.0	6,303.3
Expenses				
Operation & Maintenance	2,806.4	2,829.3	2,806.4	2,831.0
Admininistrative and General	638.0	892.6	638.0	892.6
Depreciation & Amortization	734.8	747.7	734.8	747.7
Taxes Other Than Income	198.3	203.7	198.3	210.4
CCFT	75.0	48.3	76.1	96.8
FIT	330.8	236.0	335.4	427.8
Total Expenses	4,783.3	4,957.6	4,789.0	5,206.3
Net Income	963.7	789.4	971.0	1,097.0
Rate base	11,038.9	11,658.6	11,038.9	11,658.6
Rate of Return	8.73%	6.77%	8.80%	9.41%

CHAPTER 2: CUSTOMER, CONSUMPTION, OPERATING REVENUE

Table 3- **Introduction**

This chapter sets forth DRA's analysis and recommendations regarding the number of customers, water consumption, and operating revenues in the Test Year 2008 for GSWC's Bay Point CSA in the Contra Cost County.

B. Summary of Recommendations

DRA concurs with GSWC's updated estimates (as of February 15, 2007) regarding the average number of customers, water consumption, and operating revenues. Tables 2-1 to 2-3 at the end of this chapter show DRA's recommendations and GSWC's updated estimates for the average number of customers, water consumptions, and operating revenues. For the Test Year 2008, DRA's and GSWC's estimated total average number of customers is 4,996 customers, and the total water consumption 1,241,203 Ccf.

At the present and GSWC's proposed rates, the estimated operating revenues for the Test Year 2008 are $5,747,000 and $6,303,300, respectively.

C. Discussion

DRA's and GSWC's analyses are in accordance with the provisions set forth in the Rate Case Plan D.04-06-018. The estimates for customer growth are based on the last recorded 5-year average of 2002 through 2006, and water consumption is forecasted by using the "New Committee Method."

DRA accepted GSWC's request of 8.02% water loss based on the most recent 5-year recorded average.

Operating revenue is calculated by multiplying the number of customers to the applicable water use and to the current tariff rates for the present revenue; and to the proposed rates for the proposed revenue.

D. Conclusion

DRA finds GSWC's estimates reasonable. The Commission should adopt DRA's recommendations.

TABLE 2-1				
GOLDEN STATE WATER COMPANY				
Region I- Bay Point				
AVERAGE SERVICES				
2008				
	DRA	Utility	DRA Exceeded GSWC	
Item	Analysis	Estimated	Diff	Percent
	(A)	(B)		
Metered Service:				
Commercial	98,184	98,184	0	0.00%
Industrial	252	252	0	0.00%
Public Authority	693	693	0	0.00%
Irrigation	155	155	0	0.00%
Resale	0	0	0	0.00%
Reclaimed	39	39	0	0.00%
Other	14	14	0	0.00%
Total Metered	99,337	99,337	0	0.00%
Flat Rate				
Commercial	0	0	0	0.00%
Public Authority	0	0	0	0.00%
Private Fire	1,707	1,707	0	0.00%
Total Flat Rate	1,707	1,707	0	0.00%
Total Average Customers	101,044	101,044	0	0.00%

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TABLE 2-2				
GOLDEN STATE WATER COMPANY				
Region I- bay Point				
Average consumption per customer				
2008				
	DRA	Utility	DRA Exceeded GSWC	
Item	Analysis	Estimated	Diff	Percent
	(A)	(B)		
Metered Service:				
Commercial	4,876.0	4,876.0	0.0	0.00%
Industrial	7.0	7.0	0.0	0.00%
Public Authority	11.0	11.0	0.0	0.00%
Irrigation	66.0	66.0	0.0	0.00%
Resale	0.0	0.0	0.0	0.00%
Contract	0.0	0.0	0.0	0.00%
Other	0.0	0.0	0.0	0.00%
Total Metered	4,960.0	4,960.0	0.0	0.00%
Flat Rate				
Commercial	0.0	0.0	0.0	0.00%
Public Authority	0.0	0.0	0.0	0.00%
Private Fire	0.0	0.0	0.0	0.00%
Total Flat Rate	0.0	0.0	0.0	0.00%
Total Avg. Number Cust.	4,960.0	4,960.0	0.0	0.00%

TABLE 2-3				
GOLDEN STATE WATER COMPANY				
Region I- Bay Point				
OPERATING REVENUES				
Test Year 2008				
(at Present Rates)				
Item	DRA	GSWC	DRA Exceeded GSWC	
	(A)	(B)	Diff.	%
	(Dollars in Thousands)			
Metered Service:				
Commercial	4,562.4	4,562.4	0	0.00%
Industrial	595.1	595.1	0	0.00%
Public Authority	96.1	96.1	0	0.00%
Irrigation	436.5	436.5	0	0.00%
Resale	0.0	0.0	0	0.00%
Contract	0.0	0.0	0	0.00%
Other	0.0	0.0	0	0.00%
Total Metered	5,690.1	5,690.1	0	0.00%
Flat Rate				
Commercial	0.0	0.0	0	0.00%
Public Authority	0.0	0.0	0	0.00%
Private Fire	47.6	47.6	0	0.00%
Total Flat Rate	47.6	47.6	0	0.00%
Public Fire				
Miscellaneous				
Misc. Service	9.2	9.2	0	0.00%
Rent	0.0	0.0	0	0
Other	0.1	0.1	0	0
Revenue Accrued	0.0	0.0	0	0
Supply Bal. Accts	0.0	0.0	0	0.00%
Total Misc.	9.3	9.3	0	0.00%
Total Operating Revenue	5,747.0	5,747.0	0	0.00%

CHAPTER 3: EXPENSES

A. Introduction

This Chapter sets forth DRA's analyses and recommendations for operating expenses. DRA's review is based on GSWC's application, testimonies, supporting work papers, Region I headquarter and district office, discussions with GSWC employees, e-mail from GSWC, and GSWC data responses.

B. Summary of Recommendations

DRA recommends operating expenses in the amount of $3,445,600 for Test Year 2008. GSWC's propose an amount of $3,723,600. DRA's estimate is $278,000 lower than GSWC proposal due to use of different escalation factors, assumptions, and methodologies to forecast these future expense amounts.

Table 3-1 below compares DRA's recommended and GSWC's proposed estimates of operating expenses.

C. Discussion

Table 3-1 shows line item expenses recommended by DRA and compare them with those requested by GSWC. Following this is the discussion of each expense estimate listed.

Table 3-1
Region 1 Bay Point
Test Year 2008
(Dollars in Thousands)

	DRA	GSWC
Purchased Water	$ 1,749.1	$ 1,749.1
Purchased Power	205.5	205.5
Chemicals	110.0	111.5
Allocated Common Cust Acct-GO	29.0	42.8
Uncollectibles 0.296%	17.0	18.7
Operation Labor	306.4	306.4
Other Operation Expenses	211.2	215.4
Total Operation Expenses	2,628.2	2,649.4
Maintenance Labor	68.0	71.5
Other Maintenance Expenses	110.2	110.2
Total Maintenance Expenses	178.2	181.7
Office Supplies & Expenses	45.7	45.7
Pension and Benefits	6.1	8.0
Business Meals	0.7	0.7
Regulatory Expenses	25.7	28.5
Outside Services	10.2	40.4
Miscellaneous	1.1	1.1
Allocated General Office	324.2	475.2
Allocated Region Office	94.8	104.8
Allocated District Office	44.6	58.8
Other Maint. Of Gen. Plt	12.3	56.6
Rent	29.1	29.1
A&G Labor	43.6	43.6
Total A&G Expenses	638.1	892.5
Total O&M & A&G	$ 3,445.6	$ 3,723.6

1. Escalation Factors

SWC used the escalation factors in the October 31, 2006; Memorandum of the DRA Energy Cost of Service Branch. GSWC applied other factors to determine the future amounts for labor expenses. GSWC also applied a customer growth escalation factor to forecast certain Test Year expenses.

DRA recommends using the most recent escalation factors provided in the DRA Energy Cost of Service Branch, Escalation Memorandum, dated February

28, 2007, which is reflected in DRA's estimates for Test Year 2008. DRA analyzes and recommends amounts different than those proposed by GSWC. DRA also applied a customer growth escalation factor to forecast Test Year expenses.

2. Operation Expenses

Purchased Water

DRA recommends the same level of expenses of $1,749,100 requested by GSWC for purchased water in Test Year 2008, due to the same level of water supply and sales numbers provided by DRA's revenue witness. The water supply and sales numbers are found at Chapter 2 of this Report.

DRA and GSWC applied the same rate for purchased water to estimate the purchased water expenses.

Purchased Power

DRA recommends the same level of expenses of $205,500 requested by GSWC for purchased power in Test Year 2008, due to the same level of production quantity provided by DRA's revenue witness. The production quantity numbers is found at Chapter 2 of this Report.

DRA and GSWC used the same unit of kilowatt hours per production and the same cost per kilowatt hours to determine their estimate for purchased power.

Chemicals

DRA recommends $110,000 and GSWC requested $111,500 for chemicals expenses in Test Year 2008. DRA estimate is $1,500 lower than GSWC's proposal, due to a difference in estimating the unit cost.

GSWC requested an amount of $535.40 per acre foot unit cost. GSWC uses an inflated five-year average to 2006 dollars; applied an escalation factor to the adjusted average number to develop the unit cost for 2007; and applied the escalation factor to the unit cost of 2007 to develop its estimate for Test Year 2008.

DRA uses the same methodology to develop its unit cost estimate of $528.04 per acre foot for Test Year 2008. It appears that the different publication of the escalation factors may attribute to the difference in estimates.

Various Allocated Expenses

The following data are analyzed in a separate Report by DRA's Regional witness:

- Allocated Common Customer Accounts-General Office;
- Allocated General Office Expenses;
- Allocated Regional Office Expenses; and
- Allocated District Office Expenses.

Uncollectible

DRA finds that GSWC's request for an uncollectible rate of 0.296% is reasonable. DRA and GSWC applied the same rate to uncollectible expenses.

Operation Labor Expenses

The discussion below analyzes the labor expenses in Operation, Maintenance, and Administrative and General.

DRA recommends the same level of expenses of $306,400 requested by GSWC for operation labor in Test Year 2008.

DRA recommends $68,000 and GSWC requested $71,500 for maintenance labor expenses in Test Year 2008, which DRA recommendation is $3,500 less than GSWC's proposal.

DRA recommends the same level of expenses of $43,600 requested by GSWC for administrative and general labor in Test Year 2008.

In projecting labor expense, GSWC started with actual and vacant positions for the Northern District and Bay Point District and related annual salary expense for 2006. GSWC increased the expenses for labor recorded in 2006 by including the vacant positions, resulting in a restated labor expense for 2006. Then, GSWC applied the allocated percentage of labor expenses for 2006 to the restated labor

expenses to determine a number and percentage for capitalized and expensed portion of labor expenses. The expense portion is use for its base labor expenses to project future labor expenses.

DRA replaced the restated labor expenses with the actual recorded labor expenses for 2006, which DRA uses as its base labor expense to project future amount. According to D.05-07-044, mimeo at page 10, the Commission excluded vacant positions, holding that adjustments should not be made for temporary vacancies absent a showing of extraordinary circumstances. In D.05-07-044, the Commission further stated:

> To the extent there were vacancies in the recorded year, we should assume there will also be comparable vacancy savings in the test year and escalation years.

Next, GSWC applied a wage escalation factor of 3.3% to the restated base labor expense to calculate its labor expense for 2007. Then, GSWC applied a merit increase factor of 1.28%, a wage inflation factor of 2.20%, and an overtime factor of 5.19% to the labor expense of 2007 to determine its estimate for Test Year 2008. GSWC management uses the merit increase factor to maintain its experienced and high performing employees. The merit increase factor creates a pool of fund to award employees who perform above the level expected for their positions.

DRA escalated the actual recorded labor expenses for 2006 to Test Year 2008 dollars by using the labor escalation factor of 3.2% for 2007 and 1.5% for Test Year 2008.

DRA removed the merit increase factor of 1.28% because the recorded labor expenses reflect labor activities, such as temporary vacancies, overtime, and other activities, for 2006; the Application failed to show the reasonableness and support for the merit increase factor of 1.28% in this general rate cycle; and the 1.28% merit increase factor boosters the recorded labor expenses of 2006.

Other Operation Expenses

DRA recommends $211,200 and GSWC requested $215,400 for other operation expenses, which DRA recommendation is $4,200 less than GSWC proposal.

