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adjustment reduces CalAm's LSC-allocated and Cal Corp-charged expense by \$261,125 in 2008 and by \$270,513 in 2009 (in both cases based on CalAm's requested LSC allocation factors).

Regulatory Background - Incentive compensation was not included in revenue requirements in the prior two General Office rate filings. The most recent General Office rate case decision (D.06-11-050) states that in reaching a settlement with DRA, CalAm agreed to remove incentive compensation from its rate request.⁹ In the 2003 Monterey rate case decision (which also addressed General Office expenses), the Commission denied CalAm's request for recovery of forecasted incentive compensation, noting that the requested amounts were "only estimates," and that CalAm had paid substantially less incentive pay than it had budgeted in two of three historical periods it cited.¹⁰

In its direct testimony, CalAm references the Commission's 2003 finding that CalAm's actual incentive compensation payout was substantially less than had been budgeted. CalAm's witness Buls states that "under the present mechanism, the forecasted AIP payouts should much more closely track actual payouts."¹¹ However, Overland found that in 2007 only 35 of approximately 700 NSC management employees received any incentive plan payments, and not all of these employees received 100% of their potential payout.¹² For the NSC, actual 2007 payments were about 12% the amount budgeted for the NSC in 2008. For the LSC, 2007 actual incentive plan payments were approximately 63% of the 2008 budget, and for Cal Corp 2007 actual payments were approximately 56% of the 2008 budgeted amount.

Background on AW's Annual Incentive Plan - We requested AW's Annual Incentive Plan (AIP) documents in data requests OC-16 and OC-182. CalAm sent us 2007 (and later 2008) plan documents applicable to lower and middle management employees (those from salary bands 14 through band 5). These employees are eligible for incentive pay of between _____, of their base salaries. Business unit budgets provided in response to OC-91 show that 2008 budgeted incentive compensation also includes compensation for employees in salary bands ML4, 3 and 2 (Vice President and above). These employees are eligible for incentive compensation of up to _____ of their base salaries. CalAm did not provide AIP documents applicable to these higher-level employees. Because the documents were not provided, Overland did not evaluate the basis for incentive compensation for these employees.

⁹ Decision 06-11-050, p.30.

¹⁰ Decision 03-02-030, General Office - Salaries, p.24.

¹¹ Direct testimony of Christopher Buls, p.26.

¹² Response to data request OC-194, attachment OC-194.xls.

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reflects incentive compensation for more than 700 NSC employees. Overland’s recommended General Office incentive compensation is summarized below.

Table 2-3 California American Water CalAm General Office Revenue Requirements Overland-Recommended Test Year General Office Employee Incentive Compensation									
Ln	Item	NSC		LSC		CalCorp		Total	
		2008	2009	2008	2009	2008	2009	2008	2009
1	2007 Actual Incentive Pay - Employees in Management Salary Bands 5-14	275,862	275,862	385,121	385,121	257,810	257,810	918,793	918,793
2	Labor Inflation	1.04	1.04	1.04	1.08	1.04	1.08		
3	2008 Recommended Incentive Pay Based on 2007 Actual Incentive Pay - Adjusted for Salary Inflation	286,896	286,896	400,526	415,931	268,122	278,435	955,545	981,262
4	Subtract NSC Incentive Pay Attributable to CSC (1)	22,227	22,227						
5	Test-Year Recommended GO Incentive Comp Based on 2007 Actual Incentive Comp Payments	264,669	264,669	400,526	415,931	268,122	278,435	933,318	959,035

(1) It is not necessary to provide incentive pay for the CSC because Overland is recommending 2008 budgeted CSC expense be replaced with 2003 actual CSC expense adjusted for inflation.

After allocation to CalAm, using CalAm’s recommended allocation factors, Overland’s recommended ratepayer-funded General Office incentive compensation is \$252,625 in 2008 and \$261,156 in 2009.¹⁶

3. Remove Business Development Expense - CalAm’s current General Office rates do not include business development expenses. CalAm’s regulated customer base has been stagnant since at least 2003. Overland recommends no ratepayer funding of expenses allocated from NSC and LSC business development functions. The adjustment to remove business development expense reduces General Office expense allocated to CalAm by \$371,469 in 2008 and \$383,185 in 2009, calculated using CalAm-requested allocation factors.

