

## **APPENDIX B: RESULTS OF OPERATIONS MODEL**

These comments set forth the issues discussed by Cal-Am during the November 27, 2018 all-party meeting the (“Meeting”) held pursuant to the *Administrative Law Judges’ Ruling Setting an All-Party Meeting to Review the Results of Operations Model* (“Ruling”). Cal-Am discusses below each question posed in the Ruling and in the Expense Adjustment Summary, a document provided by the ALJs at the Meeting.

### **I. THE \$7.1 MILLION REDUCTION IN OPERATIONS & MAINTENANCE IS ACCURATE**

Ruling Question 1: Why do the results of the RO model, as shown in Appendix A of the PD, reflect a reduction of only \$7.1 million in Operations and Maintenance (O&M) costs compared to Cal-Am’s April 2018 request<sup>1</sup> when the Proposed Decision proposes to deny more than \$9.8 million in Cal-Am’s requested O&M expenses? Are these results accurate?

As explained at the Meeting, Cal-Am believes the \$7.1 million number is accurate and was not able to reconcile the \$9.8 million number with the PD’s rulings. Cal-Am believes that the discrepancy might be tied to the treatment of payroll expense and purchased water.

Payroll Expense. The PD “adopts ORA’s proposal of using 2015 recorded expenses for a basis to forecast 2018 labor expenses.”<sup>1</sup> The PD further states “ORA estimates a 2018 labor expense forecast of \$19,413,281.”<sup>2</sup> ORA, however, revised its forecast as set forth in CAW-43 to \$23,685,339.<sup>3</sup> This is the number reflected in the RO Model.<sup>4</sup>

Purchased Water Costs. The PD finds “that Cal-Am’s forecasts should be modified to reflect the updated purchased water unit costs in Cal-Am’s data responses to ORA found at Attachment 3 to Exh. ORA-4.”<sup>5</sup> Attachment 3 to ORA-4 does not, however, reflect the most recent Commission authorized costs. The RO model reflects the 2017 costs approved via Advice Letters 1179, 1148-A, and 1187.<sup>6</sup> Cal-Am also obtained approval of 2018 costs via Advice Letters 1212, 1215, 1216, and 1217. Cal-Am requests that the final decision reflect the latest

---

<sup>1</sup> PD, p.74.

<sup>2</sup> PD, p.73.

<sup>3</sup> CAW-43, p.2.

<sup>4</sup> See RO Model, ALL\_CH04\_O&M\_WP\_Labor.

<sup>5</sup> PD, p.47.

<sup>6</sup> See RO Model, ALL\_CH04\_O&M\_WP\_Purchased Water

approved purchased water costs in the revenue requirement or add a language to order Cal-Am to keep the current purchase water offset surcharges until the next GRC.

**A. The Regulatory Expense Numbers Are Correct.**

Ruling Question 1(a): Why do the results of the RO model reflect approval of \$665,300 more in Regulatory Expenses than Cal-Am’s April 2018 request when the Proposed Decision proposes to reduce Cal-Am’s requested Regulatory Expenses?

The RO model is accurate. When Cal-Am filed its Application in this proceeding, it premised its request on implementation being effective September 2018. This equates to amortization of the regulatory expense items over a 27-month period. The PD, however, directs Cal-Am to amortize regulatory expense over 36 months, which causes the apparent discrepancy.<sup>7</sup>

**B. The Citizens Acquisition Premium Expenses Are Accurate.**

Ruling Question 1(b): Why do the results of the RO model reflect approval of \$683,000 more in Citizens Acquisition Premium expenses than Cal-Am’s April 2018 request when the Proposed Decision proposes to modify Cal-Am’s request with a reduced federal tax rate of 21% and a reduced rate of return of 7.61%?

There are multiple reasons why there is an increase of \$92,000 more in Citizens Acquisition Premium expenses. The discrepancy between the \$92,000 increase and the higher \$683,000 increase is a result of changes regarding how excess Accumulated Deferred Income Taxes (“ADIT”) was addressed in the initial calculation – excess ADIT for the Citizens Acquisition premium is addressed in the same manner as for all other assets. The portion of the original model for the Citizens Acquisition Premium expenses was based on a rate of return of 7.2% and Cal-Am’s new authorized rate of return is 7.61%. This increase is due to the use of 35% equity in the original model versus the new authorized capital structure of 55.39% equity. Hence, even with the tax rate reduction, the required revenue requirement is higher due to the much higher portion of the premium being covered by equity – all of which is taxable. Lastly, as with the accumulated deferred income taxes for all other assets, Cal-Am is unable to account for such changes for accumulated deferred income taxes until it can calculate such changes consistent with IRS normalization regulations.

---

<sup>7</sup> PD, p. 90.

## **II. THE \$787,000 REDUCTION IN RATE BASE IS ACCURATE**

Ruling Question 2: Why do the results of the RO model, as shown in Appendix A of the Proposed Decision, reflect a reduction of only \$787,000 in Rate Base compared to Cal-Am's April 2018 request when the Proposed Decision proposes to deny more than \$17.8 million in Cal-Am's requested capital expenditures? Are these results accurate?

The \$787,000 rate base deduction is correct. Cal-Am is not able to reconcile the \$17.8 million number with the PD's findings. The discrepancy is likely a result of the following issues.

First, refunding excess ADIT to rate payers will reduce Cal-Am's deferred taxes. Deferred taxes are a deduction to rate base, and when deferred taxes decrease, rate base increases. Second, Cal-Am proposed new depreciation rates, but the PD orders Cal-Am to use the depreciation rates approved in Cal-Am's 2010 general rate case proceeding.<sup>8</sup> This results in \$3.8 million less depreciation expense and reserve balances. Reserve balances are also a deduction to rate base and lower reserve balances result in a higher rate base. Third, not all capital expenditures requests were forecasted for Test Year 2018; many items allocated expenditures across 2018 and 2019. Additionally, most of the carry-over projects were not included in the RO model and elimination of them will not result in a reduction. Finally, disallowance of advice letter projects will not have any impact on the rate base.

## **III. THE DEPRECIATION EXPENSE NUMBER IS CORRECT**

Ruling Question 3: Why do the results of the RO model, as shown in Appendix A of the Proposed Decision, show a depreciation expense of \$27.4 million at current rates when Cal-Am's testimony states that Cal-Am is currently collecting \$21.6 million in depreciation expenses (See Exh. CAW-12, Attachment 10)? Also, why do the results of the RO model not show an adopted depreciation expense of \$21.6 million when all of Cal-Am's requested increases to depreciation are rejected in the RO model?

As shown in CAW-12, Attachment 10, \$21.6 million was the depreciation expense using December 2014 depreciation rates and based on the then-current rate base. The RO Model showed a depreciation expense of \$27.4 million because that is the depreciation expense that would result if the PD granted all of Cal-Am requests. The RO Model currently reflects a

---

<sup>8</sup> PD, p.198.

depreciation expense of \$23.5 million, which reflects all rate base changes and the depreciation rates approved in the PD<sup>9</sup>.

#### **IV. THE CORPORATE FRANCHISE TAX DEDUCTION IS ACCURATE**

Ruling Question 4: Do the results of the RO model, as shown in Appendix A of the Proposed Decision, accurately reflect the difference of \$1.7 million between the Proposed Decision's recommended and Cal-Am's requested California Corporate Franchise Tax deduction, given that the results show a difference of only \$229,000 in federal income tax expenses between Cal-Am's April 2018 request and the Proposed Decision's recommended expenses?

The \$229,000 change in federal income tax expense is accurate and it reflects (1) changes to both the Corporate Franchise Tax deduction and (2) revenue requirement impacts. Additionally, a \$1 reduction in the Corporate Franchise Tax deduction does not result in a corresponding \$1 reduction in federal tax expenses. The \$1 reduction in the Corporate Franchise Tax deduction merely reduce the federal taxable income by \$1. In another words, it is a tax deduction, not a tax credit.

#### **V. RESULTS OF OPERATIONS MODEL INPUT CORRECTIONS**

Ruling Question 5: Are there any errors in the RO model inputs for Cal-Am's April 2018 request or for the Proposed Decision's recommended numbers? If so, what are they?

Ruling Question 6: Are there any errors in the formulas or the logic of the RO model? If so, what are they?

Cal-Am is aware of no errors in inputs, formulas or logic of the RO model. As stated at the Meeting, the Meadowbrook rate design is not currently in the model, but Meadowbrook cost of service is part of Sacramento's revenue requirement in RO model. Meadowbrook's rate design will not change until the next GRC cycle.<sup>10</sup> In order to calculate the correct *rates* for Meadowbrook and Sacramento customers, Meadowbrook's revenue stream should be taken out of Sacramento's revenue requirement and remaining cost of service should be used to set rates for Sacramento customers.

Additionally, the summary tables associated with the RO Model in the Attachment A to the PD were previously pulling information for 2018 and inserting it into 2019 in the adopted

---

<sup>9</sup> See RO Model, ALL\_CH08\_DEPR\_RO\_Forecast

<sup>10</sup> PD, Ordering Paragraph 7, p.316.

section. The code has been fixed and the summary tables, which make up Attachment A to the PD, should be rerun.

**VI. EXPENSE ADJUSTMENTS SUMMARY: THE RESULTS OF OPERATIONS  
MODEL ACCURATELY REFLECTS EXPENSE ADJUSTMENTS**

**A. Monterey Leak Adjustment**

Monterey Leak Adjustments was reduced by \$1,417,924 in RO model and now reflects \$0.<sup>11</sup>

**B. GIS-Related Tasks**

The PD authorizes Cal-Am total CPS cost request and 50 % of Cal-Am's requested GIS budget for TY 2018.<sup>12</sup> Water division staff calculated the dollar value associated with the PD approvals outside of the model and hard coded them into the RO model<sup>13</sup>.

**C. Payroll Expense**

As discussed above, using the correct number for 2015 recorded payroll and the PD's methodology the correct payroll cost for Test Year 2018 is \$23,685,339. This result achieved by reducing all Cal-Am employee wages by 6.76% in the RO model.<sup>14</sup>

**D. Incentive Compensation**

Exhibit CAW-25 shows that the requested total APP for Cal-Am and Service Company is \$2.7 million.<sup>15</sup> Based on the PD,<sup>16</sup> the RO Model reflects a 50% reduction to the \$1.9 million request for Cal-Am employee APP.<sup>17</sup> Based on the PD,<sup>18</sup> the RO Model also reflects a 50% reduction to the \$739,416 request for Service Company employee APP.<sup>19</sup> The RO Model also reflects \$0 for RSUs.<sup>20</sup>

---

<sup>11</sup> See RO Model, ALL\_CH04\_O&M\_WP\_Uncollectible

<sup>12</sup> PD, p.64.

<sup>13</sup> See RO Model, ALL\_CH04\_O&M\_WP\_Other O&M Exp Adj

<sup>14</sup> See RO Model, ALL\_CH04\_O&M\_WP\_Labor

<sup>15</sup> Exh. CAW-25, p.50.

<sup>16</sup> PD, p.76.

<sup>17</sup> See RO Model ALL\_CH04\_O&M\_WP\_Labor.

<sup>18</sup> PD, p.104, p.106.

<sup>19</sup> See RO Model ALL\_CH04\_O&M\_RO\_Service Co.

<sup>20</sup> See RO Model ALL\_CH04\_O&M\_RO\_Labor.

**E. Employee Stock Purchase Program**

The RO Model reflects \$0 for ESPP based on the PD.<sup>21</sup>

**F. Charitable Contributions**

The RO Model reflects \$0 for charitable contributions in accordance with the PD.<sup>22</sup>

**G. Depreciation Expense**

Please see the discussion above in Section III.

**H. Conservation Expenses**

All of the conservation expenses relate to balancing accounts and have no impact on the RO model. Additionally, four conservation employees were removed from RO model to be transferred to conservation budget.<sup>23</sup>

**I. AMI Plant**

The AMI capital expenditure went to \$0 from total base costs of \$2.429 million for 2018 and \$11,580 for 2019.<sup>24</sup>

**J. Recycled Water Projects**

Capital dollars for the recycled water projects were not included in the RO Model, so there was no reduction to make.

**K. Recurring Projects – Los Angeles, Monterey & Sacramento**

Los Angeles. The RO Model reflects approval of 25% of Cal-Am’s requested RP budget line item for capitalized tank rehabilitation.<sup>25</sup> The adjustment was made to the base cost, and adjustments to other components, like contingency and engineering overhead, are calculated by RO model.<sup>26</sup>

Monterey. Water division staff calculated the Monterey capitalized tank rehabilitation RP line budget based on the methodology in the PD.<sup>27</sup> The Water Division number was hardcoded in the RO Model to the base cost of the project.<sup>28</sup>

---

<sup>21</sup> See RO Model ALL\_CH04\_O&M\_WP\_Labor.

<sup>22</sup> See RO Model ALL\_CH04\_O&M\_RO\_Service Co; PD, p.76.

<sup>23</sup> PD, p.73, 206.

<sup>24</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast

<sup>25</sup> PD, p.147.

<sup>26</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast

<sup>27</sup> PD, pp.148-149.

<sup>28</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast

Sacramento. The discrepancy between the RO Model number of \$50,394 and the \$58,450 rate base reduction ordered in the PD is the difference between adjustments to base costs versus adjustment to the total request with overhead.

**L. Requested Sacramento District Projects**

**1. Elverta Road Bridge Water Main, Arden Intertie, Anetlope Tank, Booster Station and Well**

These projects are carry-over projects and they were not reflected in the RO Model and/or there was no capital expenditure in the test year. The capital expenditure for all these projects are \$0 in the RO model. For example, \$0 was inserted in the RO Model for the Arden intertie project base cost of \$1,989,773 for year 2019.<sup>29</sup>

**2. New Lincoln Oak Well**

For New Lincoln Oak Well, the RO model reflects \$0 for capital expenditures. This reduced base capital expenditure for years 2017, 2018, and 2019 by \$49,776, \$199,105, \$995,525, respectively.<sup>30</sup>

**3. Water Level Monitoring**

Cal-Am's water level monitoring request sought a total base cost of \$467,382. Of that total, \$233,691 was in 2018, and the remainder in 2019. The RO Model correctly reflects \$0 for 2018 and 2019.<sup>31</sup>

**4. Dunnigan Water System Improvement Project**

RO model reflects the base cost of \$747,812, which is what was requested by Cal-Am, and it is less than authorized budget of \$815,736 in PD.<sup>32</sup> Other components of the total project cost are calculated in RO model. For example engineering overhead is calculated based on methodology authorized in PD.<sup>33</sup>

**M. Requested Larkfield Project – Londonberry Drive Creek**

This project is a carry-over project with requested \$915,500 budget in 2020. There is no cost associated with this project in the RO Model.

---

<sup>29</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast

<sup>30</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast

<sup>31</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast.

<sup>32</sup> PD, p.172

<sup>33</sup> PD, p.142-144

**N. Requested Monterey Project – Booster Station Rehabilitation**

The PD authorized a \$600,000 construction budget, which was a disallowance of \$176,506 from Cal-Am’s high-end estimate of \$716,667. The RO Model accurately reflects base cost of \$300,000 for this project in 2018 and 2019.<sup>34</sup>

**O. Requested Monterey Project – Los Padres Dam Fish Passage Project**

The RO Model correctly reflects the PD’s authorized amount of \$4,272,854.<sup>35</sup> As reflected in the RO Model, the reductions were hard-coded into the RO model based on Water Division calculations to get to the authorized amount.

**P. Requested Los Angeles District Projects**

**1. Redrill Winston Well**

The PD did not approve the \$3.6 million budget for the redrill of the Winston Well. This project was requested as an advice letter project so there were no dollars included in the RO Model.

**2. Purchase Groundwater Rights**

The PD did not approve the requested budget of \$221,846 and \$2.11 million for the purchase of groundwater rights in 2018 and 2019, respectively. Base costs were reduced by \$186,953 and \$1,869,530 for years 2018 and 2019, respectively, to reflect zeros in RO model<sup>36</sup>.

**Q. Requested San Diego Project - Coronado Reliability Study**

Cal-Am requested \$648,092 in 2018 and \$623,110 for preliminary engineering and design costs for the Coronado Reliability Study in 2018 and 2019, respectively. The PD approved a budget of \$341,315 for 2018-2019. The RO Model accurately reflects the authorized budget and splits the approved budget spending between 2018 and 2019.<sup>37</sup>

**R. Service Company – IT Upgrades and Enhancements**

In ORA-2, ORA recommended the Commission “remove the \$3,064,632 combined 2014 and 2015 BT Project cost overruns from the IT Investment forecast for TY 2018 Return on GO Rate Base.”<sup>38</sup> The PD incorrectly states that ORA recommends removing the entire IT

---

<sup>34</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast.

<sup>35</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Recorded.

<sup>36</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast.

<sup>37</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast.

<sup>38</sup> Exh. ORA-2, p.25.

Investments costs of \$4.11 million Cal-Am's general office rate base. The RO Model currently reflects the reduction of \$3,064,632 for IT in year 2015, which is last recorded year in this rate case.<sup>39</sup> RO model calculates the appropriate reduction for test year 2018 by reducing the plant balances by \$3,064,632 and reducing reserve balances based on appropriate depreciation rates and depreciation expense.

**S. Service Company – IT-related Plant Allocation Percentage**

The PD found that Cal-Am should use a 5.33% ratio to allocate American Water's 2018 IT-related plant costs. This results in a \$72,298 reduction based on Water Division calculations outside of the RO Model. The Water Division calculation is hard-coded into the model as a deduction.<sup>40</sup>

---

<sup>39</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Recorded.

<sup>40</sup> See RO Model, ALL\_CH07\_PLT\_RO\_Forecast.