

Decision No. 14213

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

OPINION

In the matter of the application
of San Jose Water Works for au-
thority to increase rates.

Application No. 9579

McCutchen, Olney, Mannon & Green, by
Allan P. Matthew and Leib & Leib, for
Applicant.
Archer Bowden, City Attorney, and C. B.
Goodwin, City Manager, for City of San
Jose, Protestant.

WHITTLESBY, COMMISSIONER:

O P I N I O N

The San Jose Water Works, a corporation, is a public utility engaged in the business of supplying water for domestic, commercial and municipal purposes to consumers in the City of San Jose, the Towns of Los Gatos and Saratoga and adjacent territory in Santa Clara County. The application in this proceeding alleges that by reason of the great decrease in the purchasing power of money and the increased cost of operation since the present schedule of rates became effective, the earnings derived for water service are now, and for a long time past have been, insufficient to yield to applicant a just and reasonable return upon the value of its used and useful properties. Therefore, the Railroad Commission is asked to authorize an increased schedule of rates which will yield a just and reasonable return upon the value of its properties.

Public hearings in this matter were held in San Jose after all interested parties were duly notified and given an opportunity to be present and be heard.

The rate schedules now in effect on this system have been

fixed by this Commission in four separate proceedings. The rates for the City of San Jose and vicinity were established May 22, 1914, in Decision No. 1534, Case No. 476. The same rates were also charged in Saratoga. With the exception of a slight modification in the charge for fire hydrant service, the above schedule was made applicable to the Los Gatos district by Decision No. 2654 in Application No. 1414, decided August 2, 1915. Rates for the so-called High Line district, between Los Gatos and Saratoga, were fixed November 27, 1917, in Decision No. 4900, Application No. 2892. The rates in effect in the Vineland district, also called the San Tomas Division, were established May 29, 1923, by Decision No. 12154 in Application No. 8917.

The present rate schedules are in part as follows:

San Jose, Los Gatos and Saratoga Division.

Meter Rates:

Monthly minimum for 4,000 gallons, or less.....	\$.90
4,000 gallons to 10,000 gallons, per 1,000 gallons.....	.20
10,000 gallons to 100,000 gallons, per 1,000 gallons.....	.15
Over 100,000 gallons, per 1,000 gallons.....	.12

County and Municipal Use:

Schools, Buildings, etc. at regular meter rates.

Sewer Flushing, Park and Lawn Irrigation. Monthly minimum.	.90
All water used, per 1,000 gallons.....	.12
Street Sprinkling, per 1000 gallons.....	.12
Fire Hydrants owned by City, per month (San Jose Division).....	1.75
Fire Hydrants owned by Water Company, per month (San Jose Division).....	2.25
Fire Hydrants owned by Water Company, per month (Los Gatos Division).....	1.75

Monthly Flat Rates:

Dwelling Houses.....	\$.45 to ...	1.10
Toilets in Private Homes.....	.40 to50
Bath tubs in Private Homes.....		.15

High Line Division.

Meter Rates:

Monthly minimum 3,000 gallons, or less.....	1.00
3,000 gallons to 10,000 gallons, per 1,000 gallons.....	.25
10,000 gallons to 100,000 gallons, per 1,000 gallons.....	.20
Above 100,000 gallons, per 1,000 gallons.....	.15

San Tomas Division.

Meter Rates:

Monthly Minimum 5/8" Meter.....	1.50
0 to 600 cubic feet, per 100 cubic feet.....	.25
600 to 1,000 cubic feet, per 100 cubic feet.....	.20
1,000 to 10,000 cubic feet, per 100 cubic feet.....	.15
All over 10,000 cubic feet, per 100 cubic feet.....	.12

The above-mentioned decisions of the Commission have contained a complete description of the system and the methods of operation. It is therefore unnecessary to go into these matters further than to state that on December 31, 1923, there were 16,009 active services on the entire system, of which 92 per cent. were metered.

W. L. Atkinson and Edward G. Angel, acting on behalf of the applicant, appraised the present market value of the lands and rights of way belonging to the Company at \$651,389.

