

Decision No. 85161

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
SAN JOSE WATER WORKS, a corporation,
for an Order authorizing it to
increase rates charged for water
service in San Jose, Campbell,
Cupertino, Los Gatos, Monte Sereno,
Saratoga and vicinity.

Application No. 55177
(Filed September 18, 1974)

McCutchen, Doyle, Brown & Enersen, by A. Crawford
Greene Jr., Attorney at Law for applicant.
Cyril M. Saroyan, Attorney at Law, James M. Barnes and
Lloyd M. Humphrey, for the Commission staff.

O P I N I O NProceeding

San Jose Water Works (San Jose) requests authority to increase water rates \$2,787,000 (12 percent) annually.

After due notice hearing in this matter was held before Examiner Coffey in Santa Clara on May 5 and in San Francisco on May 6, 1975. The matter was submitted on May 16, 1975 after the receipt of a late-filed exhibit and reporter's transcript.

San Jose supplies water to approximately 162,000 domestic and industrial customers in San Jose, Los Gatos, Saratoga, and Monte Sereno, and in portions of Campbell, Cupertino, and Santa Clara, and in territory in the county of Santa Clara surrounding and adjacent to these municipalities.

One member of the public and two representatives of water systems served by San Jose appeared at the hearing to protest the proposed rate increase.

Need for Rate Relief

San Jose states that the principal factor which makes this application for rate relief necessary is that annual increases in expenses and rate base are continuing at a rate which substantially exceeds the increase in revenues resulting from customer growth or increased consumption. The rapid urbanization of the Santa Clara Valley has made it necessary to place an ever increasing reliance upon water supplies imported under the State Water Plan which are much more expensive than previous local sources of supply. Moreover, the financing of this importation has made necessary the imposition of pump taxes upon all water produced by San Jose from the underground, such pump taxes amounting to \$1,976,788 during the 12 months ended June 30, 1974.

This urbanization has also made it advisable to filter the surface water supply obtained from the Los Gatos Creek watershed, which has required a capital investment of approximately \$2,000,000 and resulted in the incurring of regular expenses for filtration of water which did not previously require any treatment.

The increasing population of the area served by San Jose requires substantial annual plant expansion which has particular impact upon the rate of return by reason of the recent sharp increases in the cost of borrowing money. Ordinary expenses of operation, such as payroll and the cost of materials and supplies, are likewise increasing, so that the trend of earnings is downward. San Jose believes that its policy of keeping ahead of the demand for water service in the Santa Clara Valley is a most important contribution to the community's welfare. To do so, San Jose states it must increase its rates sufficiently to maintain its credit standing and enable it to attract new capital at a reasonable cost and at the same time provide a fair and reasonable return on equity. Under

prevailing economic conditions, San Jose considers a return of 9.16 percent on rate base to be a minimum appropriate rate of return and San Jose has therefore prepared rate schedules which are designed to produce this rate of return over a three-year period. The proposed rate schedules are in the form of step rates designed to produce a 9.16 percent rate of return in each year through 1977. By use of step rates, San Jose argues, the initial amount of increase is reduced and customers will pay for service based on current levels of expenses and rate base. The proposed rate schedules were designed to give effect to the operational decline in rate of return and to result in an increase of approximately 12-1/2 percent if effective throughout 1975 and 2 percent additional in each of the succeeding calendar years.

Rates

For purposes of this proceeding, the Commission will discuss below San Jose's present and proposed rates. However, it is the intention of the Commission in all future proceedings to implement a "lifeline" rate for water service.

The following tabulation compares San Jose's present and proposed metered service rates:

	<u>Present</u>	<u>Per Meter Per Month</u>			
		<u>Proposed</u>			
		<u>Calendar Year</u>			
		<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
<u>Service Charge:</u>					
For 5/8 x 3/4-inch meter	\$ 2.35	\$ 2.60	\$ 2.65	\$ 2.71	\$ 2.77
For 3/4-inch meter	2.60	2.88	2.94	3.01	3.08
For 1-inch meter	3.50	3.87	3.94	4.02	4.10
For 1-1/2-inch meter	4.90	5.42	5.52	5.63	5.74
For 2-inch meter	6.35	7.02	7.16	7.31	7.46
For 3-inch meter	11.75	12.48	12.72	12.97	13.22
For 4-inch meter	16.00	16.95	17.28	17.62	17.96
For 6-inch meter	26.50	28.15	28.69	29.24	29.79
For 8-inch meter	39.00	41.39	42.19	43.00	43.81
For 10-inch meter	48.50	51.54	52.53	53.54	54.55