Other Operation Expenses consist of many sub accounts or line items expenses. Instead of requesting an estimate for each sub accounts, GSWC consolidated each sub account into one (1) estimate for Other Operation Expense. GSWC also requested $18,000 to be added to the five year average of the conservation expenses sub account and $55,000 for sludge removal.

GSWC uses an inflated adjusted five-year average to 2006 dollars; applied the escalation factor to the adjusted average number to develop the expense for 2007 and added $18,000 for conservation expense and $55,000 for sludge removal to the 2007 expenses; and applied the escalation factor to the total expenses of 2007 to develop its estimate of $215,400 for Test Year 2008.

DRA uses an inflated adjusted three-year average to 2006 dollars; applied the escalation factor to the adjusted average number to develop the expense for 2008 and added $14,500 for conservation expenses and $55,000 for sludge removal to the 2008 expenses to develop its estimate of $211,200 for Test Year 2008. DRA used an inflated adjusted three-year average due to the fluctuation in the recorded expenses for the past five years, such as a low of $41,400 in 2002 to a high of $175,900 in 2005 and to provide a continuous level of expenses.

Table 3-2 below shows the last adopted and recorded expenses for each conservation programs from 2004 through 2006 provided by GSWC, the 2005 Urban Water Management Plan (UWMP) recommendations to implement certain conservation programs in Test Year 2008, DRA's recommendation, and GSWC's request.

The 2005 UWMP report contains recommendations to implement certain Best Management Practices (BMP) program(s) with a cost estimate of each program to GSWC. The 2005 UWMP uses the BMP programs administered by

the California Urban Water Conservation Council, which the BMP programs are adopted by the Commission Water Action Plan. GSWC is a signatory of the Memorandum of Understanding with the California Urban Water Conservation Council. The UWMP report, at Chapter 5, page 5-10, Table 5-5, recommends BMP 2 with a cost of $12,855 and BMP 5 with a cost of $339 for Test Year 2008.

Table 3-2
Region 1 Bay Point CSA
Test Year 2008
(Dollars in Thousands)

BMP	2004	2005	2006	2005 UWMP	DRA	GSWC
1	$ -	-	-	-	-	$ -
2	-	-	3.8	12.9	4.0	4.0
3	-	-	-	-	-	-
4	-	-	-	-	-	-
5	-	-	-	0.3	-	-
6	-	-	-	-	-	-
7	-	-	-	-	-	3.5
8	-	1.4	-	-	-	-
9	-	-	-	-	-	-
10	-	-	-	-	-	-
11	-	-	-	-	-	-
12	-	-	-	-	-	-
13	-	-	-	-	-	-
14	-	-	-	-	7.5	7.5
CCWD					3.0	3.0
Total	$ -	1.4	3.8	13.2	14.5	$ 18.0

DRA agrees with the request of $4,000 for BMP 2 due to the recommendation of the UWMP and the last recorded participation in 2006 by GSWC.

DRA reduced the request of $3,500 for BMP 7 by the same amount due to lack of participation by GSWC as shown in the recorded expenses since 2004; UWMP did not recommend this program; and the Application failed to show the reasonableness and support of GSWC proposal.

DRA agrees with the request of $7,500 for BMP 14, although GSWC showed no participation through its recorded expenses since 2004. BMP 14 is a program that offers rebates to consumers that participate in this residential ultra low flush toilet replacement program.

GSWC request $3,000 for BMP 9. DRA has moved the request to another line item expense titled CCWD. CCWD stands for Contra Costa Water District, which GSWC participates as a cost partner water conservation matters. DRA agrees with the request of $3,000 for Test Year 2008.

3. Maintenance Expenses

Maintenance Labor

Refer to Paragraph 2, "Operation Expenses," subparagraph (f, "Operation Labor Expenses," stated above for DRA's discussion of Maintenance Labor expenses.

Other Maintenance Expenses

DRA recommends the same level of expenses of $110,200 requested by GSWC for other maintenance in Test Year 2008.

4. Administrative and General Expenses

Office Supplies and Expenses

DRA recommends the same level of expenses of $45,700 requested by GSWC for office supplies and expenses in Test Year 2008.

Pension and Benefits Expenses

DRA recommends $6,100 and GSWC requested $8,000 for pension and benefits expenses in Test Year 2008, which DRA recommendation is $1,900 less than GSWC's proposal.

GSWC uses an inflated adjusted two-year average to 2006 dollars; applied the escalation factor to the adjusted average number to develop the expense for

2007, and applied the escalation factor to the total expenses of 2007 to develop its estimate for Test Year 2008.

DRA uses an inflated adjusted three-year to 2006 dollars and applied the escalation factor to the adjusted average number to develop its estimate for Test Year 2008. DRA uses an inflated adjusted three-year average due to the fluctuation in the recorded expenses for the past five years, such as a low of $1,100 in 2002 to a high of $7,600 in 2005 and to provide a continuous level of expenses.

Business Meals

DRA recommends the same level of expenses of $700 requested by GSWC for business meals in Test Year 2008.

Regulatory Commission Expenses

DRA recommends a regulatory commission expenses amount of $77,100 or a yearly amortized amount of $25,700 over three years. GSWC requests an expense of this type in the amount of $85,500, or a yearly amortized amount of $28,500 over three years. DRA‘s recommendation is less than GSWC’s in an amount of $8,400, or $2,800 less than GSWC’s proposed yearly amortization. Table 3-3 depicts the expense activity for the last general rate case, which DRA uses to forecast Test Year 2008 expenses.

Table 3-3
Region I Bay Point CSA
Test Year 2008
(Dollars in Thousands)

		2005	2006	2007	DRA	GSWC
D.05-05-025	Adopted	$ 41.0	41.8	42.8		
	Recorded	3.3	7.9	42.8		
	Total Regulatory Expense				77.1	85.5
	Yearly Expense-3 years				25.7	$ 28.5

GSWC uses its last general rate case expenses for Region II, A.06-02-023, as a proxy to estimate Region I’s regulatory commission expenses for Test Year

2008. As of the date of this Report, the Commission has not issued a final decision of A.06-02-023, which also addressed GSWC's General Office request to increase its revenue requirements.

DRA reviewed the level of expenses adopted in D.05-05-025 for Test Years 2005 through 2007 and compared it with the recorded expenses for 2005 and 2006 and assumes an amount equal to the adopted expense for 2007as recorded. The large difference between the adopted and recorded expenses for 2005 and 2006 as shown in Table 3-3 dictates DRA methodology to forecast its estimate for Test Year 2008.

DRA uses an inflated adjusted three-year sum to 2007 dollars; applied an escalation factor to the adjusted sum number to develop the expense for 2008 and add the estimated expenses for mailing cost, publishing cost, and miscellaneous expenses for Test Year 2008. DRA has increased the first-class U.S. postage rate of 39 cents in GSWC work papers to 42 cents due to the anticipation of the May 2007 postal rate increase.

Outside Services

DRA recommends $10,200 and GSWC requested $40,400 for outside services expenses in Test Year 2008, which DRA recommendation is $30,200 less than GSWC's proposal.

GSWC uses the recorded expenses of 2006; applied the escalation factors to the expenses of 2006 to develop its estimate for 2007; and applied the escalation factors to the expenses of 2007 to develop its estimate for Test Year 2008.

DRA uses an inflated adjusted three-year average to 2006 dollars and applied the escalation factors to the adjusted average number to develop its estimate for Test Year 2008. DRA uses an inflated adjusted three-year average due to the fluctuation in the recorded expenses for the past five years, such as a low of $1,500 in 2002 to a high of $39,200 in 2006 and to provide a continuous level of expenses.

Miscellaneous

DRA recommends the same level of expenses of $1,100 requested by GSWC for miscellaneous in Test Year 2008.

Other Maintenance General Plant

DRA recommends $12,300 and GSWC requested $56,600 for other maintenance-general plant expenses in Test Year 2008, which DRA recommendation is $44,300 less than GSWC's proposal.

GSWC uses an inflated adjusted five-year average to 2006 dollars; applied the escalation factors to the adjusted average number to develop the expenses for 2007; and applied the escalation factors to the total expenses of 2007 to develop its estimate for Test Year 2008.

DRA uses an inflated adjusted three-year average to 2006 dollars and applied the escalation factors to the adjusted average number to develop its estimate for Test Year 2008. DRA uses an inflated adjusted three-year average due to the fluctuations in the recorded expenses for the past five years, such as a low of $4,100 in 2005 to a high of $228,100 in 2006 and to provide a continuous level of expenses.

Rent

DRA recommends the same level of expenses of $29,100 requested by GSWC for rent in Test Year 2008.

Administrative and General Labor Expense

Refer to section C, subsection (2), "Operation Expenses," subparagraph (f) "Operation Labor Expenses," stated above for DRA's discussion of this type of expenses.

CHAPTER 4: PLANT IN SERVICE

A. Introduction

This Chapter sets forth DRA's analyses and recommendations for Plant in Service in the Bay Point CSA which has approximately 5,000 customers. DRA's recommendations are based on GSWC's application, testimonies, supporting work papers, discussions with GSWC employees, e-mail from GSWC, and GSWC data responses.

B. Summary

GSWC requests plant additions of $1,228,800 for 2007, $1,189,500 for Test Year 2008, and $1,187,000 for Test Year 2009. DRA recommends less plant additions in the amount of $842,300 in 2007, $885,500 in Test Year 2008, and $638,000 in Test Year 2009.

In addition to differences in plant additions, DRA will present recommendations concerning GSWC's partnership with engineering firm CH2MHill, GSWC's Overhead Rate, and GSWC's planned and unplanned project contingency adder**.**

C. Discussion

1. Capital Additions for 2007

The following Table 4-1 illustrates GSWC's requested plant additions for 2007 and DRA's recommendation. DRA has independently analyzed all of GSWC's proposed projects and estimated funding. Plant projects and estimates accepted by DRA are so indicated in the table below. Discussion concerning projects for which DRA recommends a different result follows the table.

Table 4-1: Bay Point Capital Budget for Estimated Year 2007

DESCRIPTION	GSWC	DRA	DIFFERENCE	% DIFFERENCE
Major Projects				
Hill Street WTP - Filter Media	90,000	40,000	-50,000	-56%
Misc. Bowl Replacement	21,000	2,900	-18,100	-86%
Misc Street Improvements	0	0	0	0%
Install 12" from Hill Street Reservoir to Alberts/Water	247,000	208,000	-39,000	-16%
Install 8" on Waters from Marys Ave to Marys Ave	425,000	358,000	-67,000	-16%
Relocate and replace Hydrants	53,000	45,000	-8,000	-15%
Master Plan	173,000	0	-173,000	-100%
Contingency	20,000	9,000	-11,000	-55%
New Business Funded by GSWC	25,000	25,000	0	0%
Total Major Projects	$1,054,000	$687,900	-366,100	-35%
Blanket Projects				
Meters	13,000	11,500	-1,500	-12%
Services	145,000	128,000	-17,000	-12%
Minor Main Replacement	9,700	8,500	-1,200	-12%
Minor Pumping Plant Equipment	1,400	1,300	-100	-7%
Minor Purification Equip/Structures	1,900	1,700	-200	-11%
Office Furniture and Equipment	1,900	1,700	-200	-11%
Misc. Tools and Safety Equipment	1,900	1,700	-200	-11%
Total Blanket Projects	$174,800	$154,400	-20,400	-12%
Total Capital Budget	**$1,228,800**	**$842,300**	**-386,500**	**-31%**

**All estimates include DRA's recommended Contingency and Overhead Rate which are lower than GSWC's request. DRA's discussion of the Contingency and Overhead Rate is presented at the end of this chapter.*

a) Hill Street Water Treatment Plant – Filter Media Replacement

For 2007, GSWC requests $90,000, to replace filter media that has reached the end of its useful life. Further, GSWC proposes to install an internal air scour system that will be used to provide an additional washing of the filters.

DRA recommends $40,000 to replace the filters, which is derived by deducting the cost of the air scour system from GSWC's request. DRA recommends disallowing the installation of the air scour system.

Filter media has an expected useful life of approximately 7-years. Filters are required to be inspected annually and are subject to frequent backwashing to clear mud or other sediment that can affect the effectiveness of the filter media.