E. P. McAuliffe, Commission's land expert, submitted a report prepared by himself and E. R. Robbins, Assistant Engineer, appraising the present market value of the lands and rights of way owned by the San Jose Water Works at \$533,836., as of December 31, 1923. This amount was segregated into \$506,528. for fee lands and \$27,308. for rights of way.

F. C. Herrman, Consulting Civil Engineer, acting on behalf of the San Jose Water Works, presented a report in which he estimated the present market value of its water rights and riparian rights, exclusive of rights to underground waters, to be about \$240,000.

George A. Elliott, Consulting Engineer for the applicant, submitted a report in which he found the present value of the physical properties, exclusive of lands, rights of way, water rights and other intangible values, as of December 31, 1923, to be \$3,581,933. This valuation was based upon an alleged reproduction

cost, over a two and one-half year construction period, less accrued depreciation calculated by the sinking fund method at 5 per cent and includes all physical structures and equipment owned by the Company, including certain non-operative property.

Joseph R. Ryland, President of the San Jose Water Works, presented a report setting forth the sum of \$3,570,444. as the historical book cost of the physical properties, lands, rights of way and water rights, as of December 31, 1923. This total was made up as follows:

Physical structures	\$3,103,712.
Lands	325,011.
Rights of way	28,061.
Water Rights	113,660.
	<u>\$3,570,444.</u>

This, according to the applicant, represents the undepreciated value of the various structures, lands and water rights as found by the Commission in Case 476, to which has been added the book cost of additions and betterments with the corresponding deductions for the sales of land and for retirements of other property.

A report, submitted by M. R. MacKall and M. I. Reed, Assistant Hydraulic Engineers of this Commission, gave the estimated original cost of the operative properties, exclusive of lands, rights of way and water rights, as of December 31, 1923, as \$2,814,991; a depreciation annuity calculated by the sinking fund method at six per cent was shown as \$33,449; and the estimated amount, which would have been accumulated in the sinking fund had the depreciation annuity been compounded annually at 6 per cent, was found to be \$445,154. The net additions to capital from December 31, 1923, to June 30, 1924, amounted to \$274,684. with a corresponding depreciation annuity of \$4,120.

A summary of the various appraisals presented is set out below:

Lands.

Present market value as of Dec. 31, 1923.
By Atkinson and Angel for Applicant.....\$651,389.
By McAuliffe and Robbins for Commission..... 533,836.

Water Rights.

Present Market value as of Dec. 31, 1923
By Hermann, for applicant..... 240,000.

Physical Properties.

Reproduction cost less
Depreciation as of Dec. 31, 1923.
By Elliott, for applicant..... 3,581,933.

Historical Book Cost.

As of December 31, 1923
By Ryland for Applicant.....

Physical properties.....	3,103,712.
Lands.....	325,011.
Rights of Way.....	28,061.
Water Rights.....	113,660.
<u>T O T A L</u>	<u>\$3,570,444.</u>

By MacKall and Reed for Commission

Estimated Original Cost:

Physical properties Dec. 31, 1923..	2,814,991.
Depreciation Annuity.....	33,449.
Sinking Fund Accumulation.....	445,154.

Net Additions and Betterments:

Dec. 31, 1923 to June 30, 1924.....	274,684.
Depreciation Annuity on the above, net	4,120.

Total Physical Properties as of June 30, 1924 \$3,089,675.

Depreciation Annuity on used and useful properties as of June 30, 1924.....	37,569.
Sinking fund accumulation, June 30, 1924.....	445,154.

There are no material differences in the various appraisals of the physical properties submitted in this case. There is no disagreement in the matter of the net additions and betterments to capital of \$274,684 for the first six months of 1924. When the deductions are made for equivalent non-operative properties the historical, or book cost, of the physical property submitted by Ryland agrees very closely with the estimated original cost of \$2,814,991. presented by MacKall and Reed of the Commission. After making due allowance for non-operative property and reconciling the results obtained by reason of the different methods used in determining the amount of paving over mains and services, the reproduction cost, less depreciation, of the physical properties submitted by G. A. Elliott is approximately 14 per cent greater than the estimated original cost found in the report of the Commission's engineers. Giving due consideration to the methods of valuation it is apparent that there is no great disagreement in the appraisals of value of the physical properties and structures.