Quantity Rates:

First 30,000 cu.ft., per 100 cu.ft. .	0.341	0.376	0.383	0.390	0.397
Over 30,000 cu.ft., per 100 cu.ft. .	0.300	0.331	0.337	0.343	0.349

The Service Charge is a readiness-to-serve charge, to which is to be added the monthly charge computed at the Quantity Rates.

The following tabulation compares San Jose's present and proposed resale service rates:

		<u>Per Meter Per Month</u>			
			<u>Proposed</u>		
	<u>Present</u>	<u>Calendar Year</u>			
		<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
<u>Service Charge:</u>					
For 5/8 x 3/4-inch meter.....	\$ 2.00	\$ 2.21	\$ 2.25	\$ 2.29	\$ 2.33
For 3/4-inch meter.....	2.20	2.43	2.48	2.53	2.58
For 1-inch meter.....	3.00	3.31	3.37	3.43	3.49
For 1-1/2-inch meter.....	4.20	4.64	4.73	4.82	4.91
For 2-inch meter.....	5.40	5.96	6.08	6.20	6.32
For 3-inch meter.....	10.00	11.04	11.25	11.46	11.67
For 4-inch meter.....	13.50	14.90	15.19	15.48	15.77
For 6-inch meter.....	22.00	24.29	24.76	25.23	25.70
For 8-inch meter.....	33.00	36.43	37.13	37.84	38.54
For 10-inch meter.....	41.00	45.26	46.13	47.01	47.88

Quantity Rates:

First 30,000 cu.-ft., per 100 cu.-ft.,	0.291	0.321	0.327	0.333	0.339
Over 30,000 cu.-ft., per 100 cu.-ft.,	0.255	0.281	0.286	0.291	0.296

In addition to the above proposed increases, Exhibit No. 1 sets forth the present and proposed rate increases for "Metered Service to Customers on Almaden Pipeline", "Metered Service to Customers on 6-Inch Line Installed By Santa Clara Valley Water District", "Limited Temporary Flat Rate Service" and "Limited Irrigation Service". No increases are proposed in private fire protection service, public fire hydrants rates, and service to employees. San Jose proposes to supply private fire protection service by means of a 3-inch service in addition to the sizes presently served.

Results of Operation

The following tabulation shows the staff adjusted 1974 and estimated 1975 results of operation. These are compared with San Jose's estimated results of operation at present and proposed rates.

	Applicant		Staff		
		Company		Company	
	Present	Proposed	Present	Proposed	Adopted
Item	Rates	Rates	Rates	Rates	Rates

(Dollars in Thousands)

Estimated Year 1974

Operating Rev.	\$21,991.1	\$24,214.7 ^{1/}	\$21,954.9	\$24,611.7 ^{2/}	\$
<u>Operating Exps.</u>					
Oper. & Maint.	9,057.6	9,064.9	9,176.9	9,185.6	
Admin. & Gen.	1,184.0	1,184.0	1,186.7	1,186.7	
Taxes Other Than Income	2,662.0	2,668.0	2,612.3	2,619.5	
Amort. of CCFT ^{4/}	-	-	67.5	67.5	
Depreciation	2,067.4	2,067.4	2,067.4	2,067.4	
Income Taxes	1,967.1	3,131.5	1,561.3	2,952.5	
Total Expenses	15,938.1	18,115.8	16,672.1	18,079.2	
Net Operating Rev.	5,053.0	6,098.9	5,282.8	6,532.5	
Deprec. Rate Base	66,581.6	66,581.6	65,768.1	65,768.1	
Rate of Return	7.59%	9.16%	8.03%	9.93%	