NSC - The Corporate business development function is included in a business unit within the “NSC Functions” rate filing category. It took approximately three months of discovery effort to uncover that Corporate Business Development was allocated to CalAm as part of “NSC Functions” rate filing category. Once we became aware of its existence, we asked CalAm to

¹⁶ For 2008: NSC, \$15,395; LSC, \$112,271; Cal Corp \$124,959. For 2009: NSC, \$15,395; LSC, \$116,308; Cal Corp, \$129,453

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describe corporate business development projects benefiting CalAm's regulated operations. CalAm responded:¹⁷

The role of the Corporate Business Development function is to provide coordination, tools, training and support the Business Development (BD) teams in the local operations . . . In many of these activities, there is no project number or specific state / location to charge and time is charged accordingly. In recognition of the fact that a significant proportion of the activities are non-regulated, 2008 budgeted charges for this function are allocated to regulated subsidiaries in a much lower proportion that other corporate functions.

We found that a "much lower proportion" allocated to regulated companies is still a majority of the total cost (56.43%).¹⁸

There is no evidence that the NSC's corporate Business Development unit has added or will add customers or revenue to CalAm's regulated operations. Overland therefore recommends excluding the expense from allocation to CalAm for purposes of rate-recovery. Removing business development reduces expense allocated to CalAm by \$30,439 in 2008 and the 2009 test year, using CalAm's requested allocation factors.

LSC - CalAm proposes to recover LSC business development expense by suggesting that current ratepayers benefit from the customers added by business development efforts, which permits CalAm to spread its overhead over a larger group of customers. This might be justified if the benefits of adding new regulated customers exceed the costs, but in this case, they do not. CalAm proposes incurring \$352,746 of additional annual LSC Business Development costs at the same time it projects to add only 3,400 customers to its customer base over a two-year period. Even ignoring the fact that some of the customer increase, if it occurs, will result from internal growth, CalAm's proposal effectively increases the LSC's expense allocation per CalAm customer by nearly 9% (\$20.44 vs. \$18.78 annually – see Chapter 5 for more details). Coupled with the fact that a portion of the "regulated" business being generated by this LSC group is being categorized as coming from "regulated O&M" projects (the revenues from which are primarily attributed below-the-line, to non-regulated business), Overland believes that ratepayer funding of LSC business development should not be permitted. Our adjustment to remove business development expense allocable to CalAm reduces total LSC expense by \$1,953,711 and \$2,020,833 in 2008 and 2009, respectively. The adjustment reduces LSC business development expense allocated to CalAm by \$341,030 in 2008 and \$352,746 in the 2009 test year, using CalAm's requested allocation factors.

4. Remove NSC Corporate Contributions Expense - Utility regulators, including the California Public Utilities Commission, have traditionally prohibited utilities from charging ratepayers for their charitable contributions. Perhaps the most obvious reason for recording

¹⁷ Response to OC-141.

¹⁸ Response to OC-91 (NSC budget data), 032020_CorpBusDev_2008-2012.xls, "Rates" sheet.

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charitable contributions below-the-line (in expense accounts other than those recovered from ratepayers) is that if the expense is charged to ratepayers, it is the ratepayer, not the utility, that makes the donation. To the extent a utility selects a charity and chooses to make a donation, either in the form of cash or donated labor, the utility (through its shareholders) should actually pay it. Ratepayers should be free to select their own charities and make their own donations; they should not be compelled to make donations on behalf of a utility.

Our adjustment removes \$240,500 charged to account 575140 - Charitable Contributions Expense from budgeted NSC expense allocable to CalAm regulated ratepayers. In addition, we recommend removing \$195,670 from several accounts (Other Employee Welfare, Contract Services and others) budgeted for NSC business unit 32087 - Corporate Social Responsibility. After the impact of locational overheads is factored into the amounts removed, our adjustment reduces NSC budgeted non-labor expense by \$420,021. Using CalAm's requested allocation factor, the adjustment reduces expense recoverable from CalAm's ratepayers by \$20,623 in 2008 and the 2009 test year.

5. Remove Legislative and Political Influence Expense - In the 2004 General Office rate case, the Commission disallowed expense associated with a Government Affairs Director when it became clear that the position included legislative influence responsibilities.¹⁹ It is Overland's experience that regulators in general, and the California Public Utilities Commission in particular, prohibit utilities from charging ratepayers for expenses incurred to influence politicians or legislation. Overland identified legislative influence expenses in the NSC and Cal Corp budgets. We recommend removing all such expenses from ratepayer-funded GO expense. Our recommended adjustment reduces expense allocated to CalAm by \$211,004 in 2008 and by \$218,213 in the 2009 test year.

NSC - In data request OC-21 we requested the job descriptions for all NSC positions. One of the job descriptions omitted from the response was the NSC Director of Government Affairs. We re-requested this job description in OC-192. In this request we also asked for a description of consulting expenses budgeted for the NSC's Government Affairs business unit (part of the "NSC Functions" rate filing category). It is clear from the response that both the Director's responsibilities and the consulting efforts involve legislative influence. For example, the job description includes the following:

The description of the budgeted consulting expense indicates that the consultant's responsibilities include working as an extension of the External Affairs department to develop and implement a successful legislative strategy.

¹⁹ Decision 0302030. General Office - Salaries, pp. 21-22.

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Overland recommends removing the expense budgeted for business unit 32022 - NSC Government Affairs, from expense recoverable from ratepayers. This adjustment reduces allocable NSC expense by \$459,562 in 2008 and the 2009 test year. Using CalAm's requested allocation factor, our recommended adjustment reduces NSC expense allocated to CalAm by \$22,564 in 2008 and 2009.

Cal Corp - While not always referred to in a consistent manner from data response to data response, Cal Corp employed an individual in May 2008 that was responsible for governmental affairs. This position reported to the regional president.²⁰ The only Cal Corp job description provided that remotely matches this position is the Director of Governmental Affairs. As described in this position's job responsibilities, this employee was to _____

_____²¹ These are the same responsibilities of a position specifically reviewed and disallowed by the Commission in a previous case. Overland recommends the same rate treatment in this application. Overland's recommended adjustment reduces Cal Corp expense charged to CalAm by _____ in 2008 and _____ in the 2009 test year for labor expense associated with the Director of Governmental Affairs. No adjustment to LSC expense is necessary.

6. Remove Unsupported "NSC Functions" Expense - Overland recommends removing expenses in the "NSC Functions" rate filing category that do not meet regulatory standards required for ratepayer recovery. Our recommended adjustment includes the three separate components. In total, it reduces expense allocated to CalAm by \$545,959 in 2008 and \$82,520 in the 2009 test year.

- 2008 "NSC Functions" Expense Not Supported by the 2008 NSC Budget - Supporting NSC budget data provided in OC-91 includes amounts for the business units CalAm disclosed as belonging to the "NSC Functions" rate filing category that, when allocated to California using CalAm's proposed factors, total \$1,026,220. For 2008, CalAm included \$463,439 in additional NSC Functions expense in the rate filing (CalAm, post-allocation), for a total "NSC Functions" expense of \$1,489,659.²² The additional amount is unsupported. It may have been added to 2008 to show a declining amount of NSC-allocated expense between 2008 and the 2009 test year. This component of our adjustment reduces CalAm-allocated NSC expense by \$463,439 in 2008 only.
- \$1 million Risk Reserve - The "Non-Departmental" business unit includes a \$1 million expense described in the budget as "risk reserve for EW."²³ In response to our data

²⁰ Responses to OC-2 and OC-92.

²¹ Response to OC-21.

²² See, for example, Exhibit B, Chapter 4, Section 1, Table 1 in CalAm's original (January 30, 2008) or updated (May 9, 2008) General Rate Case Application, A.08-01-024.

²³ "EW" are the Chief Financial Officer's initials, who authorized the budgeted reserve.