The appraisement of the lands and rights of way presented by Atkinson and Angel was \$651,389, and that of McAuliffe and Robbins \$533,836, a difference of \$117,553. This apparently can be attributed only to an honest difference in judgment, the engineers for the Commission being influenced, perhaps, to a somewhat greater degree by the recent sales of real property in the immediate vicinity. Both figures set out above, it should be noted here, comprise all of the real estate owned by the company with no deductions for such parts or parcels of land or rights of way as no longer may be used and useful, or reasonably necessary

for the company in the conduct of its public utility business.

While not denying that the watershed lands owned by the company have some value which may properly be made a part of the rate base in this instance, Archer Bowden, City Attorney, takes the position that the applicant owns not more than 15 per cent of the total Los Gatos Creek watershed lands above the points of diversion and therefore the resultant value to the water system is seriously diminished because the company does not own sufficient land to properly safeguard and adequately protect the purity of supply. In addition to this the city maintains that the general character of the watershed lands is the same whether belonging to the company or not, so that ownership is not essential to protect the stream flow through prevention of denuding the land of timber and other vegetation.

In this regard the Commission in its decision in the former Case No. 476 says:

"Assuming that these lands do have a value for the purpose of protecting the purity of the water, it is well to point out that inasmuch as the entire flow is not protected by ownership of lands, the value of the protection will thereby be minimized. Besides in other localities it has been found possible to protect the supply of water by filtering, and it is interesting to compare the conditions that exist where unprotected water is rendered pure by filtration so as to estimate the real value of the protection based upon the cost of an alternative method for such protection."

Mr. Allan Matthew, counsel for applicant, contends that the company was forced to purchase and in good faith did purchase these watershed lands years ago at a time when no other methods of protection against contamination were either possible or known and that, while at the present time pollution

of waters may be neutralized by proper treatment, it is nevertheless still highly desirable to preserve the initial purity of the source of water supply where economically possible. Only sufficient land has been acquired to insure safe control of the streams through ownership of the entire stream bed, the most vital of the riparian lands and a considerable proportion of the upper watershed.

The record shows that the entire watershed lands now owned by the San Jose Water Works in the Los Gatos Creek area amounts to 5,860 acres, which is a substantial land holding in view of the fact that a considerable amount of the water supply has been developed from wells.

Considerable controversy developed over the possibility of duplication of values in water rights and watershed lands. According to the best evidence available, the cost to the company of acquiring its present water rights and riparian rights, exclusive of watershed lands, has been \$113,660. The Company claims that the present market value of these rights, as given in the report of Mr. Hornmann, is \$240,000.

The City contended that through ownership of water shed lands and by the purchase of the riparian rights below points of diversion to the extent of the normal low flow of the creek, the applicant has extinguished all antagonistic diversions; there being then no such rights outstanding, other than those belonging to the applicant, there can be no value at all to the rights of appropriation not represented in these lower

riparian rights and the water shed land values. The city contends further that as the lands in the water shed have been valued for summer home purposes and for other uses to which such lands were most adaptable, which included the right to use the waters from the streams for ordinary purposes, as well as the right to dispose of sewage in the manner customary in such places, and as the value of the water rights was made, assuming the prohibition of these privileges of use and occupation there is then to that extent, a duplication of values. In summing up this position of the city, Mr. Bowden says, "If they are entitled to summer home prices upon these lands, they are not entitled to water supply prices upon their water."

That the Commission in its former rate proceeding with this Company was inclined toward this view is shown by the following extract from the opinion of Commissioner Eshelman in Case No. 476.