Estimated Year 1975

Operating Rev. ^{3/}	\$22,853.1	\$25,640.1	\$22,774.0	\$25,529.5	\$24,309.4
<u>Operating Exps.</u>					
Oper. & Maint.	9,710.6	9,719.8	9,625.1	9,633.8	9,907.9 ^{5/}
Admin. & Gen.	1,290.1	1,290.1	1,253.8	1,253.8	1,253.8
Taxes Other Than Income	2,839.2	2,846.7	2,690.5	2,697.9	2,693.9
Amort. of CCFT ^{4/}	-	-	67.5	67.5	-
Depreciation	2,180.4	2,180.4	2,160.7	2,160.7	2,160.7
Income Taxes	1,744.1	3,203.5	1,619.0	3,061.9	2,309.3
Total Expenses	17,764.4	19,240.5	17,416.6	18,875.6	18,046.6
Net Operating Rev.	5,088.7	6,399.6	5,357.4	6,653.9	5,983.8
Deprec. Rate Base	69,864.9	69,864.9	69,003.7	69,003.7	68,767.3
Rate of Return	7.28%	9.16%	7.76%	9.64%	8.70%

^{1/} 1974 step rate.^{2/} 1975 step rate.^{3/} Proposed at 1975 step rate.^{4/} California Corporation Franchise Tax.^{5/} Includes effect of Pacific Gas and Electric Company electric rate increase effective September 21, 1975, Decision No. 84902.

After considering the recorded results of 1974, San Jose concluded that the staff estimates are reasonable and accordingly accepts for the purpose of this proceeding the staff estimates and resultant rates of return. Exhibit No. 6 sets forth the basis for the differences between San Jose's and staff's estimates.

Prepaid State Corporation Franchise Taxes

San Jose has changed its method of accounting for its state corporation franchise tax. Before this accounting change, the company expensed its state franchise tax in the year after the income year on which the tax was based. For example, the company charged \$375,828 for its state franchise tax in 1973 (as shown in the following tabulation). This was based on its 1972 income.

	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
Prepaid Franchise Taxes	\$ 21,100	\$ 320,340	\$ 337,654	\$ 337,654
Franchise Tax Expense	211,356	295,034	375,828	392,000
Franchise Tax Accrued	-	-	66,898	62,844
Net Income Before Federal Income and California Franchise Taxes	\$6,226,002	\$6,422,629	\$6,002,779	\$7,076,257

In 1974, the company charged \$392,000 for its state franchise tax based on its 1974 income. This change was in accordance with the policy of the Accounting Principles Board Opinion No. 11 which stated that the franchise tax should be expensed in the income year on which the tax was based. This change also resulted in a balance of \$337,654 remaining in the Prepaid Franchise Tax Account which represents tax payment based on the income of 1973. This amount will remain on the books indefinitely unless amortized. Therefore, the staff recommends that San Jose amortize the Prepaid State Franchise Tax balance over a period of five years.

In addition the staff included in its summary of earnings for 1974 and 1975, \$67,500 to amortize the prepaid state franchise tax. We note that the change in accounting in conformance with the Accounting Principles Board Opinion No. 11 has resulted in no changes in the dates or of the amounts of payments for franchise taxes by the utility. That is, the actual cash outlay is neither greater nor smaller under other methods of accounting. The change in accounting has resulted in no duplication of payments in any year. The inclusion in the summary of earnings of an amortization of the amount in the Prepaid State Franchise Tax account would require the customer to duplicate in the future the compensation provided the utility for franchise taxes in the last rate case.

We also note that the utility has made substantial savings in its billing expenses over that allowed in the last rate case. An adjustment based on these savings would be opposed as retroactive ratemaking. Likewise even if franchise taxes were actually paid which were greater than the amount allowed in the last rate case, an increase in future revenues to recover any past deficiencies would be opposed on the same basis.

We find it is unreasonable to include in future revenues an allowance to amortize amounts in the Prepaid State Franchise Tax account. We will adopt the staff estimates of operating results but we will delete the \$67,500 amortization of prepaid franchise tax. On the staff basis this results in a return under present rates of 8.12 percent in 1974 and 7.84 percent in 1975.

Rate of Return

San Jose seeks authorization to increase rates to produce a rate of return on rate base of approximately 9.16 percent prospectively through 1977. All of San Jose's support for its requested rate of return is set forth in Exhibit No. 2.

Exhibit No. 7 sets forth the basis of the staff recommendation that the rate of return be set in the range of 8.60 percent to 8.90 percent. Within this range, the earnings allowance for common stock equity is 11.77 percent to 12.51 percent. At the hearing, the staff recommended that the rate of return be 8.6 percent.