According to the DHS inspection reports for the Hill Street Water Treatment Plant, GSWC is meeting all DHS and EPA filtration standards and requirements. Filter Vessel Analysis reports for Filter 3 at the Hill Street plant indicates that the filter media appeared clean upon inspection with the absence of mud balls, mounds, or depressions.[1] It is clear that backwashing the filters is effective in cleaning the filter media, and that the air scour system is an optional item that is not required or necessary for GSWC to meet DHS water quality standards. Furthermore, GSWC has not provided a cost benefit analysis that shows any potential savings in energy or water use, or extended life of the filter media will result from adding the air scour system. GSWC has not proved if and how the addition of the air scour system will provide a benefit to the ratepayers that is not already achieved by the current backwashing method of cleaning the filter media.

2. Miscellaneous Bowl Replacements

GSWC requests $21,000 in 2007 Miscellaneous Bowl Replacements. According to GSWC, this is for the emergency replacement of pumps and motors as well as column extension, which may routinely occur. According to GSWC's witness Ernest Gisler, GSWC's estimate was derived by trending past expenditures for this type of project.

DRA recommends a different amount of $2,900. Because of the routine nature of this project, DRA's estimate is based on GSWC's historical expenditure for this category and is escalated using the forecasted Composite of Labor and Non-labor escalation rates issued for February 2007.[2]

In DRA's Master Data Request submitted to GSWC, DRA requested GSWC's 5-year authorized budget and recorded expenditures for all major and

[1] Filter Media evaluation report by ERS Industrial Services Inc., dated March 3, 2005. This report was provided by GSWC in response to DRA Data Request PXS 012.

[2] Memorandum File No. : S-2559, from Marty Lyons, Program Supervisor, DRA Energy Cost of

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routine plant items. GSWC responded to DRA's request by providing the company authorized budgeted amount for just three years, 2000 through 2002. According to GSWC, budget amounts for 2003 through 2006 were not available because the company was not afforded a full rate case proceeding in 2004[3]. Although GSWC was not afforded the full benefit of a GRC in 2004, the company did receive an adjustment in rates. DRA is also troubled that the company management failed to prepare a capital budget in 6 years, a common best management practice for running any business. The lack of proper planning calls into question whether the capital expenditures made in any year were even justified. In response to a subsequent Data Request, GSWC did provide DRA with the recorded expenditures for 2003 through 2006. The following table illustrates the budgeted amounts compared to the actual expenditures for the past seven year period.

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Service Branch, dated February 28, 2007.

[3] GSWC filed a Notice of Intent to increase rates in January 2004. While the NOI was pending, the Commission issued R03-09-005 that deferred the filing of SCWC's Region I GRC from January 2004 to a later date to be determined. Subsequently, the Commission issued D04-06-018 which adopted the New Rate Case Plan requiring each Class A utility to submit its GRC applications according to a specified schedule. That schedule deferred SCWC's next GRC filing for Region I from January 2004 to January 2007. However, to lessen any hardship caused by the deferral the Commission ordered ORA and SCWC to devise and implement a mutually agreeable rate adjustment plan to transition Region I to the new rate case plan schedule. Decision 05-05-025 was issued in May 2005, which resulted in rate increases for SCWC's Region I. Bay Point's rates were increased 1.9% in 2005, 2.5% in 2006, and 2.5% for 2007.

Table 4- Miscellaneous Bowl Replacements[4]

Table 4-2 Misc. Bowl Replacement Budget

Year	Budgeted Amt.	Year	Recorded
2000	$5,000	2000	$5,290
2001	$10,000	2001	$61,743
2002	$10,000	2002	$4,667
2003	Not available	2003	$0
2004	Not available	2004	$6,272
2005	Not available	2005	$0
2006	Not available	2006	$0
		5-yr Avg.	$2,188

As the table above indicates, during the period 2000 through 2002, the company routinely budgeted $5,000 to $10,000 annually for Miscellaneous Bowl Replacements. However, with the exception of 2001, GSWC's average recorded expenditure for this item was well below GSWC's current request of $21,000. DRA's estimate of $2,900 is more accurate and reasonable than GSWC's, because it is based on GSWC's actual experience with this routine project category except for the unusually high expenditure during 2001. Further, GSWC has not provided any support for its estimate.

5. Miscellaneous Street Improvements

GSWC did not request any funding for Miscellaneous Street Improvements for 2007.

6. Main Replacement – Hill Street Reservoir to Alberts Ave and Water Street

For 2007, GSWC requests $247,000 to replace 2,130 feet of 10-inch pipe. DRA has performed its own analysis of this project and recommends $208,000. DRA's recommendation includes a lower contingency and Overhead Rate.

[4] GSWC response to DRA Data Request PXS 021, PXS 021-S.

7. Main Installation – Water Street Loop from Mary's Ave to Mary's Ave

For 2007, GSWC requests $425,000 to replace a 4-inch, 75-year old main with 2,000 feet of 8-inch pipe to improve fire flow. DRA has performed its own analysis of the project as well as reviewed customer petitions and local fire official recommendations supporting this project. DRA recommends $358,000. DRA's recommendation includes a lower contingency and Overhead Rate.

8. Relocate and replace Fire Hydrants

For 2007, GSWC requests $53,000 to replace obsolete fire hydrants. DRA has performed its own analysis and recommends $44,000. DRA's recommendation includes a lower contingency and Overhead Rate.

9. Master Plan Expenses

For 2007, GSWC requests recovery of $173,000 in expenses for developing its Master Plan. GSWC contracted with an engineering firm, CH2MHill, to produce Master Plans for all Region 1 service areas. GSWC represents that the Master Plans require a highly detailed analysis of the system, including water supply reliability, distribution, storage, and water quality related to anticipated demands in the system. According to GSWC's plant witness, Ernest Gisler,

> The analysis will include the utilization of our existing extended period hydraulic model of the system as a means to identify hydraulic constraints and potential areas in which water aging may lead to water quality issues. The Master Plan will project out ten years into the future and will identify and prioritize improvement projects to ensure continued water quality and service. The Master Plan will be the road map we will use as the basis for future capital budgets and it will be updated periodically to ensure system trends are being addressed.[5]

[5] Golden State Water Company, Prepared Testimony of Ernest A. Gisler, p. 32.

DRA maintains that GSWC's engineering and operations staff should have a thorough, first-hand knowledge of the water system and any needs or deficiencies that may exist, because daily operation and maintenance of the water system would engender such expertise. GSWC's engineering staff has performed a detailed analysis of the system in the past. The most recent Master Plan completed in 1999 was done in-house.

GSWC further claims that the Master Plan is a living document on which future Master Plan(s) may rely. DRA agrees and consequently, GSWC should have little, if any, problem in developing a new Plan, such as by utilizing the existing 1999 Master Plan as the basis for appropriate updates or changes.

GSWC has provided no proof justifying the need to hire an outside consultant as reasonable. While admittedly that during the last 10-years some regulatory requirements may have changed requiring additional analysis and consideration, GSWC has not shown that its own engineering staff were not informed of these changes and could not incorporate them into the 1999 or subsequent Master Plans. Presumably, a Class A water utility such as GSWC should have the expertise and resources to project future needs and to prepare the necessary models.

In GSWC's General Rate Case application for Region III, A. 06-02-023, GSWC made a similar claim that an outside consultant (CH2Mhill) was needed to prepare its Urban Water Management Plan. DRA opposed that request for the same reasons that DRA now opposes this request concerning the Master Plan. As in A. 06-02-023, GSWC also in this matter fails to prove that it lacks the ability and/or resources to develop its Master Plan in-house. In D06-01-025, the Commission denied GSWC's request and should also reject this similarly unjustified and unreasonable request.[6]

[6] D.06-01-025, Section 5.7, concerning GSWC's request for an outside consultant to prepare its Urban Water Management Plan.

10. Blanket Budget

This category includes routine items necessary to operate and maintain the water system, such as replacement of meters due to age or operational deficiencies, services, minor main replacement, miscellaneous tools and equipment, and replacement of service vehicles.

GSWC requests a total $174,800 in 2007 for the Blanket Budget. Based on DRA's analysis, DRA recommends $154,400. DRA's recommendation includes a lower Overhead Rate related to this category.

11. Contingency for Blanket Projects[7]

For 2007, GSWC request $20,000 for this Contingency. The Contingency amounts for stand-alone projects are embedded in their respective cost estimates.

GSWC requested a contingency rate of 10% for both stand-alone, major, capital projects and the Blanket Projects. In its work papers, GSWC specifically noted the amount of Contingency for Blanket Projects and identified this separately in the Capital Budget. The amount requested for Blanket Projects in 2007 is $20,000.

DRA disagrees with GSWC 10% contingency rate and instead recommends only 5% of the Blanket Budget request. DRA's 5% recommendation is more reasonable and justified than GSWC's, because GSWC fails to prove that it has taken cost-effective measures to reduce the need for a Contingency amount. For example, GSWC does not appear to have used preventative maintenance to eliminate or reduce the number of emergency repairs. Nor has GSWC demonstrated any cost management procedures that would render more accurate project management and cost estimations. Further, as in D.06-01-025, GSWC's GRC for Region III, when GSWC failed to justify its request for 10%

[7] DRA testimony regarding Contingency was prepared by both Mehboob Aslam and Patricia Esule.

Contingency, in this matter GSWC also fails show that typical cost overruns or unanticipated projects amount to 10% or more of the Capital Budget.

12. 2008 Capital Additions

For Test Year 2008, GSWC requests a total Capital Budget of $1,189,500, whereas DRA recommends a total Capital Budget of $885,500. The GSWC requested projects and estimated funding accepted by DRA are indicated in the table below. Discussion concerning projects for which DRA recommends a different result will follow the table.

Table 4-3: Bay Point Capital Budget for Test Year 2008

DESCRIPTION	GSWC	DRA	DIFFERENCE	% DIFFERENCE
Major Projects				
Misc. SCADA Improvements	11,000	10,000	-1,000	-9%
Hill Street Filter #2	112,800	43,000	-69,800	-62%
Misc Bowl Replacement	22,000	3,000	-19,000	-86%
Misc Street Improvements	22,000	20,000	-2,000	-9%
Willow Pass b/w Alberts to Port Chicago	547,000	485,000	-62,000	-11%
Alberts b/w Water St & Willow Pass	134,000	119,000	-15,000	-11%
Manuel Ct. to Driftwood Dr, Main Extension	112,000	0	-112,000	-100%
Contingency	21,000	10,000	-11,000	-52%
New Business Funded by GSWC	25,000	25,000	0	0%
Total Major Projects	$1,006,800	$715,000	-291,800	-29%
Blanket Projects				
Meters	13,700	12,700	-1,000	-7%
Services	152,200	141,300	-10,900	-7%
Minor Main Replacement	10,100	9,400	-700	-7%
Minor Pumping Plant Equipment	1,500	1,400	-100	-7%
Minor Purification Structures	2,000	1,900	-100	-5%
Office Furniture and Equipment	2,000	1,900	-100	-5%
Misc. Tools and Safety Equipment	2,000	1,900	-100	-5%
Total Blanket Projects	$183,500	$170,500	-13,000	-7%
Total Capital Budget	**$1,190,300**	**$885,500**	**-304,800**	**-26%**

**All estimates include DRA's recommended Contingency and Overhead Rate which are lower than GSWC's request. DRA's discussion of the Contingency and Overhead Rate is presented at the end of this chapter.*

13. Misc.

14. SCADA Improvements

GSWC requests $11,000 in Test Year 2008 to replace failed and/or outdated SCADA components. DRA preformed its own analysis and recommends

$10,000. DRA's recommendation includes a lower contingency and Overhead Rate.

15. Hill Street Filter #2

GSWC requests $112,000 in Test Year 2008 to replace the filter media in the Hill Street Filter #2, install an air scour system, and replace the PVC under-drain with a stainless steel under-drain system.

DRA recommends $43,000 for replacement of the filter media as it has reached the end of its useful life. However, DRA recommends that the Commission disallow installation of the air scour system and replacement of the under-drain system. DRA's estimate is based on GSWC total estimate minus the costs of the air scour and under-drain systems.

According to the DHS inspection reports for the Hill Street Water Treatment Plant, GSWC is meeting all DHS and EPA filtration standards and requirements. GSWC has not provided any support that backwashing of the filters is not adequate to meet required filtration standards. Furthermore, GSWC has not provided a cost benefit analysis that shows any potential savings in energy or water use, or extended life of the filter media will result from adding the air scour system. GSWC has not shown if and how the addition of the air scour system will provide a benefit to the ratepayers not already achieved by the current backwashing method of cleaning the filter media.

Further, GSWC has not provided any support for its assertion that the PVC under-drain is inferior to the stainless steel type. GSWC does not present any history of problems, such as cracks, enlargement of inlet holes or breaks with the existing under-drain system. GSWC has failed to justify its entire proposed project. Therefore DRA only recommends the amount stated above for approval.