"In other words, if the water is worth \$225,000. and the land in the Los Gatos water shed is necessary to this water supply, then the value of the land is included in the value of the water, and when we value the water and the land separately, we have a duplication*****

"In my opinion, it is impossible to determine what part any of the elements play in producing a supply of water. Admittedly, the water right originally had to be purchased away from this land or the company could not own it. And when, by purchasing the land, the company secures the water, it has, by this one act of purchase, received both the water right and the land itself. Not only do I consider that there is very substantial duplication produced when we value this land and these

water rights separately, but I likewise believe that if the lands were sold off with the right to use the water reserved to the owners of this water system, a very substantial effect would inevitably result upon the market value of the lands themselves. My opinion is that when you buy land which is riparian or otherwise water-bearing, the price which you pay for the land itself as much covers the water as it does the timber or anything else annexed to the realty. This is well known and recognized everywhere, in that land with water has an enhanced value over land without water, and I very much doubt if the summer home owner in the Santa Cruz mountains would give a very substantial price for a summer home in Los Gatos Canyon if the land in such site were denuded entirely of all water rights."

Mr. Matthew urges in behalf of the company that the ownership of water shed lands and riparian lands above the points of diversion give the owner thereof the power to conserve the run-off of the catchment area through the control of the timber growth and vegetation and to that extent insure regulation of the low summer flow of the streams, at the same time there exists the power to protect the purity of the supply against contamination and pollution at its source. For these necessary lands the owner is entitled to the fair market value, which value in all justice cannot reasonably be diminished, because of the restrictions imposed thereon through the dedication of such lands to the public use. In other words, the position of counsel for the applicant is that the dedication of lands to public use does not, by virtue of that act, diminish the value of such lands to the extent of the limitations and restrictions imposed thereon and bar the owner of such lands from the right to appraisalment at the fair market value.

Counsel explains further that the ownership of water shed lands and lands riparian to streams carries with it solely the right to divert the water from such streams for the beneficial use upon the riparian lands and no others; that in order to remove the water and export it for uses beyond the riparian lands, the additional and entirely distinct right to so appropriate these waters must first be acquired. In this case, the rights of appropriation have been acquired by prescription through well known open and long continuous user for a great many years and also by the extinction of conflicting riparian rights below the points of diversion. "When", says Mr. Matthew, "we are valuing water shed lands in the first instance and, in the second place, the right to divert the waters from an actual water course for use beyond the riparian land, there is no duplication whatever."

There is without doubt a value in watershed lands, a value in riparian rights and a value in the right of appropriation, and there is a definite distinction between these several elements. However, it does not appear necessary in this proceeding involving rates to determine definitely the value of these water rights.

Mr. Ryland presented an estimate of the maintenance and operating expenses for 1924 of \$290,470. including an estimate of \$42,944 for depreciation. This amount included \$68,363. for pumping expenses for the year which by an alternative method was estimated to be not less than \$58,621. No allowance, however, was made for the expense of conducting the present proceeding before the Railroad Commission.

An estimate of the average future operating costs for the next three years was also submitted by Mr. Ryland and amounted to \$250,864, exclusive of depreciation.

The investigation of the accounts and records of this company as set out in the report of the Commission's Engineers shows that the revenues and operating expenses from 1921 to June 30, 1924, have been as follows:

	1921	1922	1923	Jan. 1 to June 30, 1924
Revenues receivable	\$293,295.	\$306,981.	\$325,813.	\$168,141.
Operating Expenses, Less Depreciation	161,668.	167,762.	199,133.	129,867.

The costs of operation and maintenance, exclusive of depreciation for the immediate future were estimated in this report to be \$232,950. This estimate gives a considerable increase over the actual expenses for the preceding years as set out above. This is in part attributable to the natural growth of the business but principally to the very large expense involved in changing, lowering and replacing mains, services and meters entailed by reason of the extensive paving program being carried on by the City of San Jose and the County of Santa Clara in territory served by this company, to the additional burden of emergency pumping with the resulting increase in re-

pairs to pumping equipment necessitated by the extreme dry year and the failure of the gravity supply to fill the storage reservoirs, and also to expenses incurred in the preparation and presentation of this case before the Commission. The evidence shows that in order to avert a serious shortage of water it was necessary to install facilities to supply water to the towns of Los Gatos, Saratoga and the adjacent territory by pumping from the wells in San Jose, whereas in years of normal operation this entire district is supplied by gravity with some excess available for use in San Jose. Although consideration was given by the Commission's engineers to those items of expense which analysis of the operating conditions demonstrates should not reasonably recur annually, and provision was accordingly made to spread such expenses over a period of years, so great has been this additional burden that the result is nevertheless a substantial increase over the cost of operation during the preceding years.