The effective interest rates on bonds outstanding rose from 4.48 percent in 1969 to 5.51 percent in 1974. Series B and C bonds totalling \$6,241,000 will be refinanced in 1975 and 1976. Both the staff and San Jose assumed the refinancing can be completed at 9.5 percent which will increase the effective rate to 6.6 percent.

A major source of funds for San Jose has been internal financing. Table 3 of Exhibit 7 shows that over the past ten-year period internal financing has provided \$27,490,207 or 67 percent of the total financing required. San Jose argues that with current interest rates in excess of 10 percent, a return on equity of 12.15 percent is the minimum necessary to encourage investment.

The present upward trend of the cost of long-term debt and preferred stock leads us to accept as reasonable the rate of return of 8.70 percent with an earning allowance for common equity of 12.02 percent.

Step-Rates

San Jose argues that for it to realize a rate of return considered reasonable for a period of years, it is necessary to seek either (1) a single level of rates which will yield rates of return which, over the effective period, will result in the appropriate average, or (2) seek multiple or "step" rates which will yield the appropriate rate of return during each of the years in which the rates are effective. In the last decision involving San Jose, the Commission recognized the downward trend in rate of return and granted step rates. San Jose considers step rates to be more equitable than single-level rates in that with step rates the customers during the

initial year or years do not pay a premium to offset the deficiencies which will occur during the later year or years. Step rates also have the advantage, from San Jose's standpoint, of reducing the fluctuations in level of earnings.

Since staff figures indicate a decline at present rates of 0.27 percent and at proposed rates of 0.29 percent, the staff recommends that a decline in rate of return of 0.28 percent be used in the development of future rates.

To compensate a utility for an anticipated continued decline in earnings over a period of five years and to grant during the period offset rate increases, as was authorized San Jose, is in the main to guarantee future utility earnings. Such a guarantee removes substantial financial risks from the operation. Further, it is axiomatic that to guarantee earnings is to substantially decrease motivation to increase the efficiency of utility operations. Many of the factors contributing to decline in rate of return, such as increases in purchased water and power costs, replenishment assessments, wages, and taxes, have been handled by offset rate increases.

Considering the allowance for equity adopted herein, the burden on consumers of automatic stepped rates without consideration of changes in current operating results, and the negative impact of stepped rates on the promotion of efficiency, we shall not authorize stepped rates in this proceeding. Under present day rapidly changing economic conditions it is not reasonable to expect a reliable projection of utility earning five years into the future when based only on consideration of the earnings for two years.

Service

A tabulation of service complaints on file in San Jose's office shows the following:

Type of Complaint	Year		
	July - Dec.: 1972	1973	1974
Street Leaks	598	1,472	1,341
Meter Leaks	1,947	4,647	3,863
Pressure	479	1,317	1,015
Outage	921	2,058	1,752
Dirt/Color	296	719	704
High Bill	2,178	5,886	3,978
Miscellaneous	2,004	3,665	3,696
Total	8,423	19,764	16,349

Informal complaints registered with the Commission number as follows:

1972..... 52
 1973..... 70
 1974..... 32

A field investigation of the company's operations and facilities was made by the staff during December 1974, and February and April 1975. The facilities and equipment were in good condition and adequately maintained. It appears that the company is providing satisfactory service.

Findings

1. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base for the test year 1975 reasonably indicate the results of San Jose's operations in the near future.
2. A rate of return of 8.7 percent on the adopted rate base is reasonable.
3. Revenues will be increased \$1,535,400 by the rates herein authorized.

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.

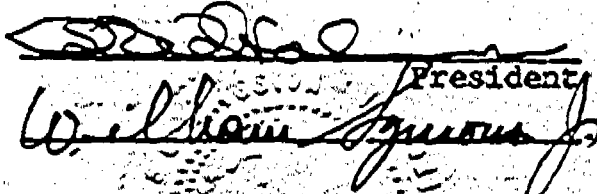
The Commission concludes that the application should be granted to the extent set forth in the order which follows.