16. Miscellaneous Bowl Replacements

For Test Year 2008, GSWC requests $22,000 for this routine category. DRA recommends a different amount of $3,000. As indicated in the previous

section for 2007, DRA's estimate is based on GSWC's historical expenditure for this category, escalated on the basis of the forecasted Composite of Labor and Non-labor escalation rates for February 2007.[8] The Commission should deny GSWC's request and instead accept DRA's estimate. DRA relies on actual and recorded data, whereas GSWC has not provided any support for its estimate.

17. Miscellaneous Street Improvements

GSWC requests $22,000 in Test Year 2008 for Miscellaneous Street Improvements. Projects in this category are routine in nature. The purpose of this budget is to replace valve boxes and other water appurtenances associated with City or County roadway widening, drainage improvement, and other projects where utility facilities are in the City or County right-of-way.

DRA has performed its own analysis and recommends $20,000. DRA's recommendation includes a lower contingency and Overhead Rate.

18. Willow Pass Main Extension

GSWC requests $547,000 in Test Year 2008 to install 1,400 feet of 12-inch pipe to replace existing 10-inch pipe on Willow Pass from Alberts Ave to Port Chicago Highway. DRA has performed its own analysis of this project and recommends $485,000. DRA's recommendation includes a lower contingency and Overhead Rate.

19. Alberts Ave between Water St & Willow Pass Road

GSWC requests $134,000 in Test Year 2008 to install 600 feet of 12-inch pipe to replace existing 10-inch pipe in Alberts Ave from Water Street to Willow Pass Road. DRA has performed its own analysis and recommends $119,000. DRA's recommendation includes a lower contingency and Overhead Rate.

[8] Memorandum File No. : S-2559, from Marty Lyons, Program Supervisor, DRA Energy Cost of Service Branch, dated February 28, 2007.

20. Manuel Court to Driftwood Drive, Main Extension

GSWC requests $112,000 in Test Year 2008 to install a new water line to create a redundant supply to the eastern side of its Evora Reservoir Zone.

DRA recommends that the Commission disallow this project. GSWC indicates that need for a redundant supply to the Evora Zone was created in 2004 with the start-up of the Pacifica Plant. At that time the Mota Booster Station, which previously provided an alternative for water to flow through the Evora area, was deactivated to allow for improved pressure in another part of the system. Although the configuration of the flow of water has changed, there does not appear to have been any detrimental effect on customers or GSWC's ability to properly maintain the system. According to GSWC, the company is able to flush the system to ensure water quality and there has been no incident when the approximately 800 customers were without water due to either a planned or unplanned shut down of the existing main. Installation of a new main to provide redundancy is not shown as reasonably necessary or otherwise justified.

21. Blanket Budget

GSWC requests a total $183,500 in Test Year 2008 for the Blanket Budget. DRA has reviewed the company's analysis concerning this request and accepts the basis for GSWC's estimate of Blanket Budget. Based on DRA's analysis DRA recommends $170,500. DRA's recommendation includes a lower Overhead Rate related to this category.

22. Contingency for Blanket Projects

GSWC requests $21,000 or 10% of the requested Blanket Budget for Test Year 2008, as the Contingency for Blanket Projects. As previously discussed DRA recommends only a 5% Contingency. DRA's position is based on the fact that GSWC fails to prove that it has taken cost-effective measures to reduce the need for a Contingency amount. GSWC does not appear to have used preventative maintenance to eliminate or reduce the number of emergency repairs. Nor has

GSWC demonstrated any cost management procedures that would render more accurate project management and cost estimations.

Further, in GSWC's GRC for Region III, D. 06-01-025, the Commission found that the company failed to justify its request for a 10% Contingency. In this case, GSWC similarly fails to carry its burden of proof. No analyses show that the typical cost overruns or unanticipated projects amount to 10% or more of the Capital Budget. Therefore, DRA recommends that GSWC's request be disallowed and DRA's recommendation of 5% be adopted by the Commission.

Table 1- 2009 Capital Additions

For Test Year 2009, GSWC request a total Capital Budget of $1,887,000, whereas DRA recommends a total Capital Budget of $735,000. GSWC requested projects and estimated funding accepted by DRA are so indicated in the table below. Discussion concerning projects for which DRA recommends a different result, follows the table.

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Table 4-4 Bay Point Capital Budget for Test Year 2009

DESCRIPTION	GSWC	DRA	DIFFERENCE	% DIFFERENCE
Major Projects				
Purchase Hill Street Property Reverse Mortgage	452,000	0	-452,000	-100%
Misc SCADA Improvements	6,000	5,000	-1,000	-17%
Hill Street Water Treatment Plant Booster Pumps	47,000	41,000	-6,000	-13%
Misc Street Improvements	23,000	20,000	-3,000	-13%
Peninsula b/w Beach St & Canal Dr	131,000	114,000	-17,000	-13%
Shore, b/w Canal Dr & Lake View Ave	310,000	269,000	-41,000	-13%
Contingency	20,000	9,000	-11,000	-55%
New Business Funded by GSWC	5,000	5,000	0	0%
Total Major Projects	$994,000	$463,000	-531,000	
Blanket Projects				
Meters	14,400	13,000	-1,400	-10%
Services	160,000	145,200	-14,800	-9%
Minor Main Replacement	10,700	9,700	-1,000	-9%
Minor Pumping Plant Equipment	1,600	1,400	-200	-13%
Minor Purification Structures	2,100	1,900	-200	-10%
Office Furniture & Equipment	2,100	1,900	-200	-10%
Misc. Tools and Safety Equipment	2,100	1,900	-200	-10%
Total Blanket Projects	$193,000	$175,000	-18,000	-9%
Total Capital Budget	**$1,187,000**	**$638,000**	**-549,000**	**-46%**

**All estimates include DRA's recommended Contingency and Overhead Rate which are lower than GSWC's request. DRA's discussion of the contingency and Overhead Rate is presented at the end of this chapter.*

1. Purchase Hill Street Property – Reverse Mortgage

GSWC requests $452,000 in Test Year 2009 to purchase in a reverse mortgage scheme a home currently owned and occupied by an elderly customer. According to GSWC, the purchase of the home is necessary to extend the Hill Street treatment plant and comply with phase 2 of the Disinfectant By-Product Rule.

DRA recommends that the Commission disallow this request. First, GSWC has not shown any authority or expertise to act as a mortgage lender. GSWC's work papers do not describe and explain the reverse mortgage procedures that will be implemented and GSWC's role therein. Neither has GSWC shown that the homeowner will participate in such a plan. GSWC has not obtained or provided

for Commission review any estimate of the value of the home or the foundation for the requested amount of $452,000. GSWC has failed to carry its burden of proof, and this proposal should be disallowed.

2. Miscellaneous SCADA Improvements

GSWC requests $6,000 in Test Year 2009 to replace SCADA components that have failed or are outdated. DRA performed its own analysis and recommends $5,000. DRA's recommendation includes a lower contingency and Overhead Rate.

3. Hill Street Water Treatment Plant Booster Pumps

GSWC requests $47,000 in Test Year 2009 to replace two water booster pumps. DRA performed its own analysis and recommends $41,000. DRA's recommendation includes a lower contingency and Overhead Rate.

4. Miscellaneous Street Improvements

GSWC requests $23,000 in Test Year 2009 for Miscellaneous Street Improvements. This budget is to replace valve boxes and other water appurtenances associated with City or County roadway widening, and other projects where utility facilities are in the City or County right-of-way. DRA preformed its own analysis and recommends $20,000. DRA's recommendation includes a lower contingency and Overhead Rate.

5. Peninsula Ave, Main Extension

GSWC requests $131,000 in Test Year 2009 to install 560 feet of 12-inch pipe on Peninsula Ave from Beach Street to Canal Drive. DRA has performed its own analysis and recommends $114,000. DRA's recommendation includes a lower contingency and Overhead Rate.

6. Shore Ave, Main Replacement

GSWC requests $310,000 in Test Year 2009 to install 1,325 feet of 12-inch pipe on Shore Ave from Canal Drive to Lake View Ave. DRA has performed its

own analysis and recommends $269,000. DRA's recommendation includes a lower contingency and Overhead Rate.

7. Blanket Budget

GSWC requests $193,000 in Test Year 2009 to cover the routine plant operation and maintenance projects. DRA has performed its own independent analysis and recommends $175,000. DRA's recommendation includes a lower contingency and Overhead Rate.

8. Contingency for Blanket Projects

GSWC requests $20,000 or 10% of the requested Blanket budget for Test Year 2009, to fund unexpected blanket expenditures or unforeseen cost overruns. As previously discussed DRA recommends 5% Contingency. DRA's position is based on the fact that the company should implement preventative maintenance in order to avoid frequent emergency repairs and also implement cost management procedures to ensure more accurate project cost estimation and project management.

In GSWC's GRC for Region III, D. 06-01-025, the Commission decided that GSWC failed to support its request for a 10% Contingency. In this rate case, GSWC similarly fails to justify its request. GSWC does not provide any proof that cost overruns or unanticipated projects have typically amounted to 10% or more of the Capital Budget. Therefore, GSWC's request should be disallowed, and DRA's recommendation of 5% adopted by the Commission.

Table 4-5 at the end of this chapter reflects GSWC's estimate for Plant in Service and DRA's recommendation.

E. CH2MHILL Partnership[9]

DRA finds problematic GSWC's ongoing partnership with CH2MHill for purposes inter alia of developing Master Plans for all of its Northern and Coastal

[9] DRA testimony concerning CH2M Hill partnership was prepared jointly by Mehboob Aslam
(continued on next page)

District CSAs; performing design and design-build tasks for all of the major Water Supply and Distribution projects; and developing project costs for all projects excluding pipeline. According to GSWC's witness, Ernest Gisler, GSWC will likely retain CH2MHill to assist with the implementation of 2008 and 2009 capital projects.[10]

GSWC has failed to justify this partnership as cost-effective or otherwise reasonably needed. No data shows that this arrangement with CH2MHILL will alleviate the backlog of capital projects company-wide, relieve any engineering workload, or render any cost savings to ratepayers. If accepted by the Commission without the requisite level of proof by GSWC, this CH2MHILL partnership will heap unfair and unreasonable rate burdens on customers in all three of GSWC's Regions.

Following is the list of the problematic issues regarding this partnership:

1- Need for the Partnership with CH2MHILL

In DRA's Data Request, AMX-32, GSWC provided a historical background of forming such partnership with CH2MHill. In doing so, GSWC re-submitted the excerpts of the testimony of David Chang, Engineering and Planning Manager of Region II, in the previous Region II GRC proceedings, A.06-02-023. In that proceeding, Mr. Chang justified the need for such a partnership based on the following reasons:

- Heavy Workload: In addition to $30 million of capital improvements each year, there have been higher volumes of new business projects (Budget Group 60)...The total number of new business projects applications totaled more than 164 from January 2003 through September 2005. That is an increase of 52% when compared with the total of new business project applications of 108 for 2000 to 2002.

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and Patricia Esule.

[10] Prepared Testimony of Ernest Gisler, A 06-01-009 thru A-06-01-015, pgs 3-5.

- Stringent local permit requirement: Many local cities are imposing more stringent conditional use permit requirements on local projects. These requirements have prolonged permitting process, caused delay or stoppage of projects, and caused significant cost increases.
- Increase in construction costs: Due to the expansion in construction sector in the US and overseas, specifically in China and India, there have been significant increases in construction material and labor costs, because of a global shortage of construction raw materials such as concrete and steel. This increases construction costs and cause project budget overruns and deferral of projects.
- Staff Shortage: Despite its aggressive recruiting efforts GSWC had difficulty in hiring qualified engineering staff, which has further increased the need to rely on outside engineering resources to complete projects.

DRA disagrees with each of the above stated claims. GSWC's purported heavy workload is attributable mainly to an increase in new business applications. Since new businesses' capitals are generally funded by the contractors or developers in the form of contributions and advances, these funding sources should pay for the hiring of CH2MHILL instead of burdening the existing ratepayers.

GSWC claims that CH2MHILL is needed to meet the increasingly stringent local permitting requirement. DRA finds no quantitative data of such an increase or that GSWC does not currently have the internal administrative and other resources to meet any such purported increase of local requirements. Further, most often these permits are required for new business applications, which should not placed on the backs of ratepayers when they financially benefit the GSWC shareholders.

GSWC fails to prove that hiring CH2MHill has effectively expedited or likely will facilitate local permitting processes. GSWC only speaks in vague generalities or anecdotally. Further, GSWC does not demonstrate that more readily available and less costly alternatives are ineffective. For example, no data shows GSWC's efforts to institute more efficient time management and planning

programs to increase GSWC's abilities to deliver projects in a more cost-effective manner.

As for the significant increases in construction material and construction labor costs, once again GSWC fails to quantify such claims and specifically explain how such purported trends justify the need to hire CH2MHILL. Increases in the price of construction materials and labor costs lift the tide for all boats: GSWC as well as CH2MHILL would have to pay the rise in such prices. GSWC fails to explain how hiring CH2MHILL would reduce costs associated with impacts due to increased international demand for steel and concrete. DRA cannot see any cost benefit,, but rather employing CH2MHILL would exacerbate the expense of construction for GSWC ratepayers.

For example, CH2MHILL adds at least 12% of the total cost of capital projects as its profit and an additional 10% is applied for CH2MHIll's contingencies. GSWC could save on these CH2MHILL profit and contingency charges, if GSWC relied on its employee and administrative resources. The issue is that GSWC has not proved its internal resources are so ineffective or inadequate as to justify hiring CH2MHILL as cost-effective and otherwise reasonable.

GSWC's claim that it has a shortage of qualified employees is also unsupported. For example, in D.06-01-025, the Commission held the following:

> The record shows that private engineering businesses assess overhead rates of about 15%. In fact, SCWC's own "overhead" rate in 1990 was only 12%, and that included its direct billings, as shown by the contract with the Department of Corrections for facilities to serve the prison discussed in detail below.
>
> The vendor rates differ substantially from SCWC's current rate because they include the vendor company's profit, as well as administration and management. SCWC's overhead rates do not include profit. This difference strongly suggests that SCWC's overhead expenses are high, a conclusion also supported by SCWC's 1990 rate, and giving credibility to customers' allegations of corporate "fat."

GSWC's past re-structuring also likely has contributed to the "corporate fat." Prior to 1994, GSWC's water operations were organized into 16 Districts and the Company's General Office housed most of the water quality and engineering staff. In 1994, GSWC consolidated the district operations into three large operating regions: Region I, Region II, and Region III, and decentralized its oversight for engineering and water quality needs and created the current organizational structure consisting of at least four layers: 1) General Office, 2) Regional Headquarters, 3) District Offices, and 4) Local CSAs.

Each layer has its own engineering and water quality staff, thus duplicating such functions throughout GSWC's three Regions. For example, each Regional Headquarter has the position of Engineering and Planning Manager, Water Quality Manager, a couple of Engineers, Senior Civil Engineers, and Engineer CAD Technicians. Similarly, each District Office has its own position of District Engineer, Water Quality Engineer, Engineering Technicians, Electrician, and Water Quality Technician. While each CSA has it own Operations Superintendent, Water Supply Operators, and Water Distribution Operators.

This decentralization in 1994 resulted in a temporary reduction of the number of staff in the Company's General Office. However, DRA finds that this reduction in the General Office was short-lived. With the exception of a brief reduction for a few years after 1994, the General Office staff has steadily risen. In 1994, there were 128 employees in Company's General Office. After the decentralization, the number was reduced to 87 in 1997. Since then, the number of employees in the General Office had increased to 102 in 2005. In the last General Office proceeding, A.06-02-023, GSWC requested the recovery of its payroll expense for a total of 139 employees. Approximately a 60% increase in General Office staffing since 1997. Thus GSWC currently not only has more employees in its General Office but has an equally elaborate staff in its regional offices since the decentralization. Nevertheless, GSWC continues to request for more positions in each subsequent GRC.

DRA would like to point out that among the newly added positions in its General Office, GSWC has a position of the Senior Vice President-Operations who is in part responsible for the Company's Infrastructure Replacement and Investment needs. GSWC also formed a new department, Operations Department in its General Office and hired a Capital Projects Manager. GSWC justified that the Capital Projects Manager is needed in order to bring organization and cohesiveness to its capital program that currently lacks central oversight.

The above stated facts belie GSWC's claim of staff shortage. Further, GSWC has failed to specifically and quantitatively prove that its present staff resources are unable or inadequate to meet its workloads. Ratepayers are already supporting elaborate teams of centralized General Office and decentralized Regional engineering staffs that in many respects appear duplicative in functionalities. Based on its Region II GRC, the combined salary for the staff from Engineering, Water Quality, and Operation Department performing water distribution and water supply functions of the company, is nearly $ 4 million. Hiring CH2MHILL to plan and construct plant projects unreasonably burdens the ratepayers, if GSWC has not or cannot justify such added expenses. GSWC failed to show that it's present staff resources are inadequate or incapable to carry out its capital projects without CH2MHILL

2- Bidding Process In Hiring CH2MHILL

The selection and hiring of CH2MHILL is improper and unfair to the ratepayers. Based upon the information provided by the company[11], DRA finds that the original Request For Proposals (RFP) was first issued in year 2004, for only a limited and specific purpose as described below:

[11] GSWC's response to DRA's Data Request AMX-32

> American States Water Company d.b.a. Southern California Water Company[12] within California is seeking a relationship with a first-rate engineering firm or firms for the purpose of 1) Performing planning and design, design-build, and construction management of a major portion of our 2005 water distribution projects; and, 2) Performing planning and design, design-build, and construction management of a major portion of our 2005 water supply projects.

The RFP was strictly for the purpose of completing portions of GSWC's 2005 capital projects. However, once hired, CH2MHILL has been retained and continued to perform capital projects beyond 2005 without further competitive bidding. In fact, GSWC's work papers reveal that CH2MHILL will perform capital projects scheduled for as far out as 2009 and there is no reason to believe that it won't go beyond that time.

GSWC appears to have disregarded its own competitive bidding policy for CH2MHILL. DRA finds no new RFPs were issued for the work beyond 2005, and the continued retention of CH2MHILL amounts to a "no-bid" contract. Further, GSWC also appears to have abandoned finding the least costly or the most cost-effective option. In the "Proposal Evaluation" section of the RFPs, GSWC assigned only a 10% weight for the "Fee Schedule" as a criterion for evaluating a bid, which gives de minimis ,weight to the overall cost estimate of the project.

3- Conflict Of Interest

CH2MHill plays an integral role in the development and construction of major plant projects CH2MHill also analyzes and prepares the Master Plan which is the roadmap for future construction projects. CH2MHill further designs and obtains permitting for the projects. GSWC has failed to show what cost

[12] Since then Company changed its d.b.a. to Golden State Water Company.

advantages result from GSWC supplanting its own engineering staff with CH2MHILL, from the planning to construction of capital projects.

For reasons discussed above, DRA finds GSWC's hiring of CH2MHILL improper, unreasonable, and unjustified. DRA recommends that the Commission remove the 12% profit factor along with its 10% contingencies from all projects involving CH2MHill.

F. Overhead Rate[13]

GSWC requests overhead rates of 21.75%, 26.81% and 33.14% for 2007, 2008, and 2009, respectively for its capital projects in Region I whereas DRA recommends 6.61%, 17.74%, and 20.82% for those same years.

DRA believes that when compared with other Class-A water companies, GSWC's overhead rates are unjustifiably high. For example, California Water Service Company has a constant overhead rate of approximately 8% year after year. GSWC's unreasonable overhead rates evidence duplicative or inefficient indirect/supervisory/support functioning in GSWC daily operations. Moreover, GSWC failed to show the calculation of the proposed overheads are reasonable and justified.

In D.06-01-025, the Commission noted a similar overhead issue

> The record shows that private engineering businesses assess overhead rates of about 15%. In fact, SCWC's own "overhead" rate in 1990 was only 12%, and that included its direct billings, as shown by the contract with the Department of Corrections for facilities to serve the prison discussed in detail below.
>
> The vendor rates differ substantially from SCWC's current rate because they include the vendor company's profit, as well as administration and management. SCWC's overhead rates do not include profit. This difference strongly suggests that SCWC's overhead expenses are high, a conclusion also

[13] DRA testimony concerning GSWC's Overhead Rate was prepared by Mehboob Aslam.

supported by SCWC's 1990 rate, and giving credibility to customers' allegations of corporate "fat".

GSWC's current accounting methodologies used to record and track these indirect costs appear to distort the amount of actual indirect costs in various operating regions of the company.

GSWC's O&M and A&G expenses are capitalized into two categories throughout the operational areas. They are capitalized directly to a specific capital project and become a part of the capital project itself. Or because these expenses are indirect and cannot be assigned to a specific capital project, they are booked into a company wide Overhead Pool Account. The amount of this Account is allocated to all capital projects through the use of Overhead Rate.

Currently, GSWC requests to book related capitalized expenses from various operational areas of its organization, which consists of Regions I, II, III, Bear Valley Electric Division (BVE), and General Office into its company-wide Overhead Pool Account. The Overhead Rate is then determined by dividing indirect cost booked in the Overhead Pool Account by the amount of proposed capital projects.

DRA has found that the capitalized amount in the Overhead Pool Account remains relatively constant over the years. For example, GSWC work papers show that the indirect expenses being booked into company-wide Overhead Pool Account for 2006 were $12,225,525. GSWC forecasts these expenses to be $12,898,918, $13,294,657, and $13,676,962 in 2007, 2008, and 2009 respectively. However, other Class-A water companies are not booking such enormous indirect costs. For example, on average, California Water Service Company, the largest regulated water company in the state, books its indirect costs at about $7,000,000 per year. Such striking difference between the two companies leads DRA to conclude that GSWC is trying to maximize the capitalization of its O&M and A&G costs in order to increase its revenue requirements with an unduly inflated rate base.

In addition, the practice of booking indirect costs into a company-wide Overhead Pool Account distorts amount of actual indirect costs incurred in one operating region of the company and the corresponding capital investment in the same region. This would result in assignment of inaccurate and possibly inflated indirect costs to the Region 1 capital projects that have little if any reasonable relation to level of construction in that Region. .

GSWC's calculation of overhead rates and expenses violated the Commission's Uniform System of Accounts for Water Utilities, which describes the application of Overhead Construction Costs as follows:

> **6. Overhead Construction Costs**
>
> A. All overheads construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others that the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amount of such overheads reasonably applicable thereto, *to the end that each job or unit shall bear its equitable proportion of such costs* and that the entire cost of the unit, both direct and overhead, shall be deducted from the utility plant account at the unit of property is retired.
>
> B. The instruction contained herein shall not be interpreted as permitting the addition to utility plant accounts of arbitrary percentages or amounts to cover assumed overhead costs, but as requiring the assignment to particular jobs and accounts of actual and reasonable overheads costs.
>
> C. The records supporting the entries for overheads construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each utility plant account, and the bases of distribution of such costs

By lumping all of its indirect costs into a single company-wide Overhead Pool Account, GSWC removes the possibility of assigning the indirect costs actually incurred in a specific operating region only to those capital projects in

that operating region. For example, GSWC includes indirect costs from its Electric Division, BVE into the company-wide Overhead Pool. As a result, regardless of the actual indirect costs booked for BVE, (i) ratepayers in Region I will bear some unspecified portion of BVE's and other Regions' indirect overhead costs; and (ii) the capital projects in Region I will likely be assigned a large part of the indirect costs based upon an arbitrary overhead percentage rate that does not reflect the actual level of capital projects in Region I.

If the indirect costs from Region I, were accounted for separately, they likely would be lower than that what GSWC proposes. A large capital project in Region I for example, would result in a lower overhead rate. However, by lumping indirect costs from all of the operating regions and BVE in a single company-wide Pool Account, GSWC is generating an Overhead Rate and an allocation of overhead expenses that does not reasonably correspond to the actual and specific indirect costs of Region I. This inflates the overhead rate in Region I, which results in unfair and unjustified rates.

Another major concern is that GSWC has historically not been able to zero-out its company-wide Overhead Pool Account. DRA believes that this situation has rendered this Overhead Pool Account a "bottom-less" pit where the relationship between indirect costs and capital projects in a particular operating region cease to exist. No matter how large or small an amount of capital project gets in a year, the indirect expenses from the subsequent years will be used to sustain a presubscribed arbitrary overhead rate.

For example, GSWC's work papers[14] indicate a year-end balance of negative $4,349,866 in 2004 in its Overhead Pool Account. Simply put, close to four and half million dollars were applied to capital projects in the name of indirect capitalized expenses that were not yet incurred. GSWC's records show that in the following year i.e. 2005, another load of $14,127,089 was being booked

[14] MS Excel File, Titled: Overhead-R1 V07 02-08-07 Update

into company-wide Overhead Pool Account. The year-end balance for 2005 was a positive $5,588,750. This surplus amount indicates that in 2005, more O&M and A&G expenses were booked into company-wide Overhead Pool Account than the amounts actually applied to capital projects as overhead.