Exception was taken by the City Attorney to the estimate of future operation expenses in this report as being excessively high throughout and particularly unreasonable as to the amounts assigned therein for the costs of pumping and for transmission and distribution main expenses as influenced by paving operations. As the year 1924 will be characterized by abnormally heavy operating expenses, the city apparently advocates that any estimate of the future costs of operation should wholly disregard 1924 expenses and should be based upon the average operating costs of the years 1921, 1922 and 1923.

Randall Ellis, as consulting engineer for the City of San Jose in this proceeding, presented a tabulation in which the operating expenses for the past three years were compared upon a

percentage basis, item for item, with the estimate of the future expenses shown in the report of the engineers of the Commission. While this comparison showed certain items to have been increased by a greater percentage than others, it is significant that this exhibit showed the total estimated future operating expenses to be but 18 per cent higher than the expenses of the year 1923. It should be pointed out that this increase must take care of the natural growth of the business, and a reasonable proportion of the abnormal expenses already incurred and to be incurred during the last six months of 1924.

Obviously it would be unfair to disregard the abnormal expenses to which this company, through no fault of its own, has been put by reason of paving operations, the present rate proceeding and the additional costs incurred through emergency pumping. It is a matter of common knowledge that the entire state has this year experienced the driest year in its history.

The evidence indicates that the allowances for paving as reflected in the various items of expenses in the report of the engineers for the Commission are somewhat greater than the uncertainties of the future warrant, and in establishing a schedule of rates the Commission will carefully consider all elements which may reasonably be expected to affect the operating and maintenance expenses during a normal year, together with the abnormal expenses to which the utility has been subjected during the few years in the immediate past.

The results of operation for the year 1923 as set out in the report of the Engineers of the Commission indicates that the Company had available for return the sum of \$93,231.00, which is the equivalent of a return of 2.94 per cent upon a tentative rate base of \$3,134,395.00. This was determined as follows:

In Case No. 476, the Commission stated that \$200,000.00 represented a liberal allowance for the original cost to the Company of all lands and water rights and by a substitutional method found their value to be \$307,329.00, as of December 31, 1913.

Approximate Actual Cost of Lands, Rights-of-Way and Water Rights, Case No. 476, December 31, 1913,	\$200,000.00
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Net Additions, Actual Cost, December 31, 1913, to December 31, 1923,	119,404.00
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Physical property as of December 31, 1923,	<u>2,814,991.00</u>
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Tentative Rate Base December 31, 1923,	\$3,134,395.00
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Maintenance & Operating Expense, 1923,	199,133.00
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Depreciation Annuity,	<u>33,449.00</u>
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Total Expense,	\$ 232,582.00
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Revenues for 1923,	\$ 325,813.00
Total Expense,	<u>232,582.00</u>

Available for Return	\$ 93,231.00
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This is equivalent to a return of 2.94 per cent upon a tentative rate base of \$3,134,395.

The rate base used above has been predicated throughout upon the original cost to the Company and represents, therefore, the extreme minimum value for rate making purposes under present price conditions of the property of this Company devoted to public use. The substitution of any of the other appraisements submitted in this case, which have been and must be given their proper consideration, will result in reducing the rate of return below 2.94 per cent. After making allowance for the additions and betterments to capital for the first six months of 1924, with the corresponding increase in the depreciation charges, and making provision for working capital and after the necessary consideration is given to the increased cost of future operation and main-

tenance, some of which were not included in the results of operations for 1923, as set out above, it must be apparent that the applicant herein is entitled to and must be given a substantial increase in rates.

