

**ORIGINAL**

Decision No. 75238

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
 SAN JOSE HIGHLANDS WATER COMPANY, )  
 a California corporation, doing )  
 business as the SAN JOSE HIGHLANDS )  
 WATER COMPANY, )  
 under Section 451, 454 and 491 of the )  
 Public Utilities Code for Authority )  
 to Increase Rates for Water Service. )

Application No. 50074  
(Filed March 6, 1968)

Walter P. Gribben, for applicant.  
Richard P. Caputo and Frank C. Burriesci, for  
 San Jose Highlands Homeowner's Association, Inc.,  
 and Daniel C. Shea, for Eureka Federal Savings &  
 Loan Association of San Francisco, protestants.  
Ferdinand P. Palla, City Attorney, by Donald C.  
Atkinson, for City of San Jose, interested party.  
William C. Bricca, Counsel, and John E. Johnson,  
 for the Commission staff.

O P I N I O N

Applicant San Jose Highlands Water Company seeks authority to increase rates for water service.

Public hearing was held before Examiner Power in San Jose on May 7, June 10 and 11 and July 8, 1968. Copies of the application had been served and notice of hearing had been published and mailed to customers, in accordance with this Commission's rules of procedure.

Testimony was presented by applicant's principal officer, its consulting engineer, one of the original land developers who formed applicant, six of applicant's customers, an officer of a savings and loan association, a Commission staff accountant and a Commission staff engineer. The matter was submitted on July 8, 1968 subject to the filing of concurrent briefs by applicant and protestant on or before

July 29, 1968. Briefs and certificates of service in the form and number of copies required by this Commission's rules of procedure were not timely filed, so the matter will be decided without receipt of briefs.

Service Area and Water System

Applicant owns and operates a water system in the San Jose Highlands area, north of Alum Rock Park in the City of San Jose, Santa Clara County. Decision No. 64952, dated February 13, 1963, in Application No. 44417, granted applicant a certificate to construct a public utility water system in a portion of the present certificated area. Decisions in subsequent applications authorized construction of extensions into the rest of the present certificated area. Applicant is restricted from expansion outside of its certificated area without Commission authorization.

The entire water supply for applicant's system is purchased from San Jose Water Works. The purchased water is boosted into applicant's storage tank, from which it is distributed by gravity flow to some customers and boosted to others by means of another pump and hydropneumatic tank. The distribution system includes about 18,000 feet of distribution mains, ranging in size from four-inch to eight-inch. As of March, 1968, applicant was furnishing water to 101 metered customers, with 20 more residences ready for service. In addition, there were 94 vacant lots that can be served with existing facilities. Unmetered free service was being provided to one customer, in violation of applicant's tariffs.

Service

In Exhibit No. 2, the Commission staff concludes that applicant now is furnishing adequate service. The staff points out

that the contracted management by T. C. Binkley, a civil engineer, has improved overall system operations.

Prior difficulties and inadequacies in service are confirmed by the testimony of six customers. The customers cited instances of mains being broken by earth movement and during the digging of sewer and utility trenches, causing interruptions in water service. Some customers also have had difficulty in contacting the utility in emergencies.

Rates

Applicant's present tariffs include schedules for general metered service and public fire hydrant service. Applicant proposes to increase its rates for general metered service. There are no proposed changes in the other schedule. The following Table I presents a comparison of applicant's present general metered service rates, those requested by applicant, and those authorized herein.

TABLE I  
COMPARISON OF MONTHLY RATES

<u>General Metered Service</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Authorized Herein</u>
First 500 cu.ft. or less	\$5.00*	\$10.50*	\$7.70*
Next 1,500 cu.ft., per 100 cu.ft.	.70	1.47	1.08
Over 2,000 cu.ft., per 100 cu.ft.	.42	.88	.65

\* Minimum charge for a 5/8 x 3/4-inch meter. A graduated scale of increased charges is provided for larger meters.

Applicant's proposed rates in each block are 110 percent higher than present rates. The rates authorized herein are 54 percent higher than present rates. Inasmuch as the record does not include an analysis of spread of water use by consumption blocks, the existing block rates are increased uniformly.

Loss Reimbursement Agreements

A water utility ordinarily must install most of its underground facilities in a newly developed area prior to the paving of streets. Thus, during the early development period of a tract, when there are relatively few water users, the utility must pay ad valorem taxes, most maintenance costs and some operating costs on essentially the entire system. At any reasonable level of water rates, it is possible that, initially, the total revenues would be less than operating expenses.