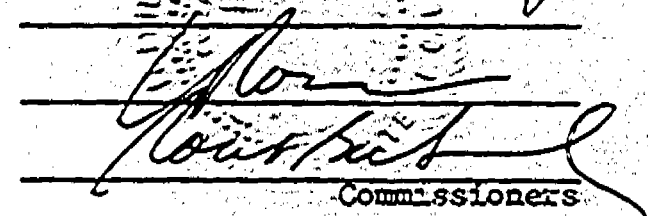
O R D E R

IT IS ORDERED that after the effective date of this order San Jose Water Works' is authorized to file the rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the new and revised schedules shall be four days after the date of filing. These schedules shall apply only to service rendered on and after the effective date thereof.

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

Dated at San Francisco, California, this 25th day of NOVEMBER, 1975.



President


Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A
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Schedule No. 1

GENERAL METERED SERVICEAPPLICABILITY

Applicable to general metered water service.

TERRITORY

Portions of Campbell, Cupertino, San Jose and Santa Clara, and in Los Gatos, Monte Sereno, and Saratoga and in contiguous territory in the County of Santa Clara.

RATES

	Per Meter Per Month	
<u>Service Charge:</u>		
For 5/8 x 3/4-inch meter	\$ 2.50	(I)
For 3/4-inch meter	2.90	
For 1-inch meter	3.70	
For 1-1/2-inch meter	5.20	
For 2-inch meter	6.70	
For 3-inch meter	12.50	
For 4-inch meter	17.00	
For 6-inch meter	28.00	
For 8-inch meter	41.00	
For 10-inch meter	51.00	
<u>Quantity Rates:</u>		
First 30,000 cu.ft., per 100 cu.ft.	0.364	(I)
Over 30,000 cu.ft., per 100 cu.ft.	0.325	

The Service Charge is a readiness-to-serve charge, to which is to be added the monthly charge computed at the Quantity Rates.

(Continued)

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Schedule No. 1

GENERAL METERED SERVICE

(Continued)

SPECIAL CONDITION

Customers who receive water deliveries for agricultural purposes under this schedule, and who present evidence to the utility that such deliveries qualify for the lower pump tax rates levied by the Santa Clara Valley Water District for agricultural water, shall receive a credit of 5.1 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill.

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Schedule No. 21X

LIMITED TEMPORARY FLAT RATE SERVICEAPPLICABILITY

Applicable to water service furnished on a limited temporary flat rate basis.

TERRITORY

Almaden area, Santa Clara County.

RATEPer Month

For each service connection, including irrigation of not more than 2,500 square feet of garden area \$3.30 (I)

SPECIAL CONDITIONS

1. Service under this schedule shall be limited to Account No. 21-505-5330, for which the installation of a meter was not expedient.
2. This schedule will remain in effect only until such time as physical limitations will permit the installation of a meter, and thereafter will be withdrawn.

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Schedule No. 3ML

LIMITED IRRIGATION SERVICE

APPLICABILITY

Applicable to all measured irrigation service furnished on a limited basis.

TERRITORY

The 460-acre area adjacent to the City of Campbell, Santa Clara County.

RATE

	<u>Per Hour</u>
For 650 gallons per minute	\$5.55 (I)

SPECIAL CONDITIONS

1. Service under this schedule is limited to the area formerly served by the system known as the E. R. Kennedy Pumping Plant System, and as more particularly described and shown on Exhibit B of Application No. 27792 and further referred to in Decision No. 39508 in that application.

2. Rates per hour for other flows will be proportionate to the rate for 650 gallons per minute.

APPENDIX A
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Schedule No. 6

RESALE SERVICEAPPLICABILITY

Applicable to all water service furnished for resale purposes.

TERRITORY

Portions of Campbell, Cupertino, San Jose, and Santa Clara, and in Los Gatos, Monte Sereno, and Saratoga and in contiguous territory in the County of Santa Clara.

RATESService Charge:

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	\$ 2.10	(I)
For 3/4-inch meter	2.30	
For 1-inch meter	3.15	
For 1-1/2-inch meter	4.40	
For 2-inch meter	5.70	
For 3-inch meter	10.50	
For 4-inch meter	14.00	
For 6-inch meter	23.00	
For 8-inch meter	35.00	
For 10-inch meter	43.00	

Quantity Rates:

First 30,000 cu.ft., per 100 cu.ft.	0.307	
Over 30,000 cu.ft., per 100 cu.ft.	0.269	(I)

The Service Charge is a readiness-to-serve charge, to which is to be added the monthly charge computed at the Quantity Rates.