This opinion would be incomplete if reference were not made to the contention of the City of San Jose to the effect that by reason of the conservative methods of financing and the economical policies of management and operation which has always characterized this utility, it is not entitled to the same rate of return upon its investments as those utilities whose costs of financing have been relatively much greater. This Company has consistently financed its projects through the issue of common stock and has never secured money by means of bond-issues. The evidence throughout this proceeding as well as the former matters before this Commission show conclusively that the management and operation of the San Jose Water Works has always been conducted in an economical and efficient manner, and it should be pointed out at this time that the salaries and wages paid to the officers and employees of this Company in several instances have been maintained at the minimum amounts for the character of service performed. Attention is invited to the provisions of the Public Utilities Act, Section 20, which are as follows:

"Section 20: Nothing in this act shall be taken to prohibit any public utility from itself profiting, to the extent permitted by the Commission, from any economies, efficiencies or improvements, which it may make, and from distributing by way of dividends or otherwise disposing of, the profits to which it may be entitled, and the Commission is authorized to make or permit such arrangement or arrangements with any public utility as it may deem wise for the purpose of encouraging economies, efficiencies or improvements, and securing to the public utility making the same such portion, if any, of the profits thereof as the Commission may determine."

To penalize a public utility for efficiency and economy in management and operation could result only in placing a premium upon extravagance.

The following increased schedule of rates will greatly simplify operations by placing the entire system upon the same general use charges. The rates set out herein, it is estimated will increase the revenues on the 1923 basis such that a fair return will result to the Company under efficient operation and at the same time will not unnecessarily burden the public.

The following form of order is submitted:

O R D E R

San Jose Water Works, a corporation, having made application for authority to increase the rates charged for water delivered to consumers in the City of San Jose, the Towns of Los Gatos and Saratoga and adjacent territory in Santa Clara County, public hearings having been held thereon, the matter having been submitted and the Commission being now fully informed thereon,

IT IS HEREBY FOUND AS A FACT that the rates now charged by San Jose Water Works, a corporation, for water supplied to its consumers are unjust and unreasonable in so far as they differ from the rates herein established, and that the rates herein established are just and reasonable rates for such service.

And basing the order upon the foregoing finding of fact, and upon the statements of fact contained in the preceding opinion,

IT IS HEREBY ORDERED that the San Jose Water Works, a corporation, be and it is hereby authorized and directed to file with the Railroad Commission on or before October 31, 1924, the following schedule of rates to be charged for all water delivered to consumers subsequent to October 31, 1924:

METER RATES

Minimum Monthly Charges:

5/8 inch meter	\$1.50
3/4 inch meter	2.00
1 inch meter	3.00
1 1/2 inch meter	6.00
2 inch meter	9.00
3 inch meter	18.00
4 inch meter	28.00
6 inch meter	55.00

Each of the foregoing "minimum monthly charges" will entitle the consumers to the quantity of water which that minimum monthly charge will purchase at the following "monthly meter rates."

Monthly Meter Rates:

From 0 to 600 cubic feet, per 100 cubic feet..	\$.25
From 600 to 1500 cubic feet, per 100 cubic feet...	.22 1/2
From 1500 to 3000 cubic feet, per 100 cubic feet...	.20
From 3000 to 10000 cubic feet, per 100 cubic feet...	.15
Over 10000 cubic feet, per 100 cubic feet...	.12

Municipal and County Use:

Street Sprinkling, per 100 cubic feet... .15

Fire Hydrants:

Hydrants owned by cities or other municipal corporations, per month..... 2.50

Hydrants owned by company, per month..... 3.25

All other municipal and county use to be charged at the regular meter rates.

Private Fire Service:

Size of service, unmetered:

2 inch, per month	\$3.50
4 inch, per month	10.00
6 inch, per month	20.00

FLAT RATES

The present flat rates for the San Jose district, as established by this Commission in Decision No. 1534, Case No. 476, are to be increased 50 per cent and made applicable to the entire system.

IT IS HEREBY FURTHER ORDERED that San Jose Water Works file with the Railroad Commission within thirty (30) days from the date of this order revised rules and regulations governing service to its consumers, said rules and regulations to become effective upon their acceptance for filing by the Commission.

The effective date of this order is hereby fixed as October 31, 1924.

The foregoing Opinion and Order are hereby approved and ordered filed as the Opinion and Order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 28th day of October, 1924.

Ol Seavey

H. B. Underhill

Dwight Martin

J. F. Whittington
Commissioners