Decision No. 69268, dated June 22, 1965 in Application No. 47357 pointed out that, at that time, applicant served only eleven customers. The decision authorized applicant to carry out the terms and conditions of an agreement (Exhibit No. 3) with its then affiliate, Priscilla, Inc. (Priscilla), one of the original developers of the San Jose Highlands subdivisions, which agreement provides, in part:

"... Developer agrees that so long as Utility shall be operating at a loss, Developer will furnish from time to time and upon demand by Utility, such sums as may be necessary to defray the costs of all operating expenses of the Utility less any income received by Utility from its operations. ..."

Subsequently, Priscilla had financial difficulties. These resulted in the acquisition of certain residual parcels of land in the San Jose Highlands area, and of a controlling interest in San Jose Highlands Water Company, by Continental Mortgage Investors (CMI). An agreement (Exhibit No. 7) dated October 27, 1966 between Priscilla, Inc. and CMI provides, in part:

"... The expenses and operation of the water company shall be the sole responsibility of the Second Party. ..."  
(Second Party is CMI)

Applicant is not a party to the latter agreement, which fact complicates applicant's collection of loss reimbursements. Presumably, applicant would look to Priscilla for reimbursement under the first agreement and Priscilla would, in turn, seek reimbursement from CMI under the second agreement.

Applicant alleges that for some time it has not sought reimbursements of losses under the existing agreements. Applicant's principal officer contends that it is improbable that applicant can collect under the loss reimbursement agreements and that funds he has received from CMI are personal loans which he must repay. Exhibit No. 6 was reserved for documentary proof of the loans from CMI, but such proof was not presented by applicant.

Protestant San Jose Highlands Homeowner's Association, Inc. contends that the funds provided by CMI were not loans to applicant's principal officer, but were actually loss reimbursements for which CMI is liable under the agreements. Protestant contends further that applicant should continue to receive financial assistance from CMI, rather than to seek a water rate increase. Protestant moved, and the motion was concurred in by the City of San Jose, that the application be dismissed on the grounds that it was prematurely filed, inasmuch as applicant had not first sought to enforce the loss reimbursement agreements.

In resolving the issue of loss reimbursements, the applicability of the loss reimbursement agreements is the end result of the rate-making process, and is not the starting point in that process. For example, it would not be appropriate to set higher than reasonable water rates because applicant may have difficulty in enforcing the reimbursement provisions. On the other hand, it would not be

appropriate to set lower than reasonable water rates in order to force a perpetual subsidy by the parties liable for reimbursement of applicant's losses.

The proper approach, then, is first to determine what water rates are reasonable, based upon the rates which would provide sufficient revenues to cover expenses and a reasonable return on rate base upon full development of all 215 of the lots for which the present system is designed. Then, if these rates do not produce sufficient revenue from the present partial development of the area, applicant should seek reimbursement of any future losses under the existing agreements. Inasmuch as utility rates are set prospectively, not retroactively, coverage of prior operating losses also must come from parties other than applicant's customers.

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Summarized in Table II, from Exhibit E attached to the application and from the staff's Exhibit No. 2 and expansion thereof are the estimated results of operation for the test year 1968 under present rates, under those proposed by applicant and rates authorized herein. For comparison, this table also shows the corresponding results of operation adopted as the basis for setting rates, assuming customers on all 215 of the lots which can be served by the present system, based upon an expansion of staff Exhibit No. 14 and related testimony.

TABLE II  
ESTIMATED RESULTS OF OPERATION  
YEAR 1968

<u>Item</u>	<u>Partial Development Applicant</u>	<u>Staff</u>	<u>Full Development</u>
<u>At Present Rates</u>			
Operating Revenues	\$ 14,076	\$17,020	\$ 32,200
<u>Deductions</u>			
Management & Oper. Service	9,400	4,800	6,000
Purchased Water & Power	7,334	9,390#	16,500*
Other Maint. & Oper. Exp.	2,989	2,750	3,100
Depreciation	4,854	2,760	4,900
Taxes Other Than On Income	4,268	2,940	4,900
Subtotal	<u>28,845</u>	<u>22,640</u>	<u>35,400</u>
Income Taxes	100	100	100
Total	28,945	22,740	35,500
Net Revenue	(14,869)	(5,720)	(3,300)
Rate Base	150,994	71,750	130,000
Rate of Return	Loss	Loss	Loss
<u>At Rates Proposed By Applicant</u>			
Operating Revenues	\$ 28,926	\$35,100	\$ 66,800
<u>Deductions</u>			
Excluding Income Taxes	29,092	22,640	35,400
Income Taxes	100	3,420	10,500
Total	<u>29,192</u>	<u>26,060</u>	<u>45,900</u>
Net Revenue	(266)	9,040	20,900
Rate Base	150,994	71,750	130,000
Rate of Return	Loss	12.6%	16.1%
<u>At Rates Authorized Herein</u>			
Operating Revenues	-	-	\$ 49,200
<u>Deductions</u>			
Excluding Income Taxes	-	-	35,400
Income Taxes	-	-	4,100
Total	-	-	39,500
Net Revenue	-	-	9,700
Rate Base	-	-	130,000
Rate of Return	-	-	7.5%