In this application, GSWC's work papers indicate that it is trying to zero out its company-wide Overhead Pool Account at the end of year by charging the excess balance of the account to various capital projects throughout the company. DRA objects to this methodology and believes that the proper method of eliminating the excess amount is to return the capitalized expenses back to O&M and A&G areas where they can be properly expensed rather than being capitalized.

In addition, GSWC books its entire employee related insurances, health benefits, and vacation expenses into its General Office. GSWC then designates 21% of these expenses as capitalized expenses. GSWC also estimates that approximately 64% of these 21% expenses should be booked into the company-wide Overhead Pool Account as an indirect capitalized labor. Once again, the true costs are distorted by this practice.

For employees' pension, GSWC has historically booked the entire 21% of this expense as indirect capitalized expense into the company-wide Overhead Account. Upon DRA's objection in its last rate case proceedings, GSWC now books 64% of this 21% of employees' pension expenses as indirect capitalized labor. However, there is no need to pool employee related costs for insurance, health benefits, pension, and vacation into General Office. These costs should be directly assigned to each employee working in his or her operating region. By booking these costs in the company-wide Overhead Pool Account, the reasonable amount of overhead costs for capital projects in GSWC's specific operating regions is distorted.

In order to end the current abuse of overhead rate, DRA recommends the following steps:

GSWC must separate its specific capitalized costs at each operating region level so that only true and real costs are passed on to the related capital projects in each operating region. GSWC should track the capitalized expense which it books into the Company-wide Overhead Pool Account for each operating region separately. Thus,, there will be no company-wide Overhead Pool Account; instead each operating region will have its own Overhead Pool Account. This will give more control and added transparency to the entire process of measuring overhead rates for specific operating regions.

GSWC should bring its annual indirect capital expenses in-line with the other Class-A water utilities. In general, a smaller size company should have lower indirect capital expenses compare to a larger size company. This is not the case with GSWC. California Water Service Company with approximately 500,000 customers and serving 28 different districts is booking an amount of indirect capital costs that is half of GSWC's. But by comparison, GSWC serves far fewer customers in fewer districts than California Water Service Co.: GSWC has approximately 275,000 customers in 16 districts. A contributing factor could be GSWC's top-heavy organizational structure and the lack of oversight and accountability. In any case, GSWC has failed to prove the reasonableness and justification for its unreasonably high overhead cost methodology. For example, GSWC has failed to show that it cannot, manage the overhead costs at various operating region levels, and properly and directly track various overhead costs into the specific operating regions. GSWC has failed to justify its practice of "zeroing out" the company-wide Overhead Pool Account is reasonable and justified. First, GSWC has not explained the need to have a company-wide Overhead Pool Account which distorts the allocation of indirect costs to Region 1. Second, GSWC has failed to justify eliminating ("zero out") excess year-end balance in overhead accounts by assigning these amounts to capital projects in the subsequent future years. Alternatively, GSWC could transfer the excess balance back to the O&M and A&G expenses where they can be properly expensed. For the subsequent future years, GSWC will then have to estimate the indirect costs in such a manner so that there is no shortage or excess in overhead pools. GSWC has failed to

> show that any other alternatives were explored and the results thereof, before engaging in the present unreasonable method of eliminating the year-end balances in the overhead accounts.

For this proceeding, DRA recommends using the following methodology to calculate applicable overhead rate for GSWC's capital projects in Region I for 2007, 2008, and 2009:

Since the data regarding company-wide Overhead Pool Account in 2006 is the latest recorded data available, DRA begins its analysis from the beginning of 2006. GSWC records show that there is a positive balance of $5,588,750 in the company-wide Overhead Pool Account at the beginning of 2006, indicating an excess of expenses being drawn out of O&M and A&G for the purpose of capitalization in 2005. Similarly, 2006 year-end balance is a positive $1,019,917. Once again this balance indicates an excess during 2006. However, during the DRA's discovery, GSWC stated that the $1,019,917 was deliberately left in the company-wide Overhead Pool Account for the purpose of recalculation of its overhead rate per Commission's decision: D.06-11-020. DRA agrees that there is a need for such adjustment; however, DRA disagrees with the amount and recommends $72,152 instead (this is based on DRA's recommendations in the proceedings i.e. D.06-11-020). Therefore, there is a total of $5,660,902[15] in excess in 2006.

In addition, GSWC work papers[16] show that for 2006 it allocated an additional $4,835,138 in order to "zero out" the company-wide Overhead Pool in 2006. It should also be noted that in GSWC's work papers[17] the adjustment for the purpose of clearing company-wide Overhead Pool Account is listed as

[15] $5,588,750 + $72,152

[16] GSWC response to DRA's Data Request AMX-59, And GSWC's Work papers: MS Excel File, Overhead –R1 V07 02-08-07 Update

[17] GSWC response to DRA's Data Request AMX-59, And GSWC's Work papers: MS Excel File,
(continued on next page)

$9,661,219 instead of $4,835,138. Upon DRA's inquiry, GSWC's staff failed to present any plausible reason for this discrepancy and insisted that the adjustment amount for zeroing-out its company-wide Overhead Pool Account was $4,835,138. Nevertheless, DRA chose to proceed with its analysis by accepting the value of $4,835,138.

As discussed earlier, DRA disagrees with the methodology employed by GSWC for the purpose of clearing its company-wide Overhead Pool Account, and instead believes that the excess monies should be transferred back to O&M and A&G expenses. Therefore, the total excess amount in 2006 is then adds up to $10,496,040.[18]

DRA's objective is to determine a reasonable overhead rate for GSWC's capital projects in Region I. Since the indirect costs from various operating regions are being booked in a company-wide Overhead Pool Account, DRA needs to know how much of these costs can be attributed to Region I and General Office. Upon DRA's request[19], GSWC provided a breakdown of these costs among its operating regions: General Office, Region I, Region II, Region III, and its Bear Valley Electric. GSWC's data shows that in 2006 it booked a total of $12,257,441 indirect costs into the company-wide Overhead Pool Account, of which $4,072,759 and $2,301,517 were contribution from General Office and Region I, respectively. These amounts translate into allocation rates of 33.22% and 18.78% for General Office and Region I, respectively.

Using these rates, DRA then calculates $585,258 and $330,729 as the indirect expenses for General Office and Region I which should be booked into the company-wide Overhead Pool Account to offset a portion of the excess amount of $10,490,040. In addition, using GSWC's historical allocation rate of

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[18] $5,660,902 + $4,835,138

16.62% for its General Office Expenses to Region I, DRA calculates $97,270[20] as the indirect expenses contributed from General Office to Region-I. This means that $427,999[21] of indirect cost should be contributed from Region-I into the company-wide Overhead Pool Account during 2006. By using appropriate escalation factors, DRA then derives $438,699, $449,052, and $459,021, as the indirect costs in Region I respectively for 2007, 2008, and 2009.

The overhead rates were then calculated by dividing above listed respective indirect costs by the recommended budget in a particular year.

In the end, it should also be noted that DRA's recommended overhead rates are defined by the specific capital budget and the specific amount of capitalized expense that are recommended by DRA for each year. Therefore, if the Commission adopts any other amounts these rates will have to be recalculated accordingly. In addition, as discussed earlier, DRA specifically recommends that the amount of capitalized expenses for the purpose of overhead rates should not exceed more than $438,699, $449,052, and $459,021 in the year 2007, 2008, and 2009 respectively, regardless of the amount of capital budget in these years.

G. Capital Budget Contingency Rate

GSWC requested a contingency rate of 10% of its Capital Budget for both stand-alone capital projects and Blanket Projects. According to GSWC,[22] the contingency budget is used for unexpected capital expenditures or to fund cost overruns on known projects. These claims do not justify the 10% contingency rate as reasonable and justified. GSWC has failed to show that it considered other available alternatives and found them to be less cost effective or unfeasible. For

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[19] DRA's data Request AMX-03

[20] $585,258 * 16.62%

[21] $97,270 + $330,729

[22] Ernest Gisler's testimony, page -64

example, firstly, GSWC has not shown that it has an effective preventive maintenance plan in place. Secondly, it has not demonstrated that the whatever preventive maintenance efforts it has in place are insufficient to the extent that it is cost effective to have a contingency budget to deal with the emergency breakdowns.

Similarly, GSWC has not demonstrated any measures have been used to reduce its cost overruns. These overruns most likely result from inaccurate cost estimations and project management. However, instead of presenting a history of improving its project management and cost estimation procedures and processes, GSWC wants to heap on ratepayers the rate burdens for its inefficiencies or lack of management. Cost overruns directly increase the rate base and the revenue requirement leading to higher rates for water service. In addition, unlike the increase in O&M and A&G expenses, GSWC earns a rate of return on the rate base. Therefore, the Commission should closely scrutinize cost overruns and their justification.

In this case, DRA recommends that the Commission reject GSWC's 10% contingency as unsupported by the record and therefore unreasonable and unjustified. The Commission has found that in a prior GRC, GSWC's contingency request was not supported. In D. 06-01-025, the Commission held:

> SCWC included a 10% adder in its capital budgets for "contingency." ORA opposed adding this amount because SCWC had not provided ORA with sufficient justification.
>
> In rebuttal, SCWC explained that the contingency budget is used where actual costs exceed budgeted costs for a capital project. On cross-examination, SCWC's witness explained that in addition to cost overruns, the contingency budget is used for unanticipated projects. SCWC also stated that in 2004, actual capital expenditures were $29.1 million, while the budgeted amount was only $20.7 million, including the contingency budget. SCWC pointed out that this

> line item had been in its capital budgets for at least 20 years.
>
> The record in this proceeding shows that SCWC often overruns its budget for a capital project. As one example, the actual costs for the Calipatria Niland Upgrade project increased by 7% from the time SCWC filed its application to the filing of rebuttal testimony. SCWC also appears to have a practice of hiring vendors on a time and materials basis. Accurate budgeting and cost containment are critical management functions that require additional attention from SCWC management. We are concerned that the contingency budget may play a role in "cushioning" SCWC from the consequences of insufficient attention.
>
> We are also aware that unanticipated capital projects may require immediate attention. The record, however, shows no historical analysis of SCWC's contingency budget expenditures on unanticipated projects. Such an analysis could be readily prepared because the general work order approval forms included in Exhibit 29 disclose when a project is funded by the contingency budget. SCWC did not do such an analysis, even after ORA recommended a disallowance. SCWC has provided us no breakdown between budget overruns and unanticipated projects that have used this fund in the past, so we will simply assume it was divided evenly between the two uses.
>
> We will allow SCWC to include a contingency budget for unanticipated projects in test years 2006 and 2007[footnote omitted]. We will set SCWC's contingency budget based on unanticipated projects only, which we will assume to be 5% of the total capital budget. Our objective is to do away with the cushion for poor budgeting. Therefore, we will allow SCWC to include in its 2006 and 2007 capital budgets a contingency adder equal to 5% of the total approved capital budget.

In this proceeding, GSWC continues its practice of failing to justify its contingency rate. The Commission's concerns of GSWC installing a "cushion for poor budgeting" remain valid today as they were at the time of D. 06-01-025.

Based upon the fact and findings discussed above, DRA recommends allowing a contingency rate of 5%.

Table 4-5

PLANT IN SERVICE
Test Year 2008 and Escalation year 2009

Item	DRA EY 2007 (A)	Utility EY 2007 (B)	DRA TY 2008 (C)	Utility TY 2008 (D)	DRA TY 2009 (E)	Utility TY 2009 (F)
	(Dollars in Thousands)					
Plant in Service-BOY	23,959.8	23,959.8	25,126.1	25,498.4	26,075.7	26,740.9
Additions:						
Utility Funded	842.3	1,228.8	885.5	1,189.5	638.0	1,187.0
Advances	52.1	52.1	52.1	52.1	26.0	26.0
Contributions	47.9	47.9	47.9	47.9	24.0	24.0
CWIP	268.1	268.1		0.0		0.0
Gross Additions	1,210.4	1,596.9	985.5	1,289.5	688.0	1,237.0
Less:						
Retirements	-44.1	-58.2	-35.9	-47.0	-25.1	-28.6
Transfer & Adjustment						
Plant-in-Service (EOY)	25,126.1	25,498.4	26,075.7	26,740.9	26,738.6	27,949.3
Weighting Factor	50%	50%	50%	50%	50%	50%
Wtd. Avg. Plant in Service	24,543.0	24,729.1	25,600.9	26,119.7	26,407.2	27,345.1

CHAPTER 5: DEPRECIATION AND AMORTIZATION

A. Introduction

This Chapter presents DRA's analysis and recommendation regarding depreciation expenses. The following table shows the weighted average of accumulated depreciation and amortization for Test Years 2008 and 2009.

B. Summary of Recommendations

Differences in DRA's and GSWC's estimates are due to differences between GSWC's requested plant additions and DRA recommended plant additions for the Test Years. These differences are discussed in Chapter 4 on Utility Plant Additions.

GSWC requests depreciation of $8,609,400 in Test Year 2008 and $9,463,600 in Test Year 2009. DRA recommends $8,622,600 in Test Year 2008 and $9,466,200 in Test Year 2009.

C. Discussion

According to GSWC's witness Jenny Darney-Lane, GSWC no longer tracks the cost of small tools through a clearing account that was then applied as an "overhead" to labor costs. Pursuant to a settlement with DRA in A.06-02-023, GSWC agreed that starting in 2007, GSWC would expense the cost of small tools. Therefore, GSWC will no longer book depreciation for small tools to the small tools clearing account and will include the amount as part of the depreciation expense. GSWC has also provided a depreciation study specific to the administrative offices.

DRA has reviewed the company's analysis and accepts GSWC's methodology to arrive at the accumulated depreciation and amortization accrual for Region I. The following table reflects GSWC's estimated Depreciation and DRA's recommendation.

Table 5-1

ACCUMULATED DEPRECIATION AND EXPENSE
Test Year 2008 and Escalation year 2009

Item	DRA EY 2007 (A)	Utility (B)	DRA TY 2008 (C)	Utility (D)	DRA TY 2009 (E)	Utility (F)
		(Dollars in Thousands)				
Accum. Depreciation (BOY)	7,438.3	7,438.3	8,211.7	8,197.6	9,033.5	9,021.2
Accruals During Year:						
Clearing Account	34.0	34.0	34.0	34.0	34.0	34.0
Contributions	87.3	87.3	88.9	88.9	90.6	90.6
Depreciaton Expense	696.2	696.2	734.8	747.7	765.9	788.9
Total Accruals	817.5	817.5	857.7	870.6	890.5	913.5
Less:						
Net Retirements	-44.1	-58.2	-35.9	-47.0	-25.1	-28.6
Adjustments	0.0	0.0		0.0		0.0
Accum. Depreciation (EOY)	8,211.7	8,197.6	9,033.5	9,021.2	9,898.9	9,906.0
Weighting Factor	50%	50%	50%	50%	50%	50%
Avg. Accumulated Deprec.	7,825.0	7,818.0	8,622.6	8,609.4	9,466.2	9,463.6

CHAPTER 6: RATE BASE

A. Introduction

This Chapter presents DRA's analysis and recommendation on rate base. The following table compares DRA and GSWC's estimates of rate base for Test Years 2008 and 2009.

B. Summary of Recommendations

GSWC requests rate base of $11,658,600 for Test Year 2008 and $12,066,900 for Test Year 2009. DRA recommends $11,038,700 for Test Year 2008 and $11,036,500 for Test Year 2009. Differences in rate base are due to differences in plant additions, and Common Utility Allocation. Differences in plant additions were previously discussed in Chapter 4.

C. Discussion

1. Common Utility Allocation

Common Utility Allocation is the allocation of Company's General Office weighted average rate base to each of the Customer Service Areas of the Region I. The amount also includes the rate base allocations from the Region I Headquarters and Northern/Coastal District Office. For the discussion regarding the Region I Headquarters, and Northern/Coastal District Office, please refer to the DRA report on "Region I Administrative Offices and Low Income Ratepayers Assistance Program".

For its General Office, the Company requested the amount of $215,300, $248,800, and $282,300 in year 2007, 2008, and 2009 respectively whereas DRA recommends $151,800, $140,200 and $141,800.

The Company's previous General Rate Application (GRC), A.06-02-023 included its General Office's operations. The Commission's decision is still pending regarding these proceedings. However, the Company's weighted average rate base allocations from its General Office to the Region I's Customer Service Areas, are based on the stipulated rate base, and assume that all contested issues

are resolved in the Company's favor. The difference is due to the fact that DRA's recommended allocations are based on the stipulated amount and the assumption that all contested issues presented in A.02-02-023 are resolved in DRA's favor.

2. Working Cash

GSWC's estimate of Working Cash for Test Years 2008 and 2009 is negative $39,900. DRA performed its own independent analysis of working cash requirement and lead/lag days. In determining working cash, DRA followed the guidelines set by Standard Practice U-16-W in determining the expense lag days. DRA arrived at a similar result as GSWC. Therefore DRA accepts the company's estimate of negative $39,900.

CONSTRUCTION WORK IN PROGRESS (CWIP)

Although DRA does not recommend a different recorded or forecasted CWIP at this time, GSWC's approach to the CWIP amount is in need of Commission review and oversight. The CWIP account is traditionally used to track capital projects that are in progress but not yet completed. The Commission allows water utilities to earn a rate of return on the CWIP dollars. The rationale for this is that typically water utilities' capital projects are comparatively simple and are therefore expected to be completed within one year and placed into service as used and useful. For the most part, this process has worked for most Class A water companies.

However, this is not the case with GSWC; DRA has observed in this rate case and prior rate cases that many of the GSWC's projects are not completed in one year and therefore, remain in the CWIP account for more than a year and some cases several years. This practice potentially turns the Company's CWIP account into a "gold mine" because the Commission allows CWIP to earn a rate of return. When projects remain in CWIP year after year, rates are developed based upon many of the same projects over and over again prior to projects becoming used and useful. In some cases, by the time projects are completed the cost to complete the project has increased well beyond the approved or authorized budget.

Because of the potential impact on rates to rate payers caused by projects remaining in CWIP beyond one year, a thorough examination is required to examine which projects are included in CWIP that have carried over from prior rate cases, why the projects were not completed within the expected timeframe, whether funds were deferred from authorized projects to other projects and whether those other "non-authorized" projects were reasonable.

In Bay Point CSA, there were over 40 projects in the CWIP account. General Work Orders for these projects were issued from 2001 through 2006. Although several of the older work orders were for projects that were funded in whole or in part via CIAC or by advances, there remained several company funded projects which were also more than 1 or 2 years old that were just completed in 2006 or will not be completed until some time in 2007.

Due to time constraints, DRA's analyst reviewing the Bay Point CSA did not perform the type of detailed analysis required to fully understand why GSWC tends to prolong projects in the CWIP account or to identify which projects should be disallowed due to age in CWIP. However DRA recommends that the Commission give serious consideration into whether it is proper to continue allowing GSWC to continue using CWIP for projects that can not or will not be completed within a years' time. Under the existing parameters, GSWC is able to book any and all projects into CWIP and there is little oversight into the reasonableness of many of the projects and almost no control over increasing costs for delayed projects. Therefore, DRA recommends that projects which GSWC can not complete within one year be allowed to earn Allowance for Funds Used during Construction (AFUDC) which will allow the company to only earn interest while the project is pending completion without earning rate of return. DRA also recommends that the Commission perform a detailed audit in GSWC's CWIP and its accounting practices.

In this rate case, GSWC requests forecasted CWIP costs in the amount of $268,100 in 2007, to complete pending projects included in the CWIP account.

These projects were initiated prior to the close of 2006 but have not been completed. In the Bay Point CSA, projects included in CWIP range from routine operation maintenance projects such as fire hydrant replacement to more specific projects to replace major distribution mains.

DRA has reviewed the projects included in the forecasted CWIP and recommends funding of $268,100 to complete projects pending completion in 2007.

The following table reflects weighted average rate base as requested by GSWC and recommended by DRA.

Table 6-1

WEIGHTED AVERAGE DEPRECIATED RATEBASE

Item	DRA EY 2007 (A)	Utility (B)	DRA TY 2008 (C)	Utility (D)	DRA TY 2009 (E)	Utility (F)
			(Dollars in Thousands)			
Wt. Avg. Plant in Service	24,542.9	24,729.1	25,600.8	26,119.7	26,407.1	27,345.1
Utility Plant Under Construction	121.6	121.6	0.0	0.0	0.0	0.0
Acquisition Adjustment	747.0	747.0	747.0	747.0	747.0	747.0
Total Utility Plant	25,411.5	25,597.7	26,347.8	26,866.7	27,154.1	28,092.1
Depreciation Reserve	-7,825.0	-7,818.0	-8,622.6	-8,609.4	-9,466.2	-9,463.6
Net Utility Plant	17,586.5	17,779.7	17,725.2	18,257.3	17,687.9	18,628.5
Materials and Supplies	2.1	2.1	2.1	2.1	2.1	2.1
Advances	-3,235.1	-3,235.1	-3,208.1	-3,208.1	-3,168.8	-3,168.8
Contributions	-2,097.4	-2,097.4	-2,057.2	-2,057.2	-2,003.4	-2,003.4
Rate Base Before Adjustment	12,256.1	12,449.4	12,462.0	12,994.1	12,517.8	13,458.4
Deferred F.I.T. Items	-1,619.7	-1,633.7	-1,669.9	-1,708.9	-1,701.2	-1,771.7
Deferred Revenues	-36.6	-36.6	-36.6	-36.6	-36.6	-36.6
Invest. In Other Water Co.		0.0		0.0		0.0
Deferred Rate Case Expense		0.0		0.0		0.0
Allowance for Working Cash	-39.9	-39.9	-39.9	-39.9	-39.9	-39.9
Common Utility Allocation	369.2	439.8	323.2	450.0	296.6	456.7
Weighted Average Rate Base	10,929.1	11,179.0	11,038.8	11,658.6	11,036.7	12,066.9

CHAPTER 7: TAXES

A. Introduction

This Chapter sets forth the analysis and recommendations of DRA regarding taxes other than income and income taxes. Tables 7-1 and 7-2 show DRA's and GSWC's estimates of taxes other than income and income taxes for Test Year 2008.

B. Summary of Recommendation

DRA estimates higher income taxes for both State and Federal Income Taxes as shown in Tables 7-1. The difference between GSWC's and DRA's estimates is due to different estimates in revenue requirement, expenses, rate base and other tax issues.

C. Discussion

1. Ad Valorem Tax (Property Tax)

DRA recommends $95,500 for ad valorem taxes for Test Year 2008. GSWC requested $101,000 for ad valorem taxes. The amount of $5,500 differs from GSWC's due to DRA's different plant estimates, discussed in Chapter 5 of this report.

2. Payroll Taxes

Payroll taxes include Social Security tax, Federal Insurance Contribution Act (FICA) tax consisting of Old Age Benefits and Medicare, Federal Unemployment Tax Assessment (FUTA), and State Unemployment Tax Assessment (SUTA).

DRA recommends $33,900 for payroll taxes for Test Year 2008. GSWC requested $34,000 for payroll taxes. The amount of $100 differs from GSWC's due to DRA's lower estimate of payroll expenses.

3. Local Taxes

DRA recommends $68,900 for local taxes for Test Year 2008. GSWC requested $75,500 for local taxes. The amount of $6,600 differs from GSWC's due to different forecast of revenue.

4. Tax Depreciation

DRA calculated tax depreciation for state and federal income tax purposes by applying the ratio of DRA's estimate of net plant to GSWC's estimate of net plant to GSWC's tax depreciation estimate.

5. Interest Deduction

To calculate the interest deduction, DRA used its recommended rate base, discussed by DRA's plant witness, multiplied by DRA's recommended weighted cost of debt.

6. Income Taxes

The differences in income taxes estimated for Test Year 2008 between DRA and GSWC are due to the differences in revenues, expenses, and rate base.

D. Conclusion

As per discussion above, DRA recommends the Commission to adopt its estimates for Taxes Other Than Income and Income Taxes for Test Year 2008.

Table 7-1		
GOLDEN STATE WATER COMPANY		
Region I- Bay Point		
TAXES OTHER THAN INCOME (2008)		
	@ Proposed Rates	
	2008	
	DRA	Utility
Item	Analysis	Estimated
	(A)	(B)
Ad Valorem Tax (0.38%)	95.5	101.0
Payroll Taxes (8.1%)	33.9	34.0
Local Franchise Tax (0.306%)	68.9	68.8
Total Taxes other than income	198.3	203.8

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TABLE 7-2

GOLDEN STATE WATER COMPANY

Region I- Bay Point

Income Tax

2008

Item	ORA Present Rates	Utility Present Rates	ORA Recommended Rates	Utility Recommended Rates
	(A)	(B)	(E)	(F)
	(Dollars in Thousands)			
Operating Revenues:	5,747.0	5,747.0	5,760.0	6,303.3
Expenses:				
Oper. & Maint. & A&G	4,178.7	4,469.6	4,178.7	4,471.2
Taxes Other than Income	198.3	203.7	198.3	210.4
Depreciation & Amortization				
Book Depreciation- District	(734.3)	(747.7)	(734.3)	(747.7)
Book Depreciation- G.O.	(15.0)	(26.4)	(15.0)	(26.4)
Interest	400.7	422.0	400.7	422.0
Expense Before Taxes	4,028.4	4,321.2	4,028.4	4,329.5
CCFT				
Tax Depreciation- State	(893.6)	(909.2)	(893.6)	(909.2)
Other Schedule M Items	23.5	30.0	23.5	30.0
State Taxable Income	848.4	546.5	861.4	1,094.5
CCFT (8.84%)	75.0	48.3	76.1	96.8
FIT				
Excess Tax Depreciation	36.9	36.9	36.9	36.9
Book Depreciation- District	(734.3)	(747.7)	(734.3)	(747.7)
Book Depreciation- G.O.	(15.0)	(26.4)	(15.0)	(26.4)
State Tax	(89.3)	(48.3)	(89.3)	(48.3)
Other Scheduled M Items	19.2	24.9	19.2	24.9
Def. Rev. Amort.- Contrib.	9.2	9.2	151.4	9.2
Federal Taxable Income	945.2	674.3	958.2	1,222.3
FIT (35%)	330.8	236.0	335.4	427.8

CHAPTER 8: RATE DESIGN

A. Introduction

This Chapter provides DRA's comments regarding GSWC's water quality and customer service in the Arden Cordova CSA.

B. Summary of Recommendations

DRA reviewed various water quality documents provided by GSWC and contacted DHS for information relating to the compliance history of the Bay Point Water System and found that these water systems have been in compliance with the drinking water standards during 2004 to 2006. DRA also learned through the Public Advisor's office that GSWC has generally been providing satisfactorily service to the Bay Point customers.

C. Discussion

1. Water Quality

DRA performed a review of GSWC's water supply and quality documents. DRA also contacted DHS to obtain the compliance history of GSWC's water systems from 2004 to 2006 in Bay Point service territory. As informed by DHS, the Bay Point water systems generally were in compliance with the drinking water standards between 2004 and 2006. The Bay Point system had exceeded bacteriological concentrations once during the three year period. The excess was a one-time problem which did not pose a re-curing problem for these plants.

The last DHS inspection was in 2003. The next inspection by DHS will occur in 2007. Bay Point has one event of bacteriological violation in March 2005. There has been no other citation or notice of violations since March 2005. Overall, the plant is in compliance.

2. Customer Complaints

DRA, through the Commission Public Advisor's Office, has received no protest to the proposed increase in rates and addressing various related cost issues such as memorandum accounts, service, compensation, water quality, and

management of the water system. The Consumer Affairs Branch has received four informal complaints involving rates, billing, installation, service for the period January 1, 2004 through December 31, 2006. There were no formal complaints filed against GSWC during this period.

CHAPTER 9: POLICY ISSUES

This chapter sets forth the analysis of DRA on the rate design. GSWC currently provides water service to its customers under the following tariffs:

Schedule No. BY-1,	GENERAL METERED SERVICE
Schedule No. 4,	PRIVATE FIRE SERVICE
Schedule No. UF,	SURCHARGE TO FUND PUBLIC UTILITIES COMMISSION REIMBURSEMENT FEE

GSWC's rate design is consistent with the method set forth in D.86-05-064. Approximately 50% of fixed costs are recovered through the service charge, and the remaining costs are recovered through a single block commodity rate.

The Commission has issued Order Instituting Investigation I.07-01-022 regarding conservation rate designs. At this time, the Commission should continue to apply the current rate design methodology until the Commission issues its final decision on the conservation rates for GSWC.

CHAPTER 10: ESCALATION YEARS

Table 10-1 below shows the Summaries of Earnings for Escalation Years 1 and 2. To obtain the increases in these years, D.04-06-018 requires water utilities to file an Advice Letter 45 days prior to the start of the year showing all calculations supporting their requested increases.

The revenues shown in the table are for illustration purposes and the actual increases would be authorized only after approval of the utility's escalation year advice letters for 2009 and 2010.

APPENDIX A: ESCALATION FACTORS

State of California — Public Utilities Commission
San Francisco

M E M O R A N D U M

Date : February 28, 2007

To : D. Sanchez, Program Manager, DRA;
K. Coughlan, Director, Water Division

From : Martin G. Lyons, Program Supervisor,
DRA Energy Cost of Service Branch

File No. : S-2559

Subject: DRA February 2007 Summary of Compensation per Hour

The following data are provided to Commission water utilities staff to enable them to utilize DRA's composite non-labor escalation methodology. The numbers are to be used in conjunction with the non-labor factors provided in DRA's monthly escalation memorandum to bring historic dollars to base year dollars and to inflate recorded dollars to test year levels. More specifically, the annual change in Compensation per Hour is applicable to contracted services, while the non-labor factor is related to material and supply purchases. In accordance with a 1991 agreement between the CPUC Water Division and the California Water Association (CWA), the monthly non-labor rate is to be weighted by 60 percent and the Compensation per Hour Index weighted 40 percent. If you have any questions regarding the application of these factors, please contact me.

COMPENSATION PER HOUR

Annual Rate of Change
Non-farm Business Sector, Seasonally Adjusted

Year	Annual Change
1997	3.6%
1998	5.3%
1999	4.4%
2000	6.9%
2001	2.7%
2002	2.8%
2003	4.0%
2004	4.5%
2005	4.4%
2006	5.4%
2007	3.7%
2008	3.5%
2009	3.9%
2010	4.1%
2011	4.2%

Source: Global Insight February 2007 U.S. Economic Outlook

State of California Public Utilities Commission
San Francisco

M E M O R A N D U M

Date : February 28, 2007

To : Division of Ratepayer Advocates and Water Division

From : M. G. Lyons, Program Supervisor
DRA Energy Cost of Service Branch

File No.: S-2559

Subject: Division of Ratepayer Advocates: Estimates of Non-labor and Wage Escalation Rates for 2007 through 2011 from the February 2007 Global Insight U.S. Economic Outlook

The purpose of the monthly Escalation Memorandum is to inform division management of the trends in the general price level of utility non-labor expenses and wage contracts. Data are provided for 12 years, which include seven historic years, the estimated current year, and four forecasted years.

The following table summarizes the major changes in forecasted labor and non-labor inflation for years 2007 through 2011. Data for 2006 are provided as benchmarks. The factors for January 2007 are presented for comparison. Near-term lagged CPI is expected to run over 3% due to petroleum price increases and fall to the 2% range by 2008. Non-labor inflation for 2007-11 is effectively checked by continued structural changes in the economy such as globalization and improved operating efficiencies. Global Insight's forecast of rising non-labor rates for 2006 is the result of temporary price increases in petroleum, chemicals/allied products, metals/metal products, and machinery. Labor escalation continues to be constrained by changes in the labor market due to corporate structural change, outsourcing, and high labor productivity.

FORECASTED INFLATION

	Labor		Non-labor	
	01/07	02/07	01/07	02/07
2006	3.4%	3.4%	5.5%	5.5%
2007	3.2%	3.2%	2.1%	1.7%
2008	1.8%	1.5%	1.3%	1.6%
2009	2.1%	2.3%	0.8%	1.1%
2010	1.9%	2.1%	0.5%	0.7%
2011	1.9%	1.9%	0.5%	0.7%
Compounded	15.2%	15.3%	11.1%	11.8%

A more extensive explanation of the derivation and use of the above factors and a complete presentation of the escalation factors from 2000 through 2011 are provided in the attached appendix.

The recommended NON-LABOR ESCALATION RATES for 2007 through 2011 are presented in Table A. The values for 2000 through 2006 are provided for comparison.

TABLE A

Year	Non-Labor Inflation Rate*
2000	3.5%
2001	0.0%
2002	0.0%
2003	2.5%
2004	5.8%
2005	5.5%
2006	5.5%
2007	1.7%
2008	1.6%
2009	1.1%
2010	0.7%
2011	0.7%

* Revised 07/17/97 based on 1995 re-weighted purchases. [Source: BLS, Supplement to Producer Price Indexes, 1995, Table 12]

These escalation rates represent the calendar year average, or alternatively stated, the 12-month-ended spot rate at mid-year. These price factors have not been adjusted for real growth of expensed materials and services. The escalation factors are generated from a composite index of 10 Wholesale Price Indexes (WPI) for materials and supplies expenses and the CPI-U weighted 5% for services and consumer-related items. **These non-labor rates are not applicable to plant, contracted services, loans, insurance, rents, and pensions and other utility employee benefits. Escalation of these expenses is addressed on pages 10-15 of D.04-06-018/R.03-09-005 (Water Rate Case Plan).**

The WAGE ESCALATION RATES in Table B are based on recorded utility labor settlements for 2000 through 2006 and Global Insight projections of the U.S. CPI for All Urban Consumers (CPI-U) for 2007 through 2011.

TABLE B

Year	Wage Increases 1/ 2/
2000	3.00%/3.50%/3.00%- PG&E/SCE/SoCal
2001	3.00%/3.50%/3.00%- PG&E/SCE/SoCal
2002	3.00%/3.50%/3.00%- PG&E/SCE/SoCal
2003	4.00%/3.25%/3.00%- PG&E/SCE/SoCal
2004	4.00%/3.50%/3.50%- PG&E/SCE/SoCal
2005	4.00%/3.50% /3.50%- PG&E/SCE/SoCal
2006	3.75%/3.75%/3.50%- PG&E/SCE/SoCal
2007	3.2% -CPI 3/
2008	1.5% -CPI 3/
2009	2.3% -CPI 3/
2010	2.1% -CPI 3/
2011	1.9% -CPI 3/

1/ Wage increases are not adjusted for changes in hours worked or the number of employees. The labor requirement is a separate issue related to the calculation of total payroll.

2/ If the proposed increase is reasonable, witnesses should use the particular utility's actual settlement on the date it becomes effective. The above recorded wage increases are for benchmark purposes only.

3/ CPI-U lagged one year to be consistent with union contracts.

The generally accepted method in labor contracts is to peg a wage increase to the rate of increase in the CPI-U for the previous year. Consequently, these wage escalation rates are based on the previous year's CPI escalation. If the utility is using an index other than

U.S. CPI-U, please contact me for directions. The witnesses should familiarize themselves with the actual wage contracts for 2000 through 2011 to ascertain the correct wage formulas, reasonableness, and the effective date of increase for the particular proceeding. The annualized wage increase should reflect the percentage changes in wages weighted by the number of months individual wage rates were in effect.

Other non-labor and labor indices may be used if a witness has more specific knowledge of any particular account. Those individuals who plan to use their own inflation factors are expressly requested to contact me for approval and direction. These forecasts are updated monthly. Please call me if you have any questions relating to these projections.

cc: M. Pocta D. Sanchez F. Curry
M. Enderby K. Coughlan

APPENDIX B**: QUALIFICATIONS AND PREPARED TESTIMONY**

Victor Chan, P.E.

- Senior Utilities Engineer
- Registered Professional Engineer in California
- Employed by the P.U.C. since 1996
- Employed in DRA Water Branch since 2004
- Sponsoring Sections:
    - Chapter 1 (Summary of Earnings)
    - Chapter 9 (Policy Issues)
    - Chapter 10 (Escalation Years)

Eric Matsuoka, PURA III

- Public Utilities Regulatory Analyst
- Employed by the P.U.C. since 1974
- Employed in DRA Water Branch since 1998
- Sponsoring Sections:
    - Chapter 3 (Expenses, O&M, A&G)
    - Chapter 7 (Taxes)

Patricia Esule, PURA IV

- Public Regulatory Analyst
- Employed by the P.U.C. since 1989
- Employed in DRA Water Branch since 2002
- Sponsoring Sections:
    - Chapter 4 (Plant in Service)
    - Chapter 5 (Depreciation and Amortization Expenses)
    - Chapter 6 (Ratebase)

Victor Moon, UE

- Utilities Engineer
- Registered Professional Engineer in California
- Employed by the P.U.C. since 1977
- Employed in DRA/Water Branch since 1984
- Sponsoring Sections:
    - Chapter 2 (Customer, Consumption, Operating Revenue)
    - Chapter 8 (Rate design)