# Assumes 17 1/2 percent unaccounted - for water.

\* Adjusted for 10% unaccounted - for water.

(Red Figure)

The summaries in Table II properly may not be compared directly because there are fundamental differences in the assumptions used in each column. Applicant's showing is based upon the revenues and expenses that it would expect actually to prevail under the present partial development. The staff's showing includes a "saturation adjustment" to certain expense and plant items, which reduces those items below the amounts the staff expects actually to occur, in recognition of lower per-customer amounts which will apply upon more complete development of the 215 lots which can be served from the present system. As hereinbefore discussed, the summary used for determining a reasonable rate level assumes a hypothetical full present occupancy of all 215 lots, with normal amounts of unaccounted-for water. Although unaccounted-for water has averaged about 17 1/2 percent of the water purchased by applicant from San Jose Water Works, the Commission staff engineer testified that this is an unreasonable loss and that 10 percent might be considered more reasonable.

Under the assumptions in each column of Table II, it is apparent that the present rates would result in an operating loss. Under applicant's proposed rates, applicant expects to just about break even, the staff shows a 12.6 percent return after the saturation adjustments, and the summary adopted for rate-making purposes shows a 16.1 percent return.

The 54 percent increase in metered service rates authorized herein is designed to produce a 7.5 percent return at the hypothetical full present development of 215 lots. At the partial 112-lot development which prevailed in 1968, these increased rates would have produced about \$26,000 in operating revenues, based upon the more recent consumption data used by the staff in its estimates. Using the



staff's corresponding estimates of purchased water and power, assuming 17 1/2 percent unaccounted-for water, and further assuming that applicant's estimates of other expenses might represent actual cash outlays, the \$26,000 would have come very close to covering applicant's out-of-pocket expenses. As additional customers are served, these rates should cover increasingly larger portions of depreciation expense and ultimately cover all expenses and provide a reasonable return on rate base. This, of course, makes no provision for cash outlays which are not expenses, but rather are capital investments, such as meters for new customers and refunds of advances for construction. Capital investments are the responsibility of applicant, not its customers.

Findings and Conclusion

The Commission finds that:

1. Applicant is in need of additional revenues, but the rates it requests are excessive.
2. The adopted estimates, previously discussed herein, of operating revenues, operating expenses and rate base for the test year 1968 reasonably indicate the results of operations which would prevail for the near future under full development of the 215 lots for which the present system is designed.
3. A rate of return of 7.5 percent on applicant's rate base, if there were customers on all 215 lots, would be reasonable.
4. The increases in rates and charges authorized herein are justified; the rates and charges authorized herein are reasonable; and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.
5. The loss reimbursement agreements discussed herein do not influence the determination of a reasonable level of water rates; they

merely provide for reimbursement of losses which may occur during partial development of the area under rates which are determined reasonable by other criteria.

The Commission concludes that the application should be granted in part.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant San Jose Highlands Water Company is authorized to file the revised rate schedule attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be four days after the date of filing. The revised schedule shall apply only to service rendered on and after the effective date thereof.

2. Protestant's motion for dismissal of this application is denied.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 21<sup>st</sup> day of JANUARY, 1969.

William Agnew Jr.  
President

Augustin  
Frank P. Monsey

Thomas Moran  
Commissioners

Commissioner Thomas Moran, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

Schedule No. 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

San Jose Highlands Subdivision and vicinity, San Jose,  
Santa Clara County.

(T)  
(T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 500 cu.ft. or less .....	\$ 7.70	I
Next 1,500 cu.ft., per 100 cu.ft. ....	1.08	
Over 2,000 cu.ft., per 100 cu.ft. ....	.65	
Minimum Charge:		
For 5/8 x 3/4-inch meter .....	\$ 7.70	I
For 3/4-inch meter .....	10.50	
For 1-inch meter .....	16.00	

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates.