ALJ/PAB/jt

Decision 89 10 038 OCT 12 1989

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of SAN JOSE WATER COMPANY, U-168-W, a corporation, for an order authorizing it to (1) increase rates charged for water service, and (2) revise and add to its Rules on file with the Public Utilities Commission.	Application 88-09-029 (Filed September 14, 1988)

A. Crawford Greene and William J. Newell, Attorneys at Law, for San Jose Water Company, applicant.

Ida Passamonti, Attorney at Law, and Mehdi Radpour, for the Commission Advisory and Compliance Division.

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INTERIM OPINION

Summary

San Jose Water Company (SJW) requests a rate increase of $4,483,000 (7.18%) in 1989, $1,203,600 (1.78%) in 1990, and $1,203,600 (1.75%) in 1991. SJW requests a rate of return on rate base of 11.74%, 11.77%, and 11.88% for 1989, 1990, and 1991 and a constant return on equity (ROE) of 13.75%. SJW's last authorized rate of return on rate base was 11.70%, 11.76%, and 11.80% for 1984, 1985, and 1986, with a constant ROE of 14.5%. Thus, the requested returns are lower than those previously authorized.

The Commission Advisory and Compliance Division, Water, Auditing and Compliance Branches (CACD) and the Division of Ratepayer Advocates, Financial and Economic Analysis Branch (DRA) recommend a rate decrease of $4,295,000 in 1989, $52,400 in 1990, and a rate increase of $162,400 in 1991. DRA recommends a return on rate base in the range of 10.40-10.66% for 1989, 10.48-10.74% for 1990, and 10.57-10.83% for 1991. DRA requests that the ROE be set in the range of 11.75-12.25%. DRA recommends a specific return on rate base of 10.53%, 10.61%, and 10.70% for 1989, 1990, and 1991, with a constant ROE of 12%.

We conclude that it is reasonable to order SJW to reduce its rates for the future by $239,100 (0.34%) from the present effective rates. We authorize 56% common equity in SJW's capital structure for 1989, 55% in 1990, and 53% in 1991. Based upon this phased decrease in common equity, we consider reasonable a rate of return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991 and a return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991.

Our authorized rates reflect the resolution of numerous disputed issues in this proceeding. We agree with CACD that commercial consumption for 1989 and 1990 will be higher than projected by SJW. We disallow all expenses for SJW employee's

personal use of vehicles. We also disallow the purchase price for all vehicles where personal use on vehicles is 50% or greater. We grant SJW's requested amount of cash deposits for its operating bank account. We deny CACD's request for new appraisals of SJW property sold to SJW Land Company (SJW Land). Instead, in accordance with Decision (D.) 86-01-026, we order SJW to establish a program to offer for public bid all parcels of land that have been in rate base and were either later transferred to SJW Land, or which SJW wishes to transfer in the future. This program will be submitted to CACD which will make any recommendations on the program in the next phase of this proceeding. In accordance with D.89-05-065, we deny SJW's request for additional tax expense for unbilled revenues. In that decision we denied the same request by the California Water Service Company and SJW in a Joint Petition for Modification of D.88-01-061, our order adjusting rates in accordance with the 1986 Tax Reform Act.

We order the estimates of consumption authorized in this proceeding to be used in calculating consumption in SJW's memorandum account, which was approved in D.89-04-041.

Tables 1 and 2 show the Commission adopted summary of earnings at present rates and authorized rates for the test years 1989 and 1990. Appendix D shows a sample of the residential customer bills.

Table 1

San Jose Water Company
Adopted Summary of Earnings
(Dollars in Thousands)
1989

	Adopted at Present Rates	Adopted at Auth. Rates
Operating revenues	$69,373.1 *	$67,180.0 *
Operating expenses		
Purchased water	13,320.0 *	13,320.0 *
Purchased power	5,107.0 *	5,107.0 *
Pump tax	10,282.0 *	10,282.0 *
Payroll	6,019.0	6,019.0
Other O & M	3,935.0	3,935.0
Other A & G	5,260.0	5,260.0
Business license	30.0	30.0
Taxes other than income	2,045.7	2,045.7
Depreciation	4,965.2	4,965.2
Subtotal	50,963.9	50,963.9
Uncollectibles	160.9	155.9
Franchise tax	154.6	149.7
State income tax	1,241.7	1,038.7
Federal income tax	4,573.7	3,898.2
Total operating expenses	57,094.9	56,206.3
Net operating revenues	12,278.2	10,973.7
Rate Base	104,694.4	104,694.4
Rate of Return	11.73%	10.48%

* Current rates based on Resolution No. W-3459, dated July 19, 1989

Table 2

San Jose Water Company
Adopted Summary of Earnings
(Dollars in Thousands)
1990

	Adopted at Present Rates	Adopted at Auth. Rates
Operating revenues	$69,967.5 *	$69,150.0 *
Operating expenses		
Purchased water	13,406.0 *	13,406.0 *
Purchased power	5,151.0 *	5,151.0 *
Pump tax	10,387.0 *	10,387.0 *
Payroll	6,348.0	6,348.0
Other O & M	4,115.0	4,115.0
Other A & G	5,489.0	5,489.0
Business license	30.0	30.0
Taxes other than income	2,126.2	2,126.2
Depreciation	5,147.3	5,147.3
Subtotal	52,199.5	52,199.5
Uncollectibles	162.3	160.4
Franchise tax	155.9	154.1
State income tax	1,171.5	1,095.9
Federal income tax	4,348.0	4,096.4
Total operating expenses	58,037.3	57,706.4
Net operating revenues	11,930.2	11,443.6
Rate Base	107,238.7	107,238.7
Rate of Return	11.12%	10.67%

* Current rates based on Resolution No. W-3459, dated July 19, 1989

Public Comments

In January, 1989, SJW notified its customers by bill inserts and local newspaper publications of this application and a public meeting to discuss the application.

CACD conducted the informal public meeting in San Jose on November 3, 1988. Four customers attended the meeting. One customer complained of occasional rust-colored material in the bathtub. A utility representative was assigned to investigate this complaint. The complaint was subsequently resolved. One customer expressed satisfaction with the service. There were no other public comments.

Public participation hearings were held on February 2, 1989 in San Jose. The only customer to comment sent a written statement. This customer opposes the rate increase and asks why the November 3 public meeting was not transcribed and why a public vote on the rate increase was not taken at that meeting. The assigned administrative law judge (ALJ) responded in writing that the public's opportunity to comment on the application is during our public participation hearing and that no public vote is required.

Evidentiary Hearings

Evidentiary hearings were held in San Francisco on February 6, 7, and March 13-17, 1989. SJW presented six witnesses and CACD and DRA presented five witnesses in support of their respective positions. Testimony of the witnesses outlined the areas of dispute. The final differences between SJW and CACD/DRA were presented in a late-filed Summary of Earnings which outlines the disputed matters. (Exhibit 14, p. 3.) The case was submitted upon the receipt of concurrent briefs on April 24, 1989.

After the submission of briefs, SJW wrote a letter to the assigned ALJ objecting to CACD/DRA attaching to its brief a membership brochure published by the American Institute of Real Estate Appraisers which explained the Member, Appraiser Institute

(MAI) requirements. SJW complained that this was not a proper document of which official notice could be taken and was not presented as evidence in the proceeding. No response was received from CACD or DRA. Accordingly, we have not used this document in the conclusions we reach in this order.

The Proposed Decision of ALJ Bennett was mailed to parties on August 7, 1989. Comments and replies to comments to the Proposed Decision were filed by both parties. We adopt SJW's suggestion to calculate levelized rates from the effective date of September 1989 rather than January 1, 1989. We have made the technical and factual corrections as suggested by both parties. We have changed four conclusions reached in the proposed decision. We have revised the sales forecast, the forecast of operating expenses, modified the transportation expense disallowance to be consistent with with our last water rate case order D.89-09-048, and we will order SJW to solicit public bids for the property that was in rate base and was subsequently moved transferred to the affiliate land company.

The following discussion addresses issues which are disputed and some issues which are not disputed. Undisputed matters are discussed to record SJW compliance with prior Commission orders or to authorize tariff rule changes. Other matters not in dispute have been reviewed and found reasonable and are not discussed below.

Utility Background

SJW became a wholly owned subsidiary of SJW Corporation (SJW Corp.) in 1985. At that time SJW Corp. acquired all outstanding shares of SJW common stock. In 1987, residents of California owned 67% of SJW Corp.'s stock. SJW Corp. has one other wholly owned subsidiary, SJW Land Company (SJW Land).

SJW's service area consists of approximately 134 square miles in Santa Clara County encompassing the cities of San Jose, Los Gatos, Monte Sereno, Saratoga, Campbell, Cupertino, and Santa

Clara. The center of the service area is flat sloping up to foothills in the southwest and northeast. The southwest portion of the service area is bordered by mountains; the northeast portion extends into adjacent foothills.

SJW's water sources are: 148 wells located in various parts of Santa Clara Valley; runoff from the watersheds of Los Gatos, Saratoga, and Alamitos Creeks; and water purchased from the Santa Clara Valley Water District (District). SJW's water contract with the District expires in 2051. In 1987, SJW delivered 50,413 million gallons of water to a total of 198,704 customers.

SJW chlorinates and filters water from the watersheds in several filter plants. SJW intends to meet new customer growth in 1989-91 by water purchases in order to avoid overdrafts of underground water. SJW performs more tests for water quality than required by the County Health Department, and its water quality meets the required standards.

SJW has approximately 2,257 miles of transmission and distribution mains ranging in sizes up to 48 inches in diameter. Water distribution is made to 51 different pressure zones. An automatic computer telemetry control system operates and monitors water service. The system can be operated and monitored manually if required. Total utility plant is valued at $213 million, producing $65.5 million in revenues in 1987.

SJW has made numerous improvements in the quality of its customer billing and account record-keeping in the past three to four years. SJW's punch card billing system was converted to a paper billing system to comply with the Commission's report card billing requirements discussed in D.84-03-055. SJW installed a hand-held computer meter reading system which has improved the productivity of meter readers. This system gives the location of a meter, the meter number, usage history, and tests for meter accuracy. SJW installed computerized cash remittance machines to accept bill payment and automatically deposit customer checks. SJW's general ledger has been transferred to a computer system.

Rate of Return

SJW requests a rate of return on rate base of 11.74% in 1989, 11.77% in 1990, and 11.88% in 1991 and a constant ROE of 13.75%. DRA recommends a rate of return on rate base ranging from 10.40%-10.66% in 1989, 10.48%-10.74% in 1990, and 10.57%-10.83% in 1991 and that the adopted ROE be within the range of 11.75% to 12.25%. Within these ranges, DRA recommends specific rates of return on rate base of 10.53% in 1989, 10.61% in 1990, 10.70% in 1991, and a constant 12% ROE.

The parties present different perceptions of SJW's classification within the utility industry. SJW compares itself with electric, gas, and telecommunication utilities. DRA compares SJW with other publicly traded water utilities. This difference of perception guides each party's application of the same general finance principles and selection of comparable companies to recommend rates of return. The different views lead to different recommended capital structures and calculations of expected ROE.

SJW and DRA's estimates for long-term debt had a minor difference in 1990. DRA agrees with SJW's average debt costs for 1989 and 1991 of 8.87% and 9.23%, respectively. However, DRA's average debt cost (effective rate) for 1990 is .11% higher than that of SJW, 9.05% versus 8.94%.

DRA used a straight arithmetic average of beginning- and end-of-year debt costs for prior years to calculate the effective rate in 1990. SJW used an average weighted in proportion to the time the debt is outstanding. DRA's method is consistent with prior Commission treatment; therefore, we adopt DRA's effective rate of 9.05% for 1990.

Capital Structure

The capital structure defines the sources of capital costs. Each source of capital can be translated to a percentage of total capital. The components of the capital structure are long-term debt, preferred stock, and common equity. SJW has no preferred stock.

Common equity was the most debated component of the capital structure. At the end of 1988, SJW's common equity ratio was 57.51%. SJW's requested and DRA's recommended capital structures for 1989, 1990, and 1991 appear in the following table:

	DRA			SJW		
	1989	1990	1991	1989	1990	1991
Long-Term Debt	47.00%	47.00%	47.00%	41.20%	41.25%	41.41%
Common Equity	53.00	53.00	53.00	58.80	58.75	58.59
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

SJW requests a higher level of common equity for the test years 1989 and 1990 and attrition year 1991. DRA imputes common equity below the existing ratio to reduce the revenue requirement for common equity costs collected from the ratepayer. SJW and DRA based their respective recommendations for capital structure on their independent analysis of SJW's business and financial risk.

Business Risk

Under general finance principles, the balance between the percentage of debt and equity is determined by the degree of business risk and financial risk. The level of business risk of a company depends upon the reliability of its revenues, the degree of technological change, and the status of other unique occurrences in the industry.

In the opinion of DRA's witness, Ms. Siegal, water utilities do not face the same degree of technological change and utility bypass faced by electric utilities. DRA considers water utilities to have advantages over electric utilities. Water utilities supply a commodity which is renewable and, unlike electric utilities, earn a return on construction work in progress.

These factors lead DRA to conclude that SJW has more steady, predictable revenues and less business risk. The less business risk a company faces, the more debt it may take on because it is assured of meeting fixed payment obligations. Because of its low business risk, DRA considers SJW capable of assuming more debt and lower equity ratios.

SJW considers the uncertainty of new Environmental Protection Agency (EPA) testing standards, the lack of normal rainfall, and potential loss of revenues during the existing drought to indicate a high business risk.

Financial Risk

The level of financial risk of a company is determined by the proportion of a company's debt to permanent capital (leverage). The larger the debt payments, the larger the financial risk of not meeting those payments. A company lowers the financial risk by increasing equity. As a company becomes more leveraged, the cost of its debt will increase and the return required on new debt issuances will increase. Such a company must weigh the benefit of cheaper debt against the increased financial risk of higher fixed payments. The existence of more debt means less common equity and the loss of financial flexibility that common equity allows. Common equity financing gives management the financial flexibility of reducing or suspending dividend payments in times of business hardship. In order to provide reliable service, a company must be able to pay its bills and meet demands for growth without facing financial instability.

The financial stability of a company is measured by bond ratings. Bond rating agencies rank the financial standing of water utilities in the categories of: total debt to permanent capital, pretax interest coverage, and internal cash flow to permanent capital. Standard and Poor's, a well-respected bond rating agency, establishes benchmark standards for these three measures. Bond ratings range from a low of BBB, A, AA to a high of AAA. SJW ranks

AAA in all three categories for water utilities. When compared with an electric utility's benchmarks, which are more strict than water utility standards, SJW ranks AAA in total debt to permanent capital and pretax interest coverage and AA in internal cash flow.

DRA considers SJW to be very stable financially based upon the three financial indicators. DRA asserts that the ratepayer does not benefit from high bond ratings in SJW's case because SJW's debt ratio, pretax interest coverage and cash flow exceed the levels required to obtain AAA and AA ratings. SJW's performance on these financial indicators is achieved at the expense of more expensive equity financing.

In DRA's opinion, SJW could lower the levels of its performance on these indicators and still meet the requirements for a superior bond rating. High bond ratings are needed only to obtain a low interest rate for new debt. SJW does not plan large debt financing in the test years. Thus, the ratepayer is not benefiting from SJW's high level of equity which generates excessive levels of internal cash. DRA recommends imputing a more reasonable level of common equity which would reduce the revenue requirement collected from the ratepayer.

SJW witness Meyer testified that bond ratings must be maintained regardless of whether bond issuances are contemplated for current years. In his opinion, it is not possible or practical to raise and lower these ratings by adjusting common equity when debt is to be issued.

<u>Comparative Analysis</u>

DRA used outside indicators to verify that SJW's equity ratio is unreasonable. DRA compared 11 water utilities throughout the nation meeting three criteria: listed in C. A. Turner's

Utility Reports; realization of 70% of revenues from water operations; and regular trading of stock.[1]

DRA's analysis shows that SJW's average year equity ratio rose from 39.13% in 1978 to 59.30% in 1987, even though in 1984, the Commission's authorized returns were based upon an equity ratio of 56%.

DRA found that the same comparable water utilities' common equity ratios averaged 40.12% for 1983-1987 and 38.22% for 1978-1987. SJW's average common equity for five years is 56.25% and for ten years is 50.42%. In the last five years, SJW's common equity ratio is 16% higher than comparable water utilities.

SJW's pretax interest coverage ratio has exceeded that of the comparable group since 1983. In the past two years SJW's coverage was 6.7x and 6.1x compared with that of the group, 3.2x and 3.4x for the same years.

DRA believes this equity growth is because cash flow has consistently exceeded cash requirements. DRA used the ratio of internal cash flow to net construction outlays to show the excess cash generation in the past ten years. Over the last five years SJW's ratio of cash to construction costs averaged nearly 120%, with cash available surpassing cash needs. DRA maintains that this excess cash has fueled the growth in common equity.

DRA believes SJW's low dividend payout rate helped to increase the high equity ratio. SJW has paid out an average of 63% in the past ten years compared to the group average of 71%. SJW has pursued a policy of low dividend payout in spite of its 11.45%

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1 American Water Works, California Water Service, Connecticut Water Service, Consumers Water, Elizabethtown Corporation, The Hydraulic Company, IWC Resources Corporation, Middlesex Water Company, Philadelphia Suburban, Southern California Water, and United Water Resources.

ten-year average growth in dividends and earnings. (The group's ten-year average growth in dividends and earnings is 6.31%.) SJW plowed earnings back into the business, increasing common equity, the sum of contributed capital and retained earnings.

DRA derived its recommended 53% common equity ratio from a review of ratios of the comparable water utilities. The company with the highest common equity within the comparable group has a ratio of 53% as of January 1989, even though the group average is 42%. DRA does not recommend imputing the group average because it is a sharp reduction from SJW's 1987 level of common equity, 59.30%.

DRA believes common equity will continue to grow during the test period unless curtailed in this proceeding. Since dividends are paid out only to SJW Corp., DRA is concerned that any cash build-up transferred to the unregulated holding company will finance unregulated ventures. Ratepayers should only pay for services rendered, not finance unregulated business ventures, in DRA's opinion.

SJW considers DRA's imputed capital structure to be a penalty when coupled with its recommended 12% ROE. SJW accuses DRA of being subversive by imputing 53% common equity and recommending 12% ROE. SJW considers it more logical for DRA to recommend maintaining the existing capital ratios and award an ROE below 11.75% due to SJW's less risky capital structure. However, in SJW's opinion, DRA did not make these recommendations because they would not be approved by the Commission. Therefore, DRA recommended a scenario of capital structure and ROE which achieves the same result of reducing internal cash.

SJW performs two calculations to show DRA's common equity and ROE recommendations are not consistent. First, SJW calculates an ROE of 11.70-11.74% for 1989-91 using SJW's requested capital structure, DRA's recommended rate of return, and the undisputed debt cost. Second, Meyer explained that if 53% equity is imputed, this results in a limit of 47% debt. In SJW's case, debt is issued in the form of bonds. At the end of 1987, SJW's debt ratio was 42.37%. Therefore, to achieve a 47% debt ratio, SJW would need to impute bonds to this level, which increases its weighted cost of debt and lowers the return on equity. If a 47% debt ratio is imputed, an additional $4.8 million in bonds is presumed to have been issued during the period 1984-1987. If SJW had issued an additional $4.8 million in bonds, it would have an additional debt cost of 11.3% during this period, giving a higher average cost for bonds. Performing the rate of return calculation with this additional debt cost, the resulting return on equity is 11.90% for 1989. Thus, applying DRA's recommended imputation of higher debt to SJW's requested capital structure results in an ROE lower than DRA's recommendation. SJW considers this shortfall in ROE to be a hidden penalty against the utility.

In order to impute a 47% debt ratio or an additional $4.8 million in bonds, SJW alleges it must have sufficient assets to secure such an issuance. If it subtracts the additional assets required by this imputation of debt from its total available assets, it has insufficient assets ($2.8 million) to secure debt which may be needed for unanticipated expenses, such as additional facilities which may be mandated by new EPA regulation. Under this scenario, in order to meet unanticipated costs, SJW would be forced to secure second mortgage bonds at a higher cost to the ratepayer. Thus, SJW alleges a 53% common equity ratio cannot be reached in three years because its bonding limits have recently reached their capacity. SJW argues that the imputed ratios are recommended without warning or opportunity for SJW to achieve the level imputed.

Meyer testified that SJW reduced its common equity in 1986 and 1987 by paying dividends to SJW Corp. in response to CACD's advice to keep common equity below 60% or penalties may occur. SJW interpreted this remark to mean a 60% common equity ratio was reasonable. SJW paid $12.07 million in dividends to SJW Corp. in 1986 and $9 million in 1987, reducing common equity to a 1987 level of 57.63%. (In 1988 SJW paid out $5.25 million in dividends, bringing the common equity ratio to its present level of 57.51%.) SJW relied on its efforts of reducing equity in 1986 and 1987 to place them within an acceptable equity ratio range. SJW considers DRA's recommendations in this proceeding to violate CACD's informal advice upon which SJW relied. DRA responds that SJW had no reason to rely on CACD's advice as being Commission policy.

SJW challenges DRA's comparable companies as ones which derive only 70% of revenues from water service, have unknown sources of supply and varying regulatory policies. Seven of these selected companies have ten-year average dividends and earnings growth rates of 1.58% to 6.12% compared with SJW's rate of 11.45%. SJW points out that SJW's rates are $14 less on an annual basis than those of comparable companies, showing no harm has occurred to SJW's ratepayers by its level of common equity.

SJW argues that this cash was generated by 1986 investment tax credits and accelerated tax depreciation. In 1987, SJW's cash flow was increased by increased sales. Thus, the increase in cash was not because of SJW's conscious effort to do so but because of external factors.

SJW considers the substitution of SJW Corp.'s statistics to represent SJW to be a serious flaw in DRA's analysis. SJW alleges it and SJW Corp. are two distinct companies with different assets and capitalization. Although DRA corrected this criticism by providing statistics for both SJW and SJW Corp. in its tables, SJW asserts that the text of DRA's written testimony referring to SJW and SJW Corp. as the same company is unreliable.

Discussion

We agree with DRA that SJW is more comparable with water utilities than electric, gas, and telephone utilities for business risk comparison purposes. Although water utilities may face business risk, it is not as great as that faced by electric, gas, and telephone utilities, as discussed by DRA.

We consider SJW's financial risk to be low based upon the financial factors considered in bond ratings. We agree that SJW's existing financial factors are excessive to maintain the highest bond ratings. We disagree with SJW that the present excessive internal cash generation and pretax interest coverage are needed to acquire additional capital and obtain favorable interest rates on new debt.

Excessive levels of common equity burden the ratepayer with excessive rates. Ratepayers do not receive a tax benefit for paying this revenue requirement on equity as they do from the tax deduction allowed for debt interest payments. We do not believe SJW's bond ratings will be affected by a reduction in common equity. A reduction in the level of SJW's common equity will allow the ratepayer to share in SJW's healthy financial state by reduced rates.

SJW's analysis of bond costs and capacity presuming a historical 53% equity level and 47% debt level is a hindsight view which is marginally relevant to its existing capital ratio status. Our purpose is not to blame SJW because its present equity is increasing but to resolve the dilemma in which it puts the ratepayer. Nor do we find that DRA's recommendations will penalize SJW if implemented in steps as discussed below. DRA's recommended equity level is made within the context of its recommended 12% ROE. It is not DRA's recommendation that SJW's requested equity levels be used in conjunction with DRA's recommended rates of return. We believe this is a distortion of DRA's recommendations by SJW.

We find that DRA's imputed common equity of 53% is reasonable when compared with the range of common equity of comparable water utilities (34% to 53%) and the average common equity of comparable water utilities (42%). We agree that imputing this average would be too large a reduction in common equity to authorize in one step.

We find little justification by SJW to raise its equity ratio above the last authorized level of 56%. Its arguments consist of attacks on DRA's recommendations. Therefore, in 1989 we authorize common equity of 56%.

The record shows that SJW's common equity has been reduced by its dividend payout policy. SJW's alternative methods of reaching the 53% level of common equity do not include an analysis of any anticipated dividends to be paid out in 1989, 1990, or 1991. We expect any dividends paid will reduce common equity. SJW alleges increasing debt to 47% will increase interest expense to the ratepayer. This analysis is incomplete without following through to calculate the benefit to the ratepayer of an additional tax deduction for interest expense. Based upon the incompleteness of both of these analyses, we cannot agree that a 53% equity ratio cannot be reached. However, in order to give SJW sufficient time and the opportunity to achieve 53% equity, we impute 55% equity in 1990, and in 1991 we impute DRA's recommended equity level of 53%.

Return On Equity

Rate of return recommendations are governed by two landmark U.S. Supreme Court decisions, Bluefield Water Works and Improvement Company vs. The West Virginia Public Service Commission (1923) 262 U.S. 679, and the Federal Power Commission vs. Hope Natural Gas Company (1944) 320 U.S. 591. The principle in these cases is to set rates for public utilities which are not only sufficient to assure the provision of adequate service, but which allow the utilities to raise capital. By this standard, the ROE should be commensurate with returns on investments in other enterprises having corresponding risks and should assure a financial integrity of the utility which maintains its credit and attracts capital.

Both parties used the standards from these cases of attracting capital and comparable earnings in its analysis in this proceeding. However, the application of the standards are based upon the parties' respective perception of SJW's classification within the utility industry. SJW perceives itself as similar to electric, gas, and telephone utilities. DRA perceives SJW as similar to other water utilities.

Both parties used the Discounted Cash Flow (DCF) and the Risk Premium (RP) financial models to justify their ROE recommendations, yet derived different conclusions based upon their comparable utilities and applications of the methodology.

Discounted Cash Flow

The DCF model is based on the premise that the current market price of a share of common stock equals the present value of anticipated dividends plus future stock price, discounted by the investor's expected return. By translating this premise into a mathematic equation and transposing the equation, the investor's expected ROE equals the expected dividend yield (the next expected dividend divided by the current market price) plus future dividend growth.[2]

DRA applied the DCF model to its 12 comparable water utilities, including SJW Corp. From this analysis, DRA derived average dividend yields of 6.07% for three months and 6.01% for six months. To these yields, DRA applied an average of historical and sustainable growth rates of 5.52%, obtaining future expected returns averaging 11.90% for a three-month dividend yield and

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2 $r = D1/P0 + g$

where r = the investor's expected return on equity;
$D1$ = the expected dividend in the next period;
$P0$ = the market price in the current period; and
g = the expected future dividend growth rate.

11.84% for a six-month dividend yield. DRA considers the group results to balance any biases in the data, such as high or low dividend growth rates. DRA included SJW Corp. as a representative of SJW to weigh the results with company-specific data. DRA used the group results in its recommended specific ROE.

SJW applied the DCF model to its own stock price, and historical dividends and earnings growth for the past five-year and ten-year periods. No comparable companies were used. SJW derived ROE estimates of 13.62% to 21.48% based upon ten-year growth and 15.89% to 17.83% based upon five-year growth.

Risk Premium

The RP model is based upon the premise that common equity investors face more risk than debt holders because they receive returns from residual revenues after debts are paid, thus requiring higher returns than debt holders. The difference between the return for debt holders and common stock investors is the risk premium which is added to the debt interest rate to obtain the common equity return. An average risk premium calculated over an extended time period is preferred to balance past variances in premiums.

DRA used the RP financial model to verify the results derived from the DCF model. DRA applied the RP model to the same comparable group of utilities obtaining a range of expected ROEs from 11.95% to 12.53%. DRA compared SJW's past earnings, common equity ratios, and growth with the comparable group, concluding that SJW exceeded the group average in these categories.

Using the results of the DCF and RP models, SJW's past earnings, and its judgment, DRA recommends a range of ROE of 11.75% to 12.25% and a specific ROE of 12%.

SJW applied the RP model to five California electric, gas, and telephone utilities[3] obtaining a range of historical ROEs from 12.70% to 13.10% and an average historical ROE of 12.81%. SJW applied the model to six California water utilities[4] obtaining a range of 1987-authorized ROEs from 12.00% to 13.00% and an average ROE of 12.71%. The combined 1987 average authorized ROE for all of the utilities selected by SJW is 12.75%. Adding the average risk premium from these utilities, 3.11%, to SJW's current imbedded cost of debt, 10.86%, SJW calculated a return of 13.97% under this method.

SJW applied the RP model to SJW's historical authorized ROEs from 1975-1984. SJW obtained an average historical ROE of 13.02% and projected ROEs for 1988, 1989, and 1990 of 15.19%, 15.22%, and 15.29%.

Using the results from the DCF and RP models, judgment and factors of business risk (technological changes and the drought), SJW recommends 13.75% as a reasonable return for the future.

SJW criticized DRA's procedure of selecting the company with the poorest financial performance and lowest ROE within its comparable group to use in its recommendation. SJW asserts that if DRA's recommendation for return on rate base is adopted, it will have the lowest return within DRA's comparable group.

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3 Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and General Telephone Company of California.

4 California American Water Company, California Water Service Company, Dominguez Water Company, Park Water Company, Southern California Water Company, and Suburban Water Systems.

SJW outlines factors which are relevant to the Commission in setting SJW's ROE:

1. The Commission's acceptance of this application was delayed because inadequate staff was available to process the application. The delay in accepting this application impacts SJW's earnings for 1989.

2. SJW's earnings will be affected by lower consumption under SJW's existing water rationing program.

3. New technology has prompted new, more stringent standards for water testing. Pending EPA regulation may require changes in existing facilities and additional testing.

4. SJW considers its management achievements in the past three to four years to warrant consideration in setting its rate of return.

Discussion

We select DRA's comparable companies for analysis over SJW's list of electric, gas, and telephone utilities because the latter utilities face greater business risks of bypass and technological change than water utilities as discussed by DRA above.

DRA's comparable utilities are preferred over SJW's comparable water companies because they are listed by C. A. Turner's Utility Reports with verified financial data, are publicly traded, and derive at least 70% of revenue from water operations. Even though 5 of the 12 companies derive up to 30% of their revenues from nonwater operations, 7 derive over 98% of their revenues from water operations. We do not accept SJW's comparison of its own historical financial data as a comparison which meets the standard set by the Bluefield and Hope decisions, cited above.

We interpret these cases to mean that a valid comparison is one made with other enterprises.

We find that SJW Corp. derives 98% of its revenues from SJW; therefore, DRA's references to SJW Corp. are synonymous with SJW. We agree with SJW that its growth and earnings are on a higher scale than the averages of historical growth and earnings of DRA's group. We find SJW more comparable with the companies having a higher financial standing of DRA's group rather than the group averages. We believe it is appropriate to consider the higher end of DRA's comparable analysis in setting SJW's return. However, we must also consider SJW's equity level, discussed below.

We do not agree that the delay in accepting this application is cause for a greater rate of return. Any such delay means that SJW is authorized to earn 14.5% ROE on slightly lower rate base and expenses until our decision in this proceeding is effective. This delay may not have caused as significant an impact as SJW argues.

We cannot agree that loss of revenue during the drought is cause for a greater rate of return. We have authorized a memorandum account procedure to allow SJW the opportunity to recover any such losses. (D.89-04-041.) We consider that procedure adequate to compensate SJW for any revenues lost and to minimize the business risk encountered by the drought. Any consideration for such revenues in SJW's ROE would be double recovery.

We believe it is premature to compensate SJW in its ROE for possible technology changes in the water industry until new requirements are mandated. To do so would be pure speculation at this time. Should technical changes significantly impact the revenues of water utilities, it is our practice to institute an investigation to adjust the rates of all affected water utilities for unanticipated expenses rather than increase rates on a case-by-case basis.

Based on the above considerations and the higher results of DRA's analysis, we consider an ROE in the range of 11.75% to 12.25% to be reasonable. However, both parties agree with the premise that ROE varies inversely with the level of common equity. Therefore, because we order a phased reduction of common equity, we also order a phased increase in ROE. During the test year 1989, SJW is authorized to earn 11.75% ROE. During the test year 1990, SJW is authorized to earn 12% ROE. During the year 1991 when 53% common equity shall be imputed, we authorize SJW to earn 12.25% ROE.

The following table shows our adopted capital structure and rates of return:

Adopted Capital Structure and Rate of Return

Component	Capital Ratios	Cost	Weighted Cost
	1989		
Long- and Short-Term Debt	44.00%	8.87%	3.90%
Common Equity	56.00	11.75	6.58
Total	100.00		10.48%
	1990		
Long- and Short-Term Debt	45.00	9.05	4.07%
Common Equity	55.00	12.00	6.60
Total	100.00		10.67%
	1991		
Long- and Short-Term Debt	47.00	9.23	4.34%
Common Equity	53.00	12.25	6.49
Total	100.00%		10.83%

Operating Revenues

SJW's estimated operating revenues for 1989 and 1990 are based upon the estimated number of customers to be served during the test years and their projected consumption. SJW serves residential, commercial, industrial, public authority, other utility, and a category of "other" customers. SJW and CACD agree on the estimated number of customers in 1989 and 1990. They agree on the total consumption by all customers except commercial customers for these years. (SJW includes residential customers in its totals for commercial customers.)

Parties in rate proceedings have used the Modified Bean (Bean) Method of estimating customer consumption since 1968. The goal of the Bean Method is to estimate normal consumption in a future year under normal weather conditions. Data containing the recorded temperature and rainfall for the past 30 years is input into the Bean Method computer model. The data is obtained from a weather station in the approximate location where consumption will occur.

The Bean model uses the 30 years of temperature and rainfall data to calculate the normal temperature and normal rainfall. The model generates one consumption estimate for each selected range of consecutive years. Each Bean run is given ratings by the computer to rank the efficiency of the data contained in the computer run. The user of the model selects the estimate of consumption from the range of years with the highest efficiency ratings. The user then verifies that this estimate is reasonable.

SJW used the Bean Method in this proceeding, and CACD used a three-year average to derive a different estimate for commercial customer consumption. However, SJW and CACD agree that the normal temperature for the past 30 years calculated under the Bean method is 60 degrees and the normal rainfall is 13.54 inches. Drought years were not excluded from these averages.

The Bean model used the following adjusted rainfall, temperature and consumption data:

Year	Rain (inches)	Temperature (degrees)	Consumption (Ccf/yr.)
1977	8.19	59.6	216
1978	17.14	60.9	238.8
1979	15.12	60.4	247.5
1980	14.04	60.4	253.6
1981	15.58	61.3	261.2
1982	19.57	59.2	247.8
1983	24.25	60.9	256
1984	11.55	60.7	283.3
1985	10.69	59.7	279.2
1986	13.61	61.6	278.4
1987	10.34	61.5	286.8

(Exhibit 4, p. 2)

The Bean model generated the following estimated consumption for the corresponding periods:

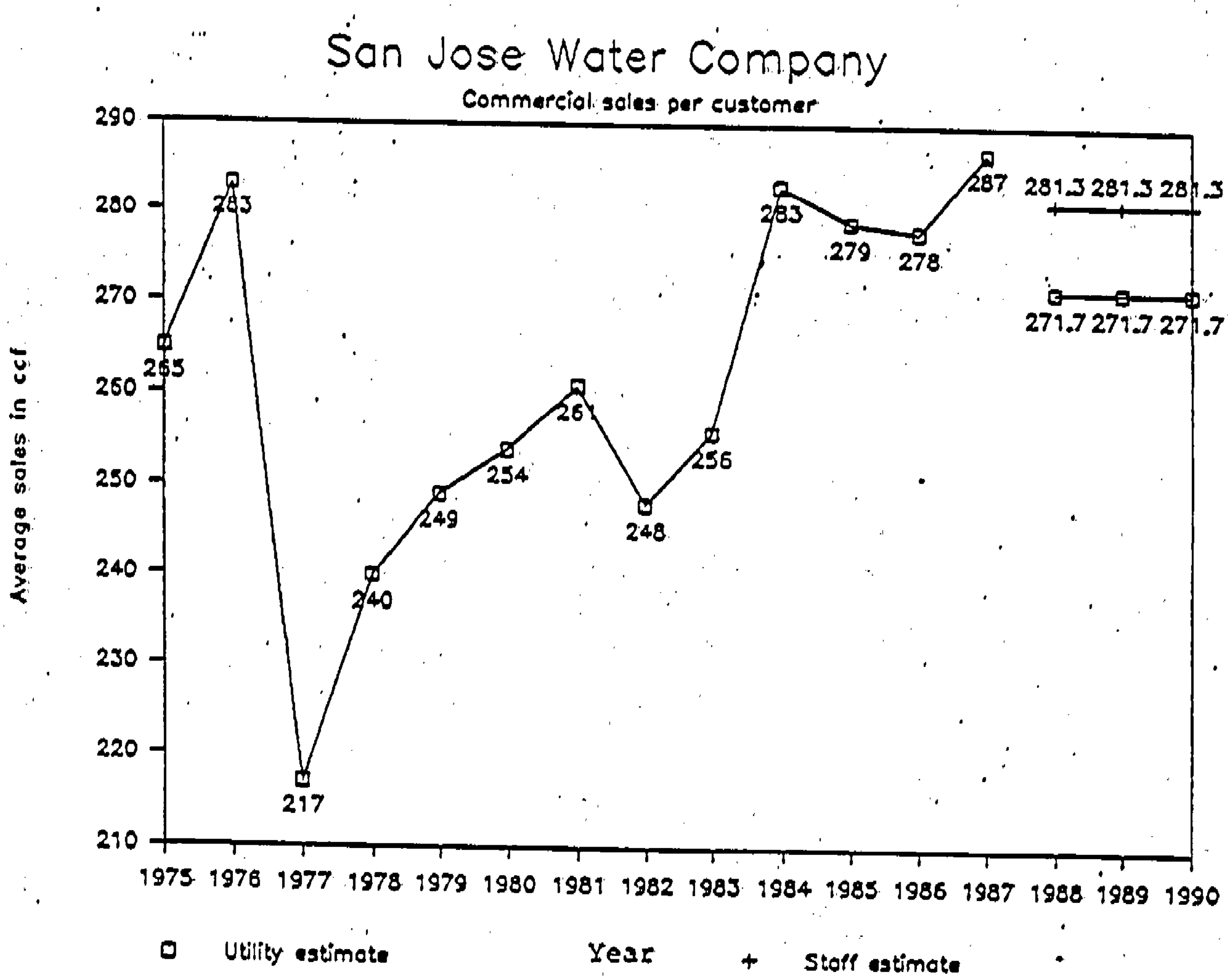
Years	Consumption (Ccf/yr.)	Reg.1/	Inverse2/ McSee
1977-87	284.5	0.935	0.035
1978-87	283.0	0.971	0.019
1979-87	281.6	0.966	0.019
1980-87	280.7	0.961	0.021
1981-87	278.9	0.963	0.022
1982-87	268.2	0.976	0.020
1983-87	271.7	0.997	0.007

1/ Regression coefficient. The number closest to 1.000 is the curve best fitted to the data input.

2/ Standard error divided by the mean. The smaller the number, the better the correlation to the data input.

(Exhibit 4, p.2)

Mr. Houck, witness for SJW, selects 271.7 hundred cubic feet (Ccf) per customer as the most accurate estimate generated by the Bean model. In comparing Bean estimates with actual



San Jose Water Company
Commercial sales per customer
290
280
270
260
250
240
230
220
210
Average sales in ccf
265
283
217
240
249
254
261
248
256
283
279
278
287
281.3 281.3 281.3
271.7 271.7 271.7
1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990
Utility estimate
Year
Staff estimate

(Exhibit 59)

In SJW's opinion, CACD's averaging of actual consumption for three years is a rejection of temperature and rainfall data and the Commission-approved method of estimating consumption that has prevented prolonged litigation of this issue in rate proceedings for the past 20 years. By using a high consumption estimate, SJW believes CACD is attempting to penalize SJW for high earnings in the dry years, 1986 and 1987. Should the Commission adopt CACD's estimated consumption, SJW requests consideration be given for the additional expenses incurred during the past three years for delivering purchased water which is more expensive than delivering water from its reservoirs. SJW bases this request on the difference in its costs to deliver water when rainfall is low, which occurred in 1985-1987. SJW calculates surface supplies were short an average of 1,230 million gallons (mg) per year during this period.

<u>Discussion</u>

In reviewing the commercial consumption trend diagrammed by CACD and shown above, we also believe the Bean estimate of 271.7 Ccf is unreliable. SJW finds this estimate reasonable based upon a presumption that when rainfall is high, consumption is lower than normal; and when temperatures are high, consumption is higher than normal.

We find this presumption is not true for 1983 when the temperature was roughly normal (60.9 degrees) and rainfall was at its highest level in ten years (24.25 inches). In 1983 consumption increased (256 Ccf) over its 1982 level (247.8), not decreased.

In analyzing CACD's diagram of customer usage from 1975 to 1987, we see a marked change in the usage trend from the periods of 1979-1983 and 1984-1987 which is not entirely explained by the lower rainfall in the latter period. In comparing 1980 consumption of 254 Ccf with 1986 consumption of 278 Ccf, the consumption in 1986 is significantly higher even though these are the two years closest to the Bean normal rainfall and temperature. Therefore, we conclude SJW's estimate of 271.7 Ccf is unreliable, based upon the recent different trend in usage. This does not mean that we reject the concept of weather adjusted forecasts.

Under the circumstances of having a marked shift in the consumption trend, we believe the three-year average of recorded consumption is more reliable for the purpose of estimating consumption in the proceeding. However, we believe that the data should be weather adjusted. Accordingly, we will adopt the CACD average for the last three years, but weather adjusted to 272.8 Ccf.

We find it unreasonable to grant SJW's request to adjust future consumption estimates for additional distribution expenses based upon those incurred from 1985-1987. This issue is one to be resolved in a future proceeding which reviews SJW's memorandum account and issues surrounding the drought.

We order the following estimated number of customers in each customer category and the consumption by each category which we authorize in this decision to be used in the calculation of SJW's authorized memorandum account from the date it was approved in D.89-04-041:

Authorized Customers and Consumption

Customer Category	Total Customers		Est. Avg. Consumption (Ccf)	
	1989	1990	1990	1991
Commercial	197,999	199,299	272.8	272.8
Public Authority	1,448	1,486	3,000	3,000
Industrial	84	84	11,619	11,619
Other	245	245	286	286
Other Utilities	28	28	11,071	11,071
Subtotal	199,804	201,142		
Private Fire Protection	2,082	2,182		
Total	201,886	203,324		

Unbilled Revenues

SJW includes a credit in revenues and a corresponding expense for unbilled revenues of $2.65 million in 1989 and $2.67 million in 1990. CACD removed these amounts. The parties agreed to resolve this issue as dictated by a decision on the California Water Service Company/SJW Joint Petition for Modification of D.88-01-061 in I.86-11-019. (This investigation explored utility recovery in rates for additional tax expense related to the removal of tax credits and deductions in 1986.) We recently denied the joint petitioners' request in D.89-05-065. Accordingly, we remove the credit in revenues and corresponding additional tax expense in this proceeding.

CPUC Reimbursement Fee

SJW included $918,000 for 1989 and $925,000 for 1990 in revenues and expenses representing the amount of regulatory fees paid under Public Utilities Code § 401 *et seq.*, the annual fee collected by the utility and remitted for Commission administration. CACD removed these amounts based upon our policy to exclude these fees from rates. SJW did not dispute this issue. We adopt CACD's treatment of this fee as appropriate and reasonable.

Allocation of Administrative and General Expenses

Although the parties stipulated to the amount of Administrative and General (A&G) expenses, CACD recommends additional allocation procedures. SJW management estimates employee time spent on capital projects. SJW presented no documentation to support its estimates. CACD recommends that SJW be ordered to develop procedures for the allocation of A&G expenses to capital accounts.

SJW disputes this recommendation. SJW witness Meyer testified that allocation of A&G expenses is based upon employee estimates of the time spent on these projects. No records of employee time devoted to each project are maintained. The work performed on these projects is intermingled within the average work schedule. In Meyer's opinion, the ratepayer is not disadvantaged by either an overestimate or underestimate of allocated construction costs. An overallocation increases the rate base and depreciation; an underallocation increases the current expense and removes the amount from earnings in rate base.

We agree that documentation of employee hours and other relevant records should be maintained to support amounts allocated to capital accounts. We will order SJW to develop such procedures and present for CACD's review within 90 days from the effective date or this decision.

Allocation of Common Expenses

SJW, SJW Corp., and SJW Land share the same facilities, staff, and expenses. SJW does not allocate expenses or charge for its sister company's use of SJW facilities. Both parties agree that these charges are minimal. However, CACD requests that an allocation procedure be developed and used.

Meyer, SJW's witness, opposed CACD's recommendation that allocation procedures be developed for expenses shared by SJW Corp. and SJW Land. Meyer considered this recommendation premature since these expenses are minimal for SJW Corp. and nonexistent for SJW Land. It is not known whether these companies will have staff or an office. An allocation of projected expenses by these companies is made at the beginning of the year. Expenses are controlled by these set percentages.

We agree that the ratepayer should not be charged for facilities, staff, or expenses used or incurred by sister subsidiaries, even though these charges are small. We believe an allocation procedure should be in place now and for use in the future should the amount of these expenses increase. We will order SJW to develop procedures to allocate common expenses incurred by SJW to its sister-subsidiary and holding company.

Conservation Plan

The Utilities Water Management Planning Act requires utilities with over 3,000 customers to prepare and adopt a water management plan for conservation. In D.86-05-064, we required water utilities to present a conservation plan pursuant to the Act. SJW presented its plan in this proceeding for our approval.

SJW coordinates conservation efforts with its retail suppliers, the Santa Clara Valley Water District (District) and the City of San Jose (City). The District sponsors conservation films and speakers to schools and service clubs. Conservation information is distributed to public schools. The City supplies and installs conservation kits in all city residences. The kits contain low flow shower heads and toilet dams to reduce water capacity in toilets. The City contacts businesses and industrial users to encourage conservation. SJW sends conservation reminders in water bills and provides a history of usage on the bill. SJW instituted an Employee Award Program for identifying unaccounted for water loss which has reduced such usage.

CACD has no objections to SJW's conservation plan. We find the plan to be reasonable.

Operation and Maintenance Expenses

SJW's estimates for purchased services and transportation expenses are disputed by CACD.

Purchased Services

Certain SJW's Operation and Maintenance (O&M) services are purchased by contracts with outside vendors. SJW estimates these O&M expenses for 1989 and 1990 based upon its recorded expenses for 1983-1987 as $2.66 million and $2.79 million, respectively. SJW adds 5% inflation for each test year to its recorded 1987 expenses to derive its projection.

CACD disputes this methodology. CACD derived an expense-per-customer factor for each of the years 1978 to 1987. These factors were adjusted for inflation based on the constant 1987 dollar, then averaged. The ten-year average was then multiplied by the predicted number of customers and nonlabor inflation factors for 1989 and 1990 to estimate expenses of $2.27 million and $2.40 million, respectively. CACD's inflation factors are taken from the November 1988 monthly Data Resources, Inc. publication. These are standard factors recommended for use in rate proceedings by CACD Advisory Branch.

Inflation Factors

	CACD		Utility	
	Labor	Nonlabor	Labor	Nonlabor
1988	1.040	1.054	1.050	1.050
1989	1.046	1.053	1.050	1.050
1990	1.046	1.051	1.050	1.050

(Exhibit 16, p. 3-1)

SJW rebuts CACD's position by testimony from Ms. Yip and Mr. Yoo that water testing expenses and expenses for water quality equipment are underestimated in its application. It is the opinion of these witnesses that pending EPA regulation and new legislation mandating increased water testing will increase testing expenses in the future. These witnesses cannot estimate the increased testing or facility expenses until these regulations are final.

SJW argues that its requested purchased services expenses for 1989 and 1990 are already invalidated by 1988 recorded expenses, which are higher. SJW alleges that 1988 recorded expense levels will continue in 1989 and 1990. SJW considers CACD's constant dollar method, an average of 1978-1987 expenses, too low of a starting point for 1989 and 1990 estimates. SJW points out that CACD's estimate for 1988 is also below recorded expenses for 1985-88. This is true for both O&M expenses. SJW concludes that both its estimates and those of CACD are too low but makes no recommendation for higher estimates.

Discussion

We envision that any increased testing, main protection or additional facilities required by new EPA regulations will affect all California water utilities, and when this occurs, our normal practice is to issue a separate investigation into the matter and/or derive special procedures at the Commission to allow all utilities an opportunity to recover unexpected expenses. However, we also believe that these expenses will not decrease in the near future. Since current expenses are already in excess of either forecast we will accept SJW's forecast for purchased service expenses. Therefore, we base purchased service expense estimates on recorded expenses plus inflation.

Transportation Expenses

SJW requests approval of the total transportation expenses for 28 company vehicles and the corresponding purchase price for the vehicles in rate base. SJW pays maintenance, insurance, and gasoline expenses for these vehicles. These vehicles are assigned to designated SJW managers to conduct utility business during the day and provide employee availability 24 hours a day to respond to after-hour emergencies or attend business meetings. There are no restrictions on the use of the vehicles. Personal use of the vehicles occurs before and after business hours. (Personal use of company vehicles during business hours would result in an employee being disciplined or fired.)

A mileage log is kept by each employee assigned a company vehicle which indicates whether the daily use of the vehicle is for business or personal use. These logs are maintained by SJW primarily for tax purposes. The personal use of these vehicles is reported to the Internal Revenue Service (IRS) as part of an employee's gross income.

According to SJW, this policy is cheaper than compensating the designated employees for transportation costs and is an employment incentive. Maintaining control over the maintenance and replacement of vehicles is the most efficient way for SJW to assure reliable employee transportation to conduct utility business.

CACD recommends a transportation expense reduction of $38,120 representing all personal usage and rate base exclusion of $133,123 for 57% of the purchase price of related vehicles for each test year based upon an average of 57% personal use of 18 company vehicles. During the hearing, CACD increased its transportation expense disallowance by $5,555 based upon SJW witness Meyer's testimony of greater personal usage miles associated with the 28 vehicles, raising the CACD recommended transportation expense reduction to $43,675.

CACD's vehicle-related reductions are based upon a review of mileage logs of 18 vehicles. The total number of personal use miles, 194,109, is multiplied by 22.5 cents. The mileage allowance of 22.5 cents was prescribed by the IRS and the State Franchise Tax Board in 1987.

CACD recommends a rate base disallowance of $16,000 representing 50% of the purchase price of the company president's luxury vehicle. CACD considers this expense unreasonable. Consistent with its personal use recommendations for other vehicles, CACD recommends that all personal use of this vehicle ($9,200) be excluded from transportation expense.

In connection with these expenses, CACD recommends that SJW record better details of the business purpose, transaction conducted, and person contacted in mileage logs in the future.

SJW argues that the Commission has never made a disallowance to transportation expense or rate base such as recommended by CACD in a Class A water utility rate proceeding. SJW cites the California American Water Company-Monterey District (Cal-American) rate order, D.89-02-067, as a recent case where the Commission rejected a similar transportation disallowance proposed by CACD.

SJW witness Meyer testified that SJW has 28 company vehicles, not 18. Using 28 mileage logs, SJW's calculation of the apportionment of 1987 business and personal use is: 53% business and 47% personal use.

CACD agrees that this calculation is correct if 28 mileage logs are used. This varies from its calculation of 43% business and 57% personal use because it used a sample of 18 mileage logs. Should the Commission choose SJW's method to calculate usage, CACD recommends an additional $3,000 reduction in 1989 and $19,000 in 1990 for transportation expense due to the different methodology and that the percentage of usage be multiplied by the total cost of 27 vehicles, or $290,704. (CACD calculates expense and rate base disallowances for the luxury vehicle separately.) This total does not include the purchase price of five vehicles which is unavailable. As an alternative, CACD recommends imputing an average purchase price of $12,000 per vehicle for these five vehicles, which results in a total purchase price of $350,704 for 27 vehicles, CACD's alternate recommendation if SJW's method is adopted.

SJW agrees to the CACD recommended exclusion from rate base of $16,000 for the purchase of a luxury automobile for its president's use. SJW does not agree that the personal use of this vehicle or any vehicle should be excluded from transportation expense or rate base.

Meyer testified that a reimbursement of $.09 per mile is the appropriate factor to use in calculating any disallowance. Meyer alleges this is the same factor used by the IRS.

Meyer opposed CACD's recommendation to maintain additional records of business use. Meyer considered such additional record-keeping unnecessary and burdensome. He testified that the IRS had not objected to applicant's present records of business and personal use contained in its mileage logs.

Discussion

We cannot agree that our recent Cal-American rate case order, D.89-02-067, shows this Commission's blind endorsement of all personal use of company-owned vehicles. All such policies are subject to our continuing review for necessary revisions and abuses. We do not find the facts regarding personal use in the Cal-American proceeding to be comparable with those in this proceeding. In Cal-American, personal use of three company-owned vehicles was 6.1%, 12.49%, and 26%, but the propriety of these levels of personal use was not explored. (In Cal-American, CACD recommended that all personal use be disallowed, a position which we rejected.) However, more recently in the San Gabriel Water Company case, D.89-09-048, we found that commuting expenses for executives were not an expense which the ratepayers should bear.

In this proceeding, total personal use of vehicles is approaching 50%. Twelve of the 28 vehicles exceed this limit. While the percentage of personal use of company vehicles was small in the Cal-American proceeding, we consider this issue a legitimate inquiry in this proceeding where personal use is significantly higher. The apparently high level of personal use being requested by SJW requires a substantial showing of ratepayer benefit to be justified.

Although SJW alleges this policy is cheaper than a policy of transportation expense reimbursement, it offers no analysis to support this allegation.

SJW argues that its personal use is a reasonable salary incentive. However, SJW gives no analysis to support this allegation. SJW did not show the salaries of its designated employees nor the additional salary expenses it would need to incur in order to compensate such employees for loss of use of their company-owned vehicles. Without this evidence we cannot find that SJW's personal use policy is, as it contends, cheaper than increasing salaries.

SJW alleges the assignment of vehicles is to assure the availability of supervisory personnel on a 24-hour basis in case of a utility emergency. On cross-examination, SJW's witness Meyer was asked about the use of the assigned vehicles. Meyer admitted that few employees assigned vehicles responded to emergencies. These employees used company cars after business hours for business purposes only on occasion. The option of a car pool for company-owned vehicles has not been considered by SJW. Emergency crew members are not assigned a company car.

Based upon this testimony and lack of statistical analysis of its policy, we find that SJW has not carried its burden of proof to justify the existing percentage of personal use of 12 company-owned vehicles. We agree with CACD on the issue of transportation expense, and we will disallow all personal use miles. Further, for each vehicle where personal use is 50% or greater we will reduce the rate base by the purchase price of these vehicles. Under such circumstances, these expenses are unreasonable for ratemaking purposes. This reduction involves the 12 following vehicles in Exhibit 7, p. 1:

Car No.	Total Miles	Business Use	Personal Use	Personal Use as a % of Total Miles
13	23,616	5,941	17,675	75%
997	10,119	1,956	8,163	81
27	13,126	4,728	8,398	64
951	11,145	3,587	7,558	68
28	11,678	5,132	6,546	56
51	9,086	3,472	5,614	62
11	13,159	5,874	7,285	55
969	13,293	5,411	7,882	59
18	26,801	6,482	20,319	76
959	10,430	3,660	6,770	65
61	11,475	2,983	8,492	74
60	8,292	2,958	5,334	64
Total	162,220	52,184	110,036	

IRS instructions for business deductions specify that a taxpayer may use a standard mileage rate of 22.5 cents a mile for the first 15,000 miles of business use of an automobile that is not fully depreciated. This standard mileage rate is a simplified method of calculating all the operating and fixed costs of the automobile. Where transportation expenses are deductible as a medical expense the standard mileage deduction is 11 cents. SJW witness Meyer explained the latter deduction does not include all operating costs.

The record shows that SJW pays all operating costs for the vehicles assigned to employees. Therefore, for the twelve vehicles 11.0 cents is the appropriate mileage rate to use in this proceeding. Accordingly, the total mileage for vehicles with personal use which exceeds 50% shall be multiplied by 11.0 cents. We calculate this transportation expense reduction to be $12,104 (110,036 miles x $.11). For the other 16 vehicles, 22.5 cents is used. The transportation expense reduction is $18,916 (84,073 miles x $.225). Total transportation expense adjustment is $31,020 ($12,104 + $18,916).

The rate base reduction for the purchase price of vehicles with 50% or greater personal use involves the same vehicles listed above. The purchase prices for these vehicles which we adopt are listed in Exhibit 66, p. 1 (column 4) and p. 4. This CACD exhibit provides more complete information than SJW's Exhibit 7:

Car No.	Should Be In Company's Exhibit 7
13	$ 14,464
997	14,414
27	14,496
951	14,272
28	11,009
51	13,807
11	14,464
969	32,054
18	14,364
959	10,729
61	14,975
60	14,974
Total Purchase Price	$184,022

We adopt a rate base disallowance of $184,022. (The luxury vehicle is one of the vehicles with 50% or greater personal use; therefore, it is included in our calculation of transportation expense reduction and rate base disallowance.)

We are concerned about the apparently high level of personal use for these vehicles on which the utility also earns a rate return. We have disallowed these vehicles from rate base in this decision. However, if SJW wishes to make a showing in its next rate case application that Commission policy should allow vehicles and personal usage in rates, they are welcome to make that showing. We also put all other water utilities on notice that personal mileage and vehicles used as personal vehicles will not necessarily be found prudently included in rates, and that a clear and convincing showing will be required to include such costs in the future.

We agree that SJW's mileage summaries are incomplete for our purposes of verifying the business and personal use of company vehicles. These mileage summaries contain space to record the purpose of each trip. However, no details other than "business" or "personal" is recorded. We believe CACD's request for more complete information on the mileage summary is reasonable to track the use of SJW vehicles. To accommodate CACD's request for better record-keeping, a new form is not needed. SJW need only adopt better procedures for completing its existing form. Accordingly, we will order SJW to provide details of the business purpose, transaction conducted, and person contacted on these existing mileage forms. Each trip need not be listed with a mileage separately. The present practice of totaling miles is satisfactory if a summary of purpose(s), transaction(s), and person(s) contacted is added.

Other Operation and Maintenance Expenses

	ADOPTED 1989	ADOPTED 1990
All Other Operations		
Op. Transp.	$ 615,000	$ 653,000
Op. Purch. Serv.	1,557,000	1,630,000
Total	2,172,000	2,283,000
All Other Maintenance		
Maint. Purch. Serv.	1,100,000	1,155,000
Total	$3,272,000	$3,438,000

Rate Base

SJW and CACD disagreed on two rate base expenses: plant additions and working cash.

Plant Additions

CACD analyzed SJW's 1989 construction budget and excluded an electronic cash processing project ($11,300) which was canceled in 1988. CACD moved the replacement of bowl units ($13,500) from 1988 to 1989 based upon SJW's rescheduling of this project. We find these plant account adjustments reasonable because they reflect more updated SJW planning of these projects.

CACD recommends amounts for the contingency construction budget, which are $164,700, $153,500, and $141,200 lower than SJW in 1988, 1989, and 1990. Contingencies are unexpected expenditures, such as facility failures or plant relocation mandated by government agencies.

SJW bases its estimate on historical budgets yet presented no basis for this method. CACD used the average of the past three years' recorded expenses, 1985-1987, and added inflation factors recommended by the CACD Advisory Branch. CACD used a three-year average because these expenses fluctuate and are somewhat unpredictable. We consider CACD's estimate for contingency expenses as reasonable and adopt it.

Working Cash

SJW includes an average bank balance of $650,000 per month in its working cash allowance. SJW calculates this is the monthly amount needed to pay bills and generate bank credits to pay the larger portion of bank charges for the account. CACD reduces this amount to $200,000 arguing that the reduced amount is sufficient for operating purposes.

SJW maintains accounts at three banks: Security Pacific, for daily operations; Bank of America, for investments; and First Interstate, for amounts to be refunded to ratepayers for advances. In March or April, 1987, SJW moved its operating account from Bank of America to Security Pacific where requirements for a line of credit and bank charges are lower. Bank of America required a customer with a line of credit to maintain as a cash balance 10% of the line of credit, or $650,000 in SJW's case. Security Pacific does not have this requirement. It allows applicant to accumulate 6.27% interest on its balance as a credit toward payment of bank charges. SJW estimates that a minimum average balance of $650,000 will generate sufficient credits to pay the majority of bank charges. In 1987, SJW maintained a minimum average balance of $650,000 at Security Pacific generating $68,751 in total credits. However, monthly credits in excess of monthly charges may not be accumulated. The total bank charges were $78,430. SJW applied the allowable credits and paid the difference, $17,425, in cash.

In the test years, SJW intends to keep the operating account balance as low as possible with a $650,000 minimum average balance. This minimum average is based upon its monthly revenues and outstanding bills. Any excess cash will be invested at Bank of America to earn 7% interest.

In rebuttal to CACD's recommendation, SJW presented Exhibit 8, a list of 1987 checks drawn on the operating account. All of the checks are for amounts greater than $200,000. In SJW's opinion, this balance will be insufficient to meet most monthly bills outstanding. With such a balance, SJW alleges it will not earn enough credits to pay monthly bank charges.

Should the Commission adopt a minimum cash allowance of $200,000, both SJW and CACD agree that the allowance for bank expenses should be increased by $26,590. In addition, for any day this account was overdrawn, applicant would be charged the prime rate daily on the overdraft. No calculation of these charges was made.

We agree with CACD that paying $26,590 in additional bank charges is significantly cheaper for the ratepayer than $650,000 in cash deposits. However, we are persuaded by Meyer's testimony and Exhibit 8 that a minimum balance of $650,000 is needed to pay debts as they become due. CACD presented no evidence to show that a $200,000 balance is sufficient to pay monthly debts. Therefore, we adopt SJW's requested cash balance of $650,000.

Rate Design

The parties have reached agreement on the following rate design issues which we find reasonable and adopt:

1. Increases in revenues are to be applied uniformly to the General Metered Schedule (No. 1) and Resale Service (No. 6). SJW proposes a 200% increase in rates for private fire protection service (Schedule No. 4). CACD recommends the use of industry standards to establish rates per inch of service connection diameter of $3.00 in 1989, $3.50 in 1990, and $4.00 in 1991. SJW did not dispute CACD's recommendation. We find CACD's recommendation to be reasonable.

2. Total revenue from service charges under authorized rates shall not exceed 50% of the fixed costs, pursuant to D.86-05-064.

3. Lifeline rates are to be eliminated, pursuant to D.86-05-064.

4. Service charge rates for 3/4 inch meters are to be eliminated and substituted with charges to customers at 5/8 x 3/4-inch meter rates.

Tariff Rule Changes

We have reviewed the proposed tariff rule changes and arguments of the parties regarding these rules. We find the following tariff rule changes reasonable and authorize their implementation as follows:

1. Rule 9B shall include the imposition of a $4.75 service charge on a customer who submits a check which is returned because of insufficient funds. This charge offsets the bank charge to SJW for such a transaction. This change was not disputed.

2. Rule 11 B.1, paragraph 1 shall include a collection charge when it is necessary to discontinue service due to nonpayment of the bill. This charge was authorized by the Commission in D.83-06-065, OIR 7, our order revising and clarifying water utility tariff procedures and practices for terminating

service in response to the Public Utilities Regulatory Policies Act (PURPA). This charge was not disputed.

3. Rule 11 C.1 shall contain an increase in the restoration of service charge from $10 to $15 during regular working hours and $15 to $20 during other hours when service is restored during these hours at the customer's request. SJW represented that other companies have this charge. SJW complained that CACD had agreed to the increase but objected to pursuing this request without a review of General Order (GO) 103. In response, SJW requested a review of the Commission's procedure and if CACD prevails that a special investigation into GO 103 be ordered so this change can be made. We do not agree that a generic investigation is needed to authorize an exception to our regulations in GO 103. Should this GO need revising, CACD may recommend a special investigation.

4. SJW proposes a new construction and temporary metered service policy. CACD requests that SJW provide, by advice letter, a proposed standard form for this rule. We authorize this advice letter filing.

SJW agreed to withdraw its request for a $7.50 service restoration charge when, to avoid discontinuance of service, a customer makes payment in full at the time a SJW employee arrives to post a 24 or 48 hour notice of discontinuance.

Gain on Sale of Land

SJW requests approval of a transfer to ratepayers of the $534,000 gain from the sale of utility property. In 1987, SJW sold over 4.5 acres of utility property to SJW Land for $2,242,000, or approximately $9.70 per square foot. At the time of the sale, the book value of the property was $1,140,465. The land consisted of 4.5 acres adjacent to SJW's offices near downtown San Jose and a parcel across the street from the offices of approximately 35,763 square feet. In compliance with D.85-06-023, the order approving the establishment of SJW Land, SJW is holding the gain in a suspense account pending a final order in this proceeding.

CACD requests adjustments in the gain calculation raising the amount to $647,455 and asserts that the valuation of the property is inadequate. CACD requests that $647,455 be transferred to the ratepayers over the next three years in this proceeding and that SJW be ordered to provide three additional independent appraisals of the property by appraisers certified by the American Institute of Real Estate Appraisers (Member, Appraisal Institute or MAI) within three months to determine the value of the property on December 31, 1986. In a future advice letter filing, the difference between SJW's appraisal and the average of the three additional appraisals would be transferred to the ratepayer.

In CACD's investigation of property value, it found:

1. Moore had insufficient documentation of his property valuation. The valuation was dated one year prior to the sale. Moore's use of the income approach in his property valuation is unsubstantiated. Moore did not include all rental income in his income analysis. Moore did not consider future development plans in his valuation. CACD also contends that the comparable sales approach is equally as applicable as Moore's income approach. Moore is not MAI-certified.

2. The transaction was not at arm's length. Moore and Weinhardt, SJW's president, are social acquaintances. Moore has represented SJW in past real estate transactions and would be hired for such matters in the future.

3. The recording of the transaction is confusing and circular. The transaction was for SJW Land to advance the amount of the purchase price to SJW for construction projects. However, the construction projects were on the books of SJW Land. The funds advanced by SJW Land were obtained by a "capital contribution" from SJW Corp. The funds were obtained by SJW Corp. from SJW's dividend payments.

4. In 1986 parcels comparable with the land sold were sold for $13.74 to $30.02 per square foot.

CACD considers the transaction between affiliates to warrant close scrutiny and appraisal by independent, MAI-certified appraisers. CACD contends that the valuation performed by SJW's real estate consultant, Moore, was outdated and lower than the market value of the property indicated in CACD's investigation.

SJW agrees to CACD's adjustments to its gain calculation to eliminate a 6% sales commission, raise the state income tax rate from 9.3% to 9.6%, and deduct the state income tax expense in calculating federal income tax expense to increase the gain to $647,455. SJW does not dispute CACD's recommendation to apply the gain to rates over a three-year period. However, SJW contests CACD's recommendation for new appraisals.

SJW considers its consultant one of the most qualified in the San Jose area. Moore has 20 years of experience in the commercial real estate market for downtown San Jose and is a licensed real estate broker and member of the San Jose Board of Realtors. Moore has recently worked on projects for Barclay's Bank, the Housing Authority of Santa Clara County, the Garden Alameda, Santa Clara Savings and Loan, and Bradfore Manufacturing Company. He has an excellent reputation in the business community.

SJW contends that its consultant has already submitted a correct property valuation based upon three independent appraisals. Moore used the same methods and information as an MAI-certified appraiser. His evaluation is based upon three verifying opinions from other appraisers who valued the property at $6.85 to $12 per sq. ft. At the time of the evaluation, future development plans were unknown and existing zoning classifications were used. The existence of continuing water rights and access to SJW wells on the property sold distinguishes it from the parcels CACD considers comparable. Several of the comparable properties used by CACD had buildings at the time of the sale of SJW vacant land, making them incomparable. In SJW's opinion, no property in San Jose was comparable to the land sold.

SJW requests that CACD's recommendation for additional appraisals be rejected because neither this Commission nor state law requires that appraisals of utility property be performed by MAI certified appraisers.

Discussion

We agree that neither this Commission nor state law requires that property be valued by MAI-certified appraisers. We do not find that the facts in this proceeding to warrant such a requirement. SJW's consultant Moore is qualified to appraise SJW property sold to SJW Land based upon his real estate licensing and 20 years of experience in commercial real estate transactions. The additional requirement that such an appraiser be MAI-certified does not guarantee a more reasonable appraisal.

While we do not find that Moore's association with SJW's president in the past or in the future disqualifies his opinion in this proceeding, it is this Commission's policy to closely review all transactions between utilities and their affiliates. This issue has risen in prominence as California's utilities have diversified into other areas. The issue of transferring land from a utility to its corporate land development company has arisen before. When PacBell requested to transfer property from rate base to another Pacific Telesis affiliate in the business of real estate business, the Commission stated in D.86-01-026,

> "We will adopt McCrary's recommendation to order PacBell to openly solicit competitive bids in disposing of owned real property which has been in its rate base, aside from instances where it is sold through condemnation. We believe this is a minimal step but one vital to ensure PacBell's ratepayers are protected from potential abuses from self-dealing inherent with the diversified Telesis corporate structure."

We believe this is a sound policy which should be continued to assure ratepayers are protected. It is our belief that market bids will provide better information as to the correct value of this land. Consistent with D.86-01-026, we will order SJW to establish and operate under a competitive bidding process and procedure for disposing of land which is removed from rate base, and it shall dispose of such property under that procedure so long as it has an affiliate in the real estate business. Staff will review the program SJW adopts for receiving competitive bids and present any recommendations it may have on whether SJW's program should be modified in the next phase of these proceedings.

We understand that the properties in this proceeding have already been transferred to SJW Land under the terms of the order permitting SJW to diversify into the real estate business. The purpose of this condition was to allow the Commission to review SJW's program in operation. By this Decision we order that the transferred properties be submitted for public bid under the terms of the property transfer program to be established in the next phase of this proceeding.

The second phase of this proceeding will review the property transfer program, and the appropriate expenses and rate treatment for related costs.

<u>Attrition Year 1991</u>

SJW does not dispute CACD's recommendation for 1991 attrition allowances. We find these recommendations to be our normal policy on attrition and, therefore, reasonable. The revenue requirement for 1991 is computed by adding the operational and financial attritions to the adopted rate base for 1990 and the net-to-gross multiplier.

The adjustment is computed as follows:

[(Oper. Attr.) + (Fin. Attr.)] [1990 Rate Base]
[net-to-gross multi.]

= [(0.0061) + (0.0016)] [107,238,700] [1.6812]

= $1,388,200

Levelized Rates

Based upon our adopted Summary of Earnings, we could order a reduction in rates in 1989 of $2,196,000 or 3.1%, effective for 3 1/2 months in 1989, and authorize rate increases of $1,970,300 or 2.9% in 1990, and $1,388,200 or 2.0% in 1991. However, an alternative is to order one set of revenue requirement calculations for the three-year period based upon a constant, levelized reduction in revenues of $239,100 or 0.34% for this period. This method was ordered in our previous D.88-01-025 for Southern California Water Company. This alternative will result in better administrative efficiency and economy for SJW, its customers, and the Commission. This levelized constant rate reduction will be adopted.

Findings of Fact

1. SJW provides satisfactory water service and the water furnished meets current state drinking water standards.

2. SJW has complied with our order in D.86-05-064 to submit in its next rate proceeding a reasonable water management plan for conservation and with our order to institute report card billing.

3. SJW and DRA have a minor difference of .11% in the estimated average debt costs for 1990. DRA's method of calculating is reasonable.

4. SJW is comparable with DRA's list of publicly traded water companies for purposes of establishing a common equity ratio. SJW's 1987 level of common equity is 16% greater than the comparable group average of 42%. The highest level of common equity within the comparable group, excluding SJW Corp., is 53%. Imputing a level of 53% common equity is more reasonable than imputing the group average of 42%.

5. SJW requests a common equity ratio of 58.80%, 58.75%, and 58.59% in 1989, 1990, and 1991, which is above the level of 56% authorized in its last rate decision, D.84-01-042. SJW provided little justification for increasing its common equity ratio level.

6. The financial stability of a company is measured by bond ratings. SJW's financial data for pretax interest coverage and internal cash flow for 1983-87 exceeds the level for AAA ratings for water utilities by Standard and Poor's. SJW's financial data for pretax interest coverage and internal cash flow for 1983-87 exceeds the level for AA ratings for electric utilities by Standard and Poor's.

7. SJW is financially stable according to Standard and Poor's financial indicators.

8. SJW could lower the levels of Standard and Poor's financial factors and still meet the requirements to retain its existing bond ratings.

9. High bond ratings are needed to obtain a low interest rate for new debt. SJW's ability to obtain low interest in the future should not be affected by lowering common equity.

10. Ratepayers do not benefit from exceeding the financial levels required to obtain the highest bond ratings.

11. DRA's comparable publicly traded water utilities are reasonable, yet SJW is more accurately compared with the comparable water utilities that rank above the financial averages of the group. SJW's historical growth and earnings exceed the group average.

12. In the last five years, SJW's ratio of cash to construction costs averaged nearly 120%, with cash available surpassing cash needs. SJW's construction needs for 1989 and 1990 do not justify the requested level of common equity.

13. SJW's dividend payout ratio of 63% compared to the group average of 70% helps to increase the high equity ratio.

14. SJW's calculations of 11.70% to 11.74% ROE and 11.95% ROE are based upon the existing capital structure, which DRA does not recommend.

15. DRA's recommended imputation of 53% common equity is reasonable, but does not allow SJW the opportunity to actually

adjust its common equity to this level if this common equity is imputed in 1989.

16. SJW paid dividends to SJW Corp. in 1986 of $12.07 million, in 1987 of $9 million, and $5.25 million in 1988. SJW's common equity declined after these payments.

17. DRA's substitution of SJW Corp. for SJW in its comparative financial analysis is reliable since 98% of SJW Corp.'s revenues are derived from SJW.

18. SJW's DCF analyses based on a comparable group of electric, gas, and telephone utilities and its own historical financial data are unreasonable. DRA's comparable group is reasonable.

19. DRA's DCF analysis based on a comparable group of publicly traded water utilities, including SJW Corp., yielded an estimated ROE of 11.90% for a three-month dividend yield and 11.84% for a six-month dividend yield.

20. DRA's RP analysis based on a comparable group of publicly traded water utilities yielded an estimated ROE in the range of 11.95% to 12.53%.

21. SJW's DCF analysis based upon its own stock price, historical dividends, and growth yielded an estimated ROE of 13.62%-21.48% for 10-year growth and 15.89%-17.83% for 5-year growth.

22. SJW's RP analysis based on a comparable group of electric, gas, and telephone utilities yielded an estimated range of average historical ROE of 12.70-13.10% and average historical ROE of 12.81%.

23. SJW's RP analysis based on SJW's historical authorized ROEs yielded an average ROE of 13.02% and projected ROEs of 15.19%, 15.22%, and 15.29%.

24. SJW and DRA agree that the ROE varies inversely with the level of common equity under general finance principles.

25. A return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991, based upon the authorized level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

26. For ratemaking purposes, a level of common equity of 56%, 55%, and 53% for 1989, 1990, and 1991, respectively, will allow ratepayers to share in the financial health of SJW.

27. A return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991, based upon the DRA's comparative analysis, judgment, and the level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

28. Contrary to Commission policy, SJW included in its revenue calculations the amount of reimbursement fees for Commission administration collected by SJW and remitted to the Commission pursuant to Public Utilities Code Section 401 et seq.

29. SJW provided insufficient documentation of amounts allocated from administrative and general expenses to its capital account. SJW provided insufficient documentation of expenses incurred by SJW which are common to SJW, SJW Corp. and SJW Land.

30. Weather adjusting CACD's estimate of annual commercial customer consumption of 281.3 Ccf to 272.8 Ccf more accurately reflects the recent trend in consumption and is more reasonable than the Bean estimate of 271.7 Ccf used by SJW to calculate operating revenues for 1989 and 1990.

31. SJW presented a conservation plan which accomplishes the goal of promoting water conservation in its service area.

32. SJW's request for other operation and maintenance purchased services is based upon 1987 recorded expenses plus inflation, unlike CACD's method of levelizing historical expenses to minimize fluctuations and applying nonlabor inflation factors specifically related to these services.

33. SJW does not justify personal transportation expenses or including in rate base the purchase price for 12 assigned vehicles with personal use of 50% or greater.

34. In D.89-09-048 the Commission policy was to disallow all commute expenses for executives associated with company owned vehicles.

35. SJW's construction budget includes a project which has been canceled and a project which has been rescheduled. CACD removed the canceled project and placed the rescheduled project in the year in which the expense will be incurred.

36. SJW presented inadequate basis for its estimate of contingency construction expenses; CACD based its estimate on the average of recorded expenses for 1985-1987 and added inflation factors recommended by the CACD Advisory Branch.

37. SJW presented a summary of checks for amounts of $200,000 or greater to justify its estimate of maintaining an average bank balance of $650,000. CACD based its estimate of the average bank balance on total expenses and presented no analysis of checking account transactions to justify its estimate of an average bank balance of $200,000.

38. SJW requests approval of an increase in the restoration of service charge from $10 to $15 during regular working hours and $15 to $20 during other hours when service is restored during these hours at the customer's request, based upon the same charges by other utilities. Contrary to CACD's assertion, we may authorize such case-by-case deviations from GO 103.

39. CACD requests that SJW's proposed new construction and temporary metered service policy contain a proposed standard form which will be presented in an advice letter in the future.

40. It is the Commission policy that before utility land that has been in rate base can be transferred to an affiliated real estate company, that such land must be offered to public bid in order to determine the fair value of the land.

41. The amounts of operating revenues, operating expenses and rate base and each element thereof shown in Tables 1 and 2, "At Authorized Rates," represent a fair and reasonable determination of the revenue requirement for test years 1989 and 1990.

42. The reduction in annual revenue authorized by this decision in order to produce the adopted rates of return is $239,100 for 1989, 1990, and 1991.

43. CACD's proposed rate design guidelines are consistent with D.86-05-064 in which we adopted a flatter rate design policy, and are reasonable.

44. SJW and CACD agreed to abide by the Commission's decision in the California Water Service Company/SJW Joint Petition for Modification of D.88-01-061. In D.89-05-065 we denied joint petitioners' request for additional tax expense for unbilled revenues.

45. The decreases in present rates and charges required by this decision are justified and are reasonable; present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

Conclusions of Law

1. A constant reduction in revenues of $239,100 or 0.34% during 1989, 1990, and 1991 is reasonable based upon our adopted results of operations for SJW.

2. SJW has complied with the requirement in D.86-05-064 of filing a reasonable utility water management plan for conservation.

3. SJW's request to recover additional tax expense for unbilled revenues should be denied pursuant to D.89-05-065 which denied the same request.

4. Lifeline rates should be eliminated from SJW's rate design pursuant to D.86-05-064.

5. Total revenue from service charges under authorized rates should not exceed 50% of the fixed costs pursuant to D.86-05-064.

6. A utility's analysis of its own historical financial data is not sufficient comparative analysis to set a rate of return.

7. The application should be granted to the extent provided by the following order.

8. Because of length of hearings in this proceeding and the need to establish current rates immediately, this order should be effective today.

9. Additional hearings are required to establish an appropriate program for SJW to transfer land from rate base to its affiliate SJW Land. Hearings are also appropriate to consider ratemaking treatment of deferred taxes on the land transfers.

INTERIM ORDER

IT IS ORDERED that:

1. San Jose Water Company (SJW) shall immediately file for its company, to be effective 5 days after today, the reduced rate schedules and tariffs attached as Appendix A. This filing shall comply with General Order Series 96. The revised schedules shall apply only to service rendered on and after their effective date.

2. Common equity of 56% shall be imputed in SJW's 1989 capital structure effective today. Common equity of 55% and 53% shall be imputed on January 1 for 1990 and 1991, respectively.

3. SJW is authorized to file an advice letter regarding a new construction and temporary metered service policy. SJW shall provide in this filing a proposed standard form for this rule.

4. SJW shall develop procedures, including standards for supporting documents, to allocate Administrative and General expenses to capital projects. The procedures shall be mailed for review within 90 days from the effective date of this decision to: Commission Compliance and Advisory Division, Auditing and Compliance Branch, 505 Van Ness Avenue, San Francisco, CA 94102.

5. SJW shall develop procedures to allocate common expenses to SJW Land and SJW Corp., including standards for supporting documents. The procedures shall be mailed for review within 90 days of the effective date of this decision to: Commission Compliance and Advisory Division, Auditing and Compliance Branch, 505 Van Ness Avenue, San Francisco, CA 94102.

6. SJW shall provide more information in its mileage logs by indicating the business purpose, transaction conducted, and person contacted for each trip or a summary of this information where it is appropriate.

7. The consumption estimates authorized in this decision shall be used in calculating any loss revenues in SJW's memorandum account from the date the account was approved in D.89-04-041.

8. SJW's request to recover additional tax expense for unbilled revenues is denied pursuant to D.89-05-065 which denied the same request.

9. Within 90 days from the effective date of this order, SJW will establish and operate under a competitive bidding process and procedure for disposing of land which is removed from rate base, and it shall dispose of all such land under that procedure so long as it has an affiliate in the real estate business. CACD shall review the program SJW adopts for receiving competitive bids and present any recommendations it may have on whether SJW's program should be modified in the next phase of of these proceedings.

10. SJW shall retain $647,455 in the existing suspense account until our final decision in this proceeding.

This order is effective today.

Dated October 12, 1989, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Wesley Franklin

WESLEY FRANKLIN, Acting Executive Director

SAN JOSE WATER COMPANY

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to general metered water service.

TERRITORY

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

RATES

Service Charges:	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$4.35	
For 3/4-inch meter	4.35	(R) ✓
For 1-inch meter	7.30	
For 1-1/2-inch meter	10.00	
For 2-inch meter	12.50	
For 3-inch meter	25.00	
For 4-inch meter	34.00	
For 6-inch meter	53.00	
For 8-inch meter	81.00	
For 10-inch meter	108.00	

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the Quantity Rates. (T)
|
(T)

Quantity Rate:

Per 100 cu. ft. 0.947 (R) ✓

SPECIAL CONDITION

1. 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 agricultual water, shall receive a credit of 13.7 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill.

2. All rates are subject to the reimbursement fee set forth on Schedule No. UF.

APPENDIX A
Page 2

SAN JOSE WATER COMPANY

Schedule No. 6

RESALE SERVICE

APPLICABILITY

Applicable to all water service furnished for resale purposes.

TERRITORY

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

RATES

Service Charges:

	Per Meter Per Month
For 5/8 x 3/4-inch meter	$3.85
For 3/4-inch meter	4.40
For 1-inch meter	5.90
For 1-1/2-inch meter	8.00
For 2-inch meter	10.50
For 3-inch meter	19.00
For 4-inch meter	28.00
For 6-inch meter	43.00
For 8-inch meter	66.00
For 10-inch meter	92.00

Quantity Rate:

Per 100 cu. ft. 0.686 (R)

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the Quantity Rates. (T)

SPECIAL CONDITION

1. All rates are subject to the reimbursement fee set forth on Schedule No. UF.

SAN JOSE WATER COMPANY

Schedule No. 6

RESALE SERVICE

APPLICABILITY

Applicable to all water service furnished for resale purposes.

TERRITORY

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

RATES*

Service Charges:

	Per Meter Per Month
For 5/8 x 3/4-inch meter	$3.85
For 3/4-inch meter	4.40
For 1-inch meter	5.90
For 1-1/2-inch meter	8.00
For 2-inch meter	10.50
For 3-inch meter	19.00
For 4-inch meter	28.00
For 6-inch meter	43.00
For 8-inch meter	66.00
For 10-inch meter	92.00

Quantity Rate:

Per 100 cu. ft. 0.683 (R)

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the Quantity Rates. (T) | (T)

SPECIAL CONDITION

1. Due to the transfer to rate payers of the gain from sale of land, an amount of $0.266 is to be deducted from each water bill for twelve months from the effective date of this tariff filing. (N) | (N)

2. All rates are subject to the reimbursement fee set forth on Schedule No. UF. (L) (L)

SAN JOSE WATER COMPANY

Table 16-A

Rule No. 9

RENDERING AND PAYMENT OF BILLS (Continued)

B. Payment of Bills

Bills for service are due and payable upon presentation, and payment may be made at the commercial office of the utility or to any representative of the utility authorized to make collections. Collection of closing bills may be made at the time of presentation. If a customer tenders a check in payment of any bill and such check is not honored by the customer's bank, the utility may assess the customer a bad check service charge of $4.75. (N)

(N)

SAN JOSE WATER COMPANY

Table 16-B

Rule No. 11

DISCONTINUANCE AND RESTORATION OF SERVICE (Continued)

B.1.1. The utility may require payment of a collection charge of $7.50 when Utility's representative makes a call at a customers's premises to discontinue service for non-payment. No collection charge is assessed when, to avoid discontinuance of service, the customer makes payment in full. (N)

(N)

SAN JOSE WATER COMPANY

Table 16-C

Rule No. 11

DISCONTINUANCE AND RESTORATION OF SERVICE (Continued)

C. Restoration of Service

1. Restoration of Service

Where service has been discontinued for violation of these rules or for nonpayment of bills, the utility may charge $15.00 for restoration of service during (I) regular working hours or $20.00 for restoration of (I) service at other than regular working hours when the customer has requested that the restoration be made at other than regular working hours.

SAN JOSE WATER COMPANY

Table 16-D

Schedule No. 9C

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE

APPLICABILITY (N)

Applicable to all portable metered water service furnished for construction and other temporary purposes.

TERRITORY

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

RATES

Currently effective monthly service charge for the applicable 3/4, 1, 2 and 3 inch meter and quantity rates listed in Schedule No. 1 General Metered Service will apply to service furnished under this schedule.

SPECIAL CONDITION

1. To obtain water service under this schedule an applicant must first apply for and obtain written permission from the utility.
2. Applicant will be required to deposit with the utility the amount, shown in the table below, which corresponds to the size and type of meter used.

Size of Meter	Refundable Deposit	Non-Refundable Handling Charge	Total Deposit
3/4 inch	$ 240.00	$10.00	$ 250.00
1-inch	390.00	10.00	400.00
2-inch	1,240.00	10.00	1,250.00
3-inch	1,540.00	10.00	1,550.00	(N)

SAN JOSE WATER COMPANY

Schedule No. 9C

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE

Special Condition - Continued (N)

The refundable deposit is based on two times the cost of the applicable meter. The refundable deposit less (a) the cost of any repairs other than those due to normal depreciation, and (b) any outstanding unpaid water bills, will be returned to the customer upon return of the meter to the utility.

3. On the last working day of each month the customer shall call-in or mail-in to the utility the readings on the meter or meters used by him. All such read information must contain the meter number and reading as of the last working day of the month. The utility will bill the customer monthly under its General Metered Service, Schedule No. 1 on the basis of such reading. Failure to so notify the utility will result in imposition of a monthly charge of $25.00 per meter in addition to the monthly charges under such Metered Service Schedule. Failure to so notify the utility for a period in excess of 60 days will result in loss of permit to retain such portable meter and forfeiture of meter deposit.

4. No such meter may be retained for a period in excess of one year. Failure to return a meter to utility at the end of one year will result in the denial in the future of such temporary service.

5. When a person takes water from a fire hydrant or other outlet without first having obtained written permission from the utility, the utility shall assess a fine of (N)

SAN JOSE WATER COMPANY

Schedule No. 9C

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE (Continued)

$200.00 per occurrence against such person and shall confiscate any connections used for such unauthorized taking. When a person has written permission to draw water from the utility's service area, but fails to use the meter supplied while drawing water, the utility shall assess a fine of $50.00 per occurrence against such person; the failure to use such meter a second time shall result in loss of permit to retain a portable meter, forfeiture of the meter deposit and denial in the future of such temporary service. (N)

San Jose Water Company
Form No. 15
Temporary Water Service Deposit Receipt

Date ______________________

Account No. ________________ Meter Size ____________________

Name of Depositor ____

Business Address ____

____

Billing Address ____

____

Person in Charge of Billing __________________________________

Amount of Deposit ____

Location of job ____

Permission to use water until ________________________________
on which date meter and couplings will be returned (see over)

Customer accepts the meter described above subject to the provisions of the attached Rule __ of San Jose Water Company. Customer further agrees to comply with the requirements attached.

Customer	Utility
I, ________________________ acknowledge receipt of meter and couplings from San Jose Water Company and agree to return meter and couplings on or before ________________	On behalf of SAN JOSE WATER COMPANY, I ______________ acknowledge receipt of the ________________________ deposit set forth above. SAN JOSE WATER COMPANY
________________________ Customer	By ________________________ Utility

IMPORTANT INFORMATION - READ CAREFULLY

1. A deposit for temporary water service is required and is based upon the size of the water meter. The deposit, less the cost of any repairs, other than those due to normal depreciation, and any outstanding unpaid bills, will be returned to the customer upon return of the meter.

2. The Fire Department has asked that we remind customers requiring temporary water service to use only approved hydrant spanner wrenches when taking water from fire hydrants. See attached instruction on the hook-up to the fire hydrants.

3. The customer, by acceptance of this agreement, shall be responsible for any damage to fire hydrants, the water system, and/or water meter which results from the use herein authorized. The cost of repairs over the amount of the deposit shall be paid as soon as the amount thereof is known.

4. The customer shall defend, indemnify, and hold the water utility, its officers and employees, harmless from and against, all claims and/or liabilities for injury to person or persons, or damage to property arising out of the exercise of the permission herein given.

5. The customer shall cease using water at any time upon request of a utility or fire department representative.

6. The customer shall use the meter supplied by the utility at all times while drawing water. The drawing of water other than through the meter provided by the San Jose Water Company is subject to a $50.00 penalty per occurrence.

Repeated offense will result in loss of permit to obtain a portable meter and forfeiture of meter deposit.

7. TERMS:

The customer shall call-in or mail-in (post-marked) to the utility the meter readings on the last working day of each month. Failure to comply with this provision will result in a $25.00 monthly charge in addition to the monthly meter and quantity charges. Continued failure to comply with the meter reading requirement will result in loss of permit to obtain a portable meter and forfeiture of meter deposit.

8. Additional permits will not be granted to any person or entity which has not paid a past due account.

9. The customer shall return the meter to utility for an annual check-up and maintenance. Failure to return the meter annually will result in utility not granting a permit in the future.

(END OF APPENDIX A)

APPENDIX B
Page 1

SAN JOSE WATER COMPANY

(INTENTIONALLY LEFT BLANK SINCE A LEVELIZED CONSTANT RATE IS ORDERED BY THIS DECISION)

SAN JOSE WATER COMPANY

Adopted Quantities

San Jose Water Company	1989	1990
1. Water Production : KCcf		
Wells	33,175	33,515
Surface Supply	4,813	4,813
Purchased Water	27,632	27,807
Total	65,620	66,135
2. Purchased Water Expenses		
Santa Clara Valley Water Dist. (7-1-89)		
Purchased Water (MG)	20,670	20,801
Unit Cost ($/MG)	$644.47	$644.47
Total Cost ($ in thousands)	$13,321	$13,406
3. Pumped Tax		
Santa Clara Valley Water Dist. (7-1-89)		
Quantity (MG)	24,817	25,071
Unit Cost ($/MG)	$414.30	$414.30
Total Cost ($ in thousands)	$10,282	$10,387
4. Purchased Power		
Supplier - PG&E (1-1-89)		
Production (KCcf)	65,620	66,135
Kwhr per Ccf	0.9417	0.9423
Kwhr	61,794,354	62,319,011
Unit Cost ($/Kwhr)	0.082652	0.082652
Total Cost ($ in thousands)	$5,107	$5,151
5. Ad Valorem Taxes ($ in thousands)	$1,479	$1,479
Tax Rate	1.13%	1.13%

APPENDIX C
Page 2

SAN JOSE WATER COMPANY

Adopted Quantities

6. Number of Services by meter size

	Schedule No.1 1989	Schedule No.1 1990	Schedule No.6 1989	Schedule No.6 1990
5/8 x 3/4 inch	169,649	170,765	0	0
3/4	3,186	3,206	1	1
1	19,199	19,328	4	4
1 1/2	2,491	2,510	3	3
2	3,809	3,792	14	14
3	974	1,038	4	4
4	292	296	1	1
6	145	146	1	1
8	30	32	0	0
10	1	1	0	0
	199,776	201,114	28	28

Meter Sales (Ccf)

	Schedule 1		Schedule 6	
0-3 ccf	6,490,440	6,533,804	0	0
Over 3 ccf	52,913,687	53,338,963	310,000	310,000
Total	59,404,127	59,872,767	310,000	310,000

8. Number of Service and Usage

	No. of Service 1989	No. of Service 1990	Usage - Kccf 1989	Usage - Kccf 1990	Ave Usage - ccf 1989	Ave Usage - ccf 1990
Commercial	197,999	199,299	54,014	54,369	272.8	272.8
Public Authority	1,448	1,486	4,344	4,458	3,000	3,000
Industrial	84	84	976	976	11,619	11,619
Other	245	245	70	70	286	286
Other Utilities	28	28	310	310	11071	11071
Subtotal	199,804	201,142	59,714	60,183		
Priv Fire Prot.	2,082	2,182				
Total	201,886	203,324				
Water Loss	9.0%		5,906	5,952		
Total Water Produced			65,620	66,135		

9. Postage (effective June 30, 1988) - $0.0205 per billing

APPENDIX C
Page 3

SAN JOSE WATER COMPANY

Income Tax Calculation

	1989	1990
	(Dollars in thousands)	
Operating Revenue (authorized rates)	67180.0	69150.0
Expenses		
Payroll	6,019.0	6,348.0
Purchased Power	5,107.0	5,151.0
Purchased Water	13,320.0	13,406.0
Pump Tax	10,282.0	10,387.0
Other O & M	3,935.0	4,115.0
Other A & G	5,260.0	5,489.0
Business License	30.0	30.0
Franchise Tax	149.7	154.1
Uncollectibles	155.9	160.4
Taxes Other than Income	2,045.7	2,126.2
Transp. Depreciation	(223.1)	(257.9)
Interest Expense	3,809.0	3,936.0
Other	(3.0)	(3.0)
Total Deduction	49,887.2	51,041.9
State Tax Depreciation	6,124.0	6,324.0
Net Taxable Income	11,168.8	11,784.1
State Corp. Franch. Tax 9.3%	1,038.7	1,095.9
Federal Tax Depreciation	4,715.0	4,869.0
State Income Tax	1,038.7	1,095.9
Less Deferred Revenue	104.6	130.5
Net Taxable Income	11,434.5	12,012.7
Fed. Income Tax 34.12%	3,901.5	4,098.7
Less ITC	(9.2)	(8.2)
Add Unrecov tax	5.9	5.9
Total Federal Income Tax	3,898.2	4,096.4
Total Income Tax	4,936.9	5,192.4

(END OF APPENDIX C)

APPENDIX D
Page 1

SAN JOSE WATER COMPANY

Comparison of typical bills for residential metered customers of various usage level and average level at present and authorized rates for the year 1989.

General Metered Service
(5/8 x 3/4-inch meters)

Monthly Usage	At Present Rates	At Authorized Rates	Percent Increase
(Cubic Feet)			
500	$8.54	$9.09	6.41%
1000	13.41	13.82	3.03
2000	23.16	23.29	0.55
2500 (Mean)	28.04	28.03	-0.05
3000	32.91	32.76	-0.46
5000	52.41	51.70	-1.36
10000	101.16	99.05	-2.09

(END OF APPENDIX D)

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CORRECTION

THIS DOCUMENT HAS

BEEN REPHOTOGRAPHED

TO ASSURE

LEGIBILITY

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O P I N I O N

Summary

San Jose Water Company (SJW) requests a rate increase of $4,483,000 (7.18%) in 1989, $1,203,600 (1.78%) in 1990, and $1,203,600 (1.75%) in 1991. SJW requests a rate of return on rate base of 11.74%, 11.77%, and 11.88% for 1989, 1990, and 1991 and a constant return on equity (ROE) of 13.75%. SJW's last authorized rate of return on rate base was 11.70%, 11.76%, and 11.80% for 1984, 1985, and 1986, with a constant ROE of 14.5%. Thus, the requested returns are lower than those previously authorized.

The Commission Advisory and Compliance Division, Water, Auditing and Compliance Branches (CACD) and the Division of Ratepayer Advocates, Financial and Economic Analysis Branch (DRA) recommend a rate decrease of $4,295,000 in 1989, $52,400 in 1990, and a rate increase of $162,400 in 1991. DRA recommends a return on rate base in the range of 10.40-10.66% for 1989, 10.48-10.74% for 1990, and 10.57-10.83% for 1991. DRA requests that the ROE be set in the range of 11.75-12.25%. DRA recommends a specific return on rate base of 10.53%, 10.61%, and 10.70% for 1989, 1990, and 1991, with a constant ROE of 12%.

We conclude that it is reasonable to order SJW to reduce its rates for the future by $1,324,400 (1.9%) from the present effective rates. We authorize 56% common equity in SJW's capital structure for 1989, 55% in 1990, and 53% in 1991. Based upon this phased decrease in common equity, we consider reasonable a rate of return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991 and a return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991.

Our authorized rates reflect the resolution of numerous disputed issues in this proceeding. We agree with CACD that commercial consumption for 1989 and 1990 will be higher than projected by SJW. We decline to disallow all expenses for SJW

INTERIM OPINION

Summary

San Jose Water Company (SJW) requests a rate increase of $4,483,000 (7.18%) in 1989, $1,203,600 (1.78%) in 1990, and $1,203,600 (1.75%) in 1991. SJW requests a rate of return on rate base of 11.74%, 11.77%, and 11.88% for 1989, 1990, and 1991 and a constant return on equity (ROE) of 13.75%. SJW's last authorized rate of return on rate base was 11.70%, 11.76%, and 11.80% for 1984, 1985, and 1986, with a constant ROE of 14.5%. Thus, the requested returns are lower than those previously authorized.

The Commission Advisory and Compliance Division, Water, Auditing and Compliance Branches (CACD) and the Division of Ratepayer Advocates, Financial and Economic Analysis Branch (DRA) recommend a rate decrease of $4,295,000 in 1989, $52,400 in 1990, and a rate increase of $162,400 in 1991. DRA recommends a return on rate base in the range of 10.40-10.66% for 1989, 10.48-10.74% for 1990, and 10.57-10.83% for 1991. DRA requests that the ROE be set in the range of 11.75-12.25%. DRA recommends a specific return on rate base of 10.53%, 10.61%, and 10.70% for 1989, 1990, and 1991, with a constant ROE of 12%.

We conclude that it is reasonable to order SJW to reduce its rates for the future by $239,100 (0.34%) from the present effective rates. We authorize 56% common equity in SJW's capital structure for 1989, 55% in 1990, and 53% in 1991. Based upon this phased decrease in common equity, we consider reasonable a rate of return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991 and a return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991.

Our authorized rates reflect the resolution of numerous disputed issues in this proceeding. We agree with CACD that commercial consumption for 1989 and 1990 will be higher than projected by SJW. We disallow all expenses for SJW employee's personal use of vehicles. However, we disallow all costs associated with vehicles where personal use on vehicles is 50% or greater. We grant SJW's requested amount of cash deposits for its operating bank account. We deny CACD's request for new appraisals of SJW property sold to SJW Land Company (SJW Land). In accordance with Decision (D.) 89-05-065, we deny SJW's request for additional tax expense for unbilled revenues. In that decision we denied the same request by the California Water Service Company and SJW in a Joint Petition for Modification of D.88-01-061, our order adjusting rates in accordance with the 1986 Tax Reform Act.

We order the estimates of consumption authorized in this proceeding to be used in calculating consumption in SJW's memorandum account, which was approved in D.89-04-041.

Table 1 shows the SJW requested, CACD/DRA recommended, and Commission adopted summary of earnings at present rates and authorized rates for the test years 1989 and 1990. Appendix D shows a sample of the ordered decrease in residential customer bills.

employee's personal use of vehicles. We also disallow the purchase price for all vehicles where personal use on vehicles is 50% or greater. We grant SJW's requested amount of cash deposits for its operating bank account. We deny CACD's request for new appraisals of SJW property sold to SJW Land Company (SJW Land). Instead, in accordance with Decision (D.) 86-01-026, we order SJW to establish a program to offer for public bid all parcels of land that have been in rate base and were either later transferred to SJW Land, or which SJW wishes to transfer in the future. This program will be submitted to CACD which will make any recommendations on the program in the next phase of this proceeding. In accordance with D.89-05-065, we deny SJW's request for additional tax expense for unbilled revenues. In that decision we denied the same request by the California Water Service Company and SJW in a Joint Petition for Modification of D.88-01-061, our order adjusting rates in accordance with the 1986 Tax Reform Act.

We order the estimates of consumption authorized in this proceeding to be used in calculating consumption in SJW's memorandum account, which was approved in D.89-04-041.

Tables 1 and 2 show the Commission adopted summary of earnings at present rates and authorized rates for the test years 1989 and 1990. Appendix D shows a sample of the residential customer bills.

Table 1

San Jose Water Company
Adopted Summary of Earnings
(Dollars in Thousands)
1989

	Adopted at Present Rates	Adopted at Auth. Rates
Operating revenues	$70,968.2 *	$67,862.8 *
Operating expenses		
Purchased water	13,320.0 *	13,320.0 *
Purchased power	5,615.0 *	5,615.0 *
Pump tax	10,855.0 *	10,855.0 *
Payroll	6,019.0	6,019.0
Other O & M	3,530.0	3,530.0
Other A & G	5,260.0	5,260.0
Business license	30.0	30.0
Taxes other than income	2,045.7	2,045.7
Depreciation	4,965.2	4,965.2
Subtotal	51,639.9	51,639.9
Uncollectibles	164.6	157.4
Franchise tax	158.2	151.3
State income tax	1,327.4	1,039.0
Federal income tax	4,859.0	3,899.3
Total operating expenses	58,149.1	56,886.9
Net operating revenues	12,819.1	10,975.9
Rate Base	104,694.4	104,694.4
Rate of Return	12.24%	10.48%

* Current rates based on Resolution No. W-3459, dated July 19, 1989

Table 2

San Jose Water Company
Adopted Summary of Earnings
(Dollars in Thousands)
1990

	Adopted at Present Rates	Adopted at Auth. Rates
Operating revenues	$71,573.1 *	$69,840.2 *
Operating expenses		
Purchased water	13,406.0 *	13,406.0 *
Purchased power	5,660.0 *	5,660.0 *
Pump tax	10,965.0 *	10,965.0 *
Payroll	6,348.0	6,348.0
Other O & M	3,709.0	3,709.0
Other A & G	5,489.0	5,489.0
Business license	30.0	30.0
Taxes other than income	2,126.2	2,126.2
Depreciation	5,147.3	5,147.3
Subtotal	52,880.5	52,880.5
Uncollectibles	166.0	162.0
Franchise tax	159.5	155.7
State income tax	1,258.0	1,096.4
Federal income tax	4,635.9	4,098.1
Total operating expenses	59,099.9	58,392.7
Net operating revenues	12,473.2	11,447.5
Rate Base	107,238.7	107,238.7
Rate of Return	11.63%	10.67%

* Current rates based on Resolution No. W-3459, dated July 19, 1989

(MAI) requirements. SJW complained that this was not a proper document of which official notice could be taken and was not presented as evidence in the proceeding. No response was received from CACD or DRA. Accordingly, we have not used this document in the conclusions we reach in this order.

The following discussion addresses issues which are disputed and some issues which are not disputed. Undisputed matters are discussed to record SJW compliance with prior Commission orders or to authorize tariff rule changes. Other matters not in dispute have been reviewed and found reasonable and are not discussed below.

Utility Background

SJW became a wholly owned subsidiary of San Jose Water Corporation (SJW Corp.) in 1985. At that time SJW Corp. acquired all outstanding shares of SJW common stock. In 1987, residents of California owned 67% of SJW Corp.'s stock. SJW Corp. has one other wholly owned subsidiary, SJW Land Company (SJW Land).

SJW's service area consists of approximately 134 square miles in Santa Clara County encompassing the cities of San Jose, Los Gatos, Monte Sereno, Saratoga, Campbell, Cupertino, and Santa Clara. The center of the service area is flat sloping up to foothills in the southwest and northeast. The southwest portion of the service area is bordered by mountains; the northeast portion extends into adjacent foothills.

SJW's water sources are: 148 wells located in various parts of Santa Clara Valley; runoff from the watersheds of Los Gatos, Saratoga, and Alamitos Creeks; and water purchased from the Santa Clara Valley Water District (District). SJW's water contract with the District expires in 2051. In 1987, SJW delivered 50.4 million gallons of water to a total of 198,704 customers.

SJW chlorinates and filters water from the watersheds in several filter plants. SJW intends to meet new customer growth in 1989-91 by water purchases in order to avoid overdrafts of

Clara. The center of the service area is flat sloping up to foothills in the southwest and northeast. The southwest portion of the service area is bordered by mountains; the northeast portion extends into adjacent foothills.

underground water. SJW performs more tests for water quality than required by the County Health Department, and its water quality meets the required standards.

SJW has approximately 2,257 miles of transmission and distribution mains ranging in sizes up to 48 inches in diameter. Water distribution is made to 51 different pressure zones. An automatic computer telemetry control system operates and monitors water service. The system can be operated and monitored manually if required. Total utility plant is valued at $213 million, producing $65.5 million in revenues in 1987.

SJW has made numerous improvements in the quality of its customer billing and account record-keeping in the past three to four years. SJW's punch card billing system was converted to a paper billing system to comply with the Commission's report card billing requirements discussed in D.84-03-055. SJW installed a hand-held computer meter reading system which has improved the productivity of meter readers. This system gives the location of a meter, the meter number, usage history, and tests for meter accuracy. SJW installed computerized cash remittance machines to accept bill payment and automatically deposit customer checks. SJW's general ledger has been transferred to a computer system.

<u>Rate of Return</u>

SJW requests a rate of return on rate base of 11.74% in 1989, 11.77% in 1990, and 11.88% in 1991 and a constant ROE of 13.75%. DRA recommends a rate of return on rate base ranging from 10.40%-10.66% in 1989, 10.48%-10.74% in 1990, and 10.57%-10.83% in 1991 and that the adopted ROE be within the range of 11.75% to 12.25%. Within these ranges, DRA recommends specific rates of return on rate base of 10.53% in 1989, 10.61% in 1990, 10.70% in 1991, and a constant 12% ROE.

The parties present different perceptions of SJW's classification within the utility industry. SJW compares itself with electric, gas, and telecommunication utilities. DRA compares

SJW's water sources are: 148 wells located in various parts of Santa Clara Valley; runoff from the watersheds of Los Gatos, Saratoga, and Alamitos Creeks; and water purchased from the Santa Clara Valley Water District (District). SJW's water contract with the District expires in 2051. In 1987, SJW delivered 50,413 million gallons of water to a total of 198,704 customers.

SJW chlorinates and filters water from the watersheds in several filter plants. SJW intends to meet new customer growth in 1989-91 by water purchases in order to avoid overdrafts of underground water. SJW performs more tests for water quality than required by the County Health Department, and its water quality meets the required standards.

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<u>Rate of Return</u>

SJW requests a rate of return on rate base of 11.74% in 1989, 11.77% in 1990, and 11.88% in 1991 and a constant ROE of

SJW with other publicly traded water utilities. This difference of perception guides each party's application of the same general finance principles and selection of comparable companies to recommend rates of return. The different views lead to different recommended capital structures and calculations of expected ROE.

SJW and DRA's estimates for long-term debt had a minor difference in 1990. DRA agrees with SJW's average debt costs for 1989 and 1991 of 8.87% and 9.23%, respectively. However, DRA's average debt cost (effective rate) for 1990 is .11% higher than that of SJW, 9.05% versus 8.94%.

DRA used a straight arithmetic average of beginning- and end-of-year debt costs for prior years to calculate the effective rate in 1990. SJW used an average weighted in proportion to the time the debt is outstanding. DRA's method is consistent with prior Commission treatment; therefore, we adopt DRA's effective rate of 9.05% for 1990.

Capital Structure

The capital structure defines the sources of capital costs. Each source of capital can be translated to a percentage of total capital. The components of the capital structure are long-term debt, preferred stock, and common equity. SJW has no preferred stock.

Common equity was the most debated component of the capital structure. At the end of 1988, SJW's common equity ratio was 57.51%. SJW's requested and DRA's recommended capital structures for 1989, 1990, and 1991 appear in the following table:

	DRA			SJW		
	1989	1990	1991	1989	1990	1991
Long-Term Debt	47.00%	47.00%	47.00%	41.20%	41.25%	41.41%
Common Equity	53.00	53.00	53.00	58.80	58.75	58.59
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

13.75%. DRA recommends a rate of return on rate base ranging from 10.40%-10.66% in 1989, 10.48%-10.74% in 1990, and 10.57%-10.83% in 1991 and that the adopted ROE be within the range of 11.75% to 12.25%. Within these ranges, DRA recommends specific rates of return on rate base of 10.53% in 1989, 10.61% in 1990, 10.70% in 1991, and a constant 12% ROE.

The parties present different perceptions of SJW's classification within the utility industry. SJW compares itself with electric, gas, and telecommunication utilities. DRA compares SJW with other publicly traded water utilities. This difference of perception guides each party's application of the same general finance principles and selection of comparable companies to recommend rates of return. The different views lead to different recommended capital structures and calculations of expected ROE.

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SJW requests a higher level of common equity for the test years 1989 and 1990 and attrition year 1991. DRA imputes common equity below the existing ratio to reduce the revenue requirement for common equity costs collected from the ratepayer. SJW and DRA based their respective recommendations for capital structure on their independent analysis of SJW's business and financial risk.

Business Risk

Under general finance principles, the balance between the percentage of debt and equity is determined by the degree of business risk and financial risk. The level of business risk of a company depends upon the reliability of its revenues, the degree of technological change, and the status of other unique occurrences in the industry.

In the opinion of DRA's witness, Ms. Siegal, water utilities do not face the same degree of technological change and utility bypass faced by electric utilities. DRA considers water utilities to have advantages over electric utilities. Water utilities supply a commodity which is renewable and, unlike electric utilities, earn a return on construction work in progress. These factors lead DRA to conclude that SJW has more steady, predictable revenues and less business risk. The less business risk a company faces, the more debt it may take on because it is assured of meeting fixed payment obligations. Because of its low business risk, DRA considers SJW capable of assuming more debt and lower equity ratios.

SJW considers the uncertainty of new Environmental Protection Agency (EPA) testing standards, the lack of normal rainfall, and potential loss of revenues during the existing drought to indicate a high business risk.

Financial Risk

The level of financial risk of a company is determined by the proportion of a company's debt to permanent capital (leverage). The larger the debt payments, the larger the financial risk of not was 57.51%. SJW's requested and DRA's recommended capital structures for 1989, 1990, and 1991 appear in the following table:

	DRA			SJW		
	1989	1990	1991	1989	1990	1991
Long-Term Debt	47.00%	47.00%	47.00%	41.20%	41.25%	41.41%
Common Equity	53.00	53.00	53.00	58.80	58.75	58.59
	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

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The financial stability of a company is measured by bond ratings. Bond rating agencies rank the financial standing of water utilities in the categories of: total debt to permanent capital, pretax interest coverage, and internal cash flow to permanent capital. Standard and Poor's, a well-respected bond rating agency, establishes benchmark standards for these three measures. Bond ratings range from a low of BBB, A, AA to a high of AAA. SJW ranks AAA in all three categories for water utilities. When compared with an electric utility's benchmarks, which are more strict than water utility standards, SJW ranks AAA in total debt to permanent capital and pretax interest coverage and AA in internal cash flow.

DRA considers SJW to be very stable financially based upon the three financial indicators. DRA asserts that the ratepayer does not benefit from high bond ratings in SJW's case because SJW's debt ratio, pretax interest coverage and cash flow exceed the levels required to obtain AAA and AA ratings. SJW's performance on these financial indicators is achieved at the expense of more expensive equity financing.

In DRA's opinion, SJW could lower the levels of its performance on these indicators and still meet the requirements for a superior bond rating. High bond ratings are needed only to business risk, DRA considers SJW capable of assuming more debt and lower equity ratios.

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Financial Risk

The level of financial risk of a company is determined by the proportion of a company's debt to permanent capital (leverage). The larger the debt payments, the larger the financial risk of not meeting those payments. A company lowers the financial risk by increasing equity. As a company becomes more leveraged, the cost of its debt will increase and the return required on new debt issuances will increase. Such a company must weigh the benefit of cheaper debt against the increased financial risk of higher fixed payments. The existence of more debt means less common equity and the loss of financial flexibility that common equity allows. Common equity financing gives management the financial flexibility of reducing or suspending dividend payments in times of business hardship. In order to provide reliable service, a company must be able to pay its bills and meet demands for growth without facing financial instability.

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obtain a low interest rate for new debt. SJW does not plan large debt financing in the test years. Thus, the ratepayer is not benefiting from SJW's high level of equity which generates excessive levels of internal cash. DRA recommends imputing a more reasonable level of common equity which would reduce the revenue requirement collected from the ratepayer.

SJW witness Meyer testified that bond ratings must be maintained regardless of whether bond issuances are contemplated for current years. In his opinion, it is not possible or practical to raise and lower these ratings by adjusting common equity when debt is to be issued.

Comparative Analysis

DRA used outside indicators to verify that SJW's equity ratio is unreasonable. DRA compared 11 water utilities throughout the nation meeting three criteria: listed in C. A. Turner's Utility Reports; realization of 70% of revenues from water operations; and regular trading of stock.[1]

DRA's analysis shows that SJW's average year equity ratio rose from 39.13% in 1978 to 59.30% in 1987, even though in 1984, the Commission's authorized returns were based upon an equity ratio of 56%.

DRA found that the same comparable water utilities' common equity ratios averaged 40.12% for 1983-1987 and 38.22% for 1978-1987. SJW's average common equity for five years is 56.25% and for ten years is 50.42%. In the last five years, SJW's common equity ratio is 16% higher than comparable water utilities.

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1 American Water Works, California Water Service, Connecticut Water Service, Consumers Water, Elizabethtown Corporation, The Hydraulic Company, IWC Resources Corporation, Middlesex Water Company, Philadelphia Suburban, Southern California Water, and United Water Resources.

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SJW's pretax interest coverage ratio has exceeded that of the comparable group since 1983. In the past two years SJW's coverage was 6.7x and 6.1x compared with that of the group, 3.2x and 3.4x for the same years.

DRA believes this equity growth is because cash flow has consistently exceeded cash requirements. DRA used the ratio of internal cash flow to net construction outlays to show the excess cash generation in the past ten years. Over the last five years SJW's ratio of cash to construction costs averaged nearly 120%, with cash available surpassing cash needs. DRA maintains that this excess cash has fueled the growth in common equity.

DRA believes SJW's low dividend payout rate helped to increase the high equity ratio. SJW has paid out an average of 63% in the past ten years compared to the group average of 71%. SJW has pursued a policy of low dividend payout in spite of its 11.45% ten-year average growth in dividends and earnings. (The group's ten-year average growth in dividends and earnings is 6.31%.) SJW plowed earnings back into the business, increasing common equity, the sum of contributed capital and retained earnings.

DRA derived its recommended 53% common equity ratio from a review of ratios of the comparable water utilities. The company with the highest common equity within the comparable group has a ratio of 53% as of January 1989, even though the group average is 42%. DRA does not recommend imputing the group average because it is a sharp reduction from SJW's 1987 level of common equity, 59.30%.

DRA believes common equity will continue to grow during the test period unless curtailed in this proceeding. Since dividends are paid out only to SJW Corp., DRA is concerned that any cash build-up transferred to the unregulated holding company will finance unregulated ventures. Ratepayers should only pay for services rendered, not finance unregulated business ventures, in DRA's opinion.

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SJW considers DRA's imputed capital structure to be a penalty when coupled with its recommended 12% ROE. SJW accuses DRA of being subversive by imputing 53% common equity and recommending 12% ROE. SJW considers it more logical for DRA to recommend maintaining the existing capital ratios and award an ROE below 11.75% due to SJW's less risky capital structure. However, in SJW's opinion, DRA did not make these recommendations because they would not be approved by the Commission. Therefore, DRA recommended a scenario of capital structure and ROE which achieves the same result of reducing internal cash.

SJW performs two calculations to show DRA's common equity and ROE recommendations are not consistent. First, SJW calculates an ROE of 11.70-11.74% for 1989-91 using SJW's requested capital structure, DRA's recommended rate of return, and the undisputed debt cost. Second, Meyer explained that if 53% equity is imputed, this results in a limit of 47% debt. In SJW's case, debt is issued in the form of bonds. At the end of 1987, SJW's debt ratio was 42.37%. Therefore, to achieve a 47% debt ratio, SJW would need to impute bonds to this level, which increases its weighted cost of debt and lowers the return on equity. If a 47% debt ratio is imputed, an additional \$4.8 million in bonds is presumed to have been issued during the period 1984-1987. If SJW had issued an additional \$4.8 million in bonds, it would have an additional debt cost of 11.3% during this period, giving a higher average cost for bonds. Performing the rate of return calculation with this additional debt cost, the resulting return on equity is 11.90% for 1989. Thus, applying DRA's recommended imputation of higher debt to SJW's requested capital structure results in an ROE lower than DRA's recommendation. SJW considers this shortfall in ROE to be a hidden penalty against the utility.

In order to impute a 47% debt ratio or an additional \$4.8 million in bonds, SJW alleges it must have sufficient assets to secure such an issuance. If it subtracts the additional assets required by this imputation of debt from its total available assets, it has insufficient assets ($2.8 million) to secure debt which may be needed for unanticipated expenses, such as additional facilities which may be mandated by new EPA regulation. Under this scenario, in order to meet unanticipated costs, SJW would be forced to secure second mortgage bonds at a higher cost to the ratepayer. Thus, SJW alleges a 53% common equity ratio cannot be reached in three years because its bonding limits have recently reached their capacity. SJW argues that the imputed ratios are recommended without warning or opportunity for SJW to achieve the level imputed.

Meyer testified that SJW reduced its common equity in 1986 and 1987 by paying dividends to SJW Corp. in response to CACD's advice to keep common equity below 60% or penalties may occur. SJW interpreted this remark to mean a 60% common equity ratio was reasonable. SJW paid $12.07 million in dividends to SJW Corp. in 1986 and $9 million in 1987, reducing common equity to a 1987 level of 57.63%. (In 1988 SJW paid out $5.25 million in dividends, bringing the common equity ratio to its present level of 57.51%.) SJW relied on its efforts of reducing equity in 1986 and 1987 to place them within an acceptable equity ratio range. SJW considers DRA's recommendations in this proceeding to violate CACD's informal advice upon which SJW relied. DRA responds that SJW had no reason to rely on CACD's advice as being Commission policy.

SJW challenges DRA's comparable companies as ones which derive only 70% of revenues from water service, have unknown sources of supply and varying regulatory policies. Seven of these selected companies have ten-year average dividends and earnings growth rates of 1.58% to 6.12% compared with SJW's rate of 11.45%. SJW points out that SJW's rates are $14 less on an annual basis than those of comparable companies, showing no harm has occurred to SJW's ratepayers by its level of common equity.

SJW argues that this cash was generated by 1986 investment tax credits and accelerated tax depreciation. In 1987, SJW's cash flow was increased by increased sales. Thus, the increase in cash was not because of SJW's conscious effort to do so but because of external factors.

SJW considers the substitution of SJW Corp.'s statistics to represent SJW to be a serious flaw in DRA's analysis. SJW alleges it and SJW Corp. are two distinct companies with different assets and capitalization. Although DRA corrected this criticism by providing statistics for both SJW and SJW Corp. in its tables, SJW asserts that the text of DRA's written testimony referring to SJW and SJW Corp. as the same company is unreliable.

Discussion

We agree with DRA that SJW is more comparable with water utilities than electric, gas, and telephone utilities for business risk comparison purposes. Although water utilities may face business risk, it is not as great as that faced by electric, gas, and telephone utilities, as discussed by DRA.

We consider SJW's financial risk to be low based upon the financial factors considered in bond ratings. We agree that SJW's existing financial factors are excessive to maintain the highest bond ratings. We disagree with SJW that the present excessive internal cash generation and pretax interest coverage are needed to acquire additional capital and obtain favorable interest rates on new debt.

Excessive levels of common equity burden the ratepayer with excessive rates. Ratepayers do not receive a tax benefit for paying this revenue requirement on equity as they do from the tax deduction allowed for debt interest payments. We do not believe SJW's bond ratings will be affected by a reduction in common equity. A reduction in the level of SJW's common equity will allow the ratepayer to share in SJW's healthy financial state by reduced rates.

SJW's analysis of bond costs and capacity presuming a historical 53% equity level and 47% debt level is a hindsight view which is marginally relevant to its existing capital ratio status. Our purpose is not to blame SJW because its present equity is increasing but to resolve the dilemma in which it puts the ratepayer. Nor do we find that DRA's recommendations will penalize SJW if implemented in steps as discussed below. DRA's recommended equity level is made within the context of its recommended 12% ROE. It is not DRA's recommendation that SJW's requested equity levels be used in conjunction with DRA's recommended rates of return. We believe this is a distortion of DRA's recommendations by SJW.

We find that DRA's imputed common equity of 53% is reasonable when compared with the range of common equity of comparable water utilities (34% to 53%) and the average common equity of comparable water utilities (42%). We agree that imputing this average would be too large a reduction in common equity to authorize in one step.

We find little justification by SJW to raise its equity ratio above the last authorized level of 56%. Its arguments consist of attacks on DRA's recommendations. Therefore, in 1989 we authorize common equity of 56%.

The record shows that SJW's common equity has been reduced by its dividend payout policy. SJW's alternative methods of reaching the 53% level of common equity do not include an analysis of any anticipated dividends to be paid out in 1989, 1990, or 1991. We expect any dividends paid will reduce common equity. SJW alleges increasing debt to 47% will increase interest expense to the ratepayer. This analysis is incomplete without following through to calculate the benefit to the ratepayer of an additional tax deduction for interest expense. Based upon the incompleteness of both of these analyses, we cannot agree that a 53% equity ratio cannot be reached. However, in order to give SJW sufficient time and the opportunity to achieve 53% equity, we impute 55% equity in 1990, and in 1991 we impute DRA's recommended equity level of 53%.

Return On Equity

Rate of return recommendations are governed by two landmark U.S. Supreme Court decisions, Bluefield Water Works and Improvement Company vs. The West Virginia Public Service Commission (1923) 262 U.S. 679, and the Federal Power Commission vs. Hope Natural Gas Company (1944) 320 U.S. 591. The principle in these cases is to set rates for public utilities which are not only sufficient to assure the provision of adequate service, but which allow the utilities to raise capital. By this standard, the ROE should be commensurate with returns on investments in other enterprises having corresponding risks and should assure a financial integrity of the utility which maintains its credit and attracts capital.

Both parties used the standards from these cases of attracting capital and comparable earnings in its analysis in this proceeding. However, the application of the standards are based upon the parties' respective perception of SJW's classification within the utility industry. SJW perceives itself as similar to electric, gas, and telephone utilities. DRA perceives SJW as similar to other water utilities.

Both parties used the Discounted Cash Flow (DCF) and the Risk Premium (RP) financial models to justify their ROE recommendations, yet derived different conclusions based upon their comparable utilities and applications of the methodology.

Discounted Cash Flow

The DCF model is based on the premise that the current market price of a share of common stock equals the present value of anticipated dividends plus future stock price, discounted by the investor's expected return. By translating this premise into a mathematic equation and transposing the equation, the investor's expected ROE equals the expected dividend yield (the next expected dividend divided by the current market price) plus future dividend growth.[2]

DRA applied the DCF model to its 12 comparable water utilities, including SJW Corp. From this analysis, DRA derived average dividend yields of 6.07% for three months and 6.01% for six months. To these yields, DRA applied an average of historical and sustainable growth rates of 5.52%, obtaining future expected returns averaging 11.90% for a three-month dividend yield and 11.84% for a six-month dividend yield. DRA considers the group results to balance any biases in the data, such as high or low dividend growth rates. DRA included SJW Corp. as a representative of SJW to weigh the results with company-specific data. DRA used the group results in its recommended specific ROE.

SJW applied the DCF model to its own stock price, and historical dividends and earnings growth for the past five-year and ten-year periods. No comparable companies were used. SJW derived ROE estimates of 13.62% to 21.48% based upon ten-year growth and 15.89% to 17.83% based upon five-year growth.

Risk Premium

The RP model is based upon the premise that common equity investors face more risk than debt holders because they receive returns from residual revenues after debts are paid, thus requiring higher returns than debt holders. The difference between the return for debt holders and common stock investors is the risk premium which is added to the debt interest rate to obtain the common equity return. An average risk premium calculated over an

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2 $r = D1/P0 + g$

where r = the investor's expected return on equity;
$D1$ = the expected dividend in the next period;
$P0$ = the market price in the current period; and
g = the expected future dividend growth rate.

extended time period is preferred to balance past variances in premiums.

DRA used the RP financial model to verify the results derived from the DCF model. DRA applied the RP model to the same comparable group of utilities obtaining a range of expected ROEs from 11.95% to 12.53%. DRA compared SJW's past earnings, common equity ratios, and growth with the comparable group, concluding that SJW exceeded the group average in these categories.

Using the results of the DCF and RP models, SJW's past earnings, and its judgment, DRA recommends a range of ROE of 11.75% to 12.25% and a specific ROE of 12%.

SJW applied the RP model to five California electric, gas, and telephone utilities[3] obtaining a range of historical ROEs from 12.70% to 13.10% and an average historical ROE of 12.81%. SJW applied the model to six California water utilities[4] obtaining a range of 1987-authorized ROEs from 12.00% to 13.00% and an average ROE of 12.71%. The combined 1987 average authorized ROE for all of the utilities selected by SJW is 12.75%. Adding the average risk premium from these utilities, 3.11%, to SJW's current imbedded cost of debt, 10.86%, SJW calculated a return of 13.97% under this method.

SJW applied the RP model to SJW's historical authorized ROEs from 1975-1984. SJW obtained an average historical ROE of 13.02% and projected ROEs for 1988, 1989, and 1990 of 15.19%, 15.22%, and 15.29%.

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3 Pacific Gas and Electric Company, Southern California Edison Company, San Diego Gas & Electric Company, Southern California Gas Company, and General Telephone Company of California.

4 California American Water Company, California Water Service Company, Dominguez Water Company, Park Water Company, Southern California Water Company, and Suburban Water Systems.

Using the results from the DCF and RP models, judgment and factors of business risk (technological changes and the drought), SJW recommends 13.75% as a reasonable return for the future.

SJW criticized DRA's procedure of selecting the company with the poorest financial performance and lowest ROE within its comparable group to use in its recommendation. SJW asserts that if DRA's recommendation for return on rate base is adopted, it will have the lowest return within DRA's comparable group.

SJW outlines factors which are relevant to the Commission in setting SJW's ROE:

1. The Commission's acceptance of this application was delayed because inadequate staff was available to process the application. The delay in accepting this application impacts SJW's earnings for 1989.

2. SJW's earnings will be affected by lower consumption under SJW's existing water rationing program.

3. New technology has prompted new, more stringent standards for water testing. Pending EPA regulation may require changes in existing facilities and additional testing.

4. SJW considers its management achievements in the past three to four years to warrant consideration in setting its rate of return.

Discussion

We select DRA's comparable companies for analysis over SJW's list of electric, gas, and telephone utilities because the latter utilities face greater business risks of bypass and technological change than water utilities as discussed by DRA above.

DRA's comparable utilities are preferred over SJW's comparable water companies because they are listed by C. A. Turner's Utility Reports with verified financial data, are publicly traded, and derive at least 70% of revenue from water operations. Even though 5 of the 12 companies derive up to 30% of their revenues from nonwater operations, 7 derive over 98% of their revenues from water operations. We do not accept SJW's comparison of its own historical financial data as a comparison which meets the standard set by the Bluefield and Hope decisions, cited above. We interpret these cases to mean that a valid comparison is one made with other enterprises.

We find that SJW Corp. derives 98% of its revenues from SJW; therefore, DRA's references to SJW Corp. are synonymous with SJW. We agree with SJW that its growth and earnings are on a higher scale than the averages of historical growth and earnings of DRA's group. We find SJW more comparable with the companies having a higher financial standing of DRA's group rather than the group averages. We believe it is appropriate to consider the higher end of DRA's comparable analysis in setting SJW's return. However, we must also consider SJW's equity level, discussed below.

We do not agree that the delay in accepting this application is cause for a greater rate of return. Any such delay means that SJW is authorized to earn 14.5% ROE on slightly lower rate base and expenses until our decision in this proceeding is effective. This delay may not have caused as significant an impact as SJW argues.

We cannot agree that loss of revenue during the drought is cause for a greater rate of return. We have authorized a memorandum account procedure to allow SJW the opportunity to recover any such losses. (D.89-04-041.) We consider that procedure adequate to compensate SJW for any revenues lost and to minimize the business risk encountered by the drought. Any consideration for such revenues in SJW's ROE would be double recovery.

We believe it is premature to compensate SJW in its ROE for possible technology changes in the water industry until new requirements are mandated. To do so would be pure speculation at this time. Should technical changes significantly impact the revenues of water utilities, it is our practice to institute an investigation to adjust the rates of all affected water utilities for unanticipated expenses rather than increase rates on a case-by-case basis.

Based on the above considerations and the higher results of DRA's analysis, we consider an ROE in the range of 11.75% to 12.25% to be reasonable. However, both parties agree with the premise that ROE varies inversely with the level of common equity. Therefore, because we order a phased reduction of common equity, we also order a phased increase in ROE. During the test year 1989, SJW is authorized to earn 11.75% ROE. During the test year 1990, SJW is authorized to earn 12% ROE. During the year 1991 when 53% common equity shall be imputed, we authorize SJW to earn 12.25% ROE.

The following table shows our adopted capital structure and rates of return:

Adopted Capital Structure and Rate of Return

1989

Component	Capital Ratios	Cost	Weighted Cost
Long- and Short-Term Debt	44.00%	8.87%	3.90%
Common Equity	56.00	11.75	6.58
Total	100.00		10.48%

1990

Component	Capital Ratios	Cost	Weighted Cost
Long- and Short-Term Debt	45.00	9.05	4.07%
Common Equity	55.00	12.00	6.60
Total	100.00		10.67%

1991

Component	Capital Ratios	Cost	Weighted Cost
Long- and Short-Term Debt	47.00	9.23	4.34%
Common Equity	53.00	12.25	6.49
Total	100.00%		10.83%

Operating Revenues

SJW's estimated operating revenues for 1989 and 1990 are based upon the estimated number of customers to be served during the test years and their projected consumption. SJW serves residential, commercial, industrial, public authority, other utility, and a category of "other" customers. SJW and CACD agree on the estimated number of customers in 1989 and 1990. They agree on the total consumption by all customers except commercial customers for these years. (SJW includes residential customers in its totals for commercial customers.)

Parties in rate proceedings have used the Modified Bean (Bean) Method of estimating customer consumption since 1977. The goal of the Bean Method is to estimate normal consumption in a future year under normal weather conditions. Data containing the recorded temperature, rainfall and consumption for the past 30 years is input into the Bean Method computer model. The data is obtained from a weather station in the approximate location where consumption will occur. Bean Method guidelines dictate that data from abnormal years, for example, a drought year, should not be used.

The Bean model uses the 30 years of temperature and rainfall data to calculate the normal temperature and normal rainfall. The model generates one consumption estimate for each range of consecutive years from 13 years to 5 years. Each Bean run is given ratings by the computer to rank the efficiency of the data contained in the computer run. The user of the model selects the estimate of consumption from the range of years with the highest efficiency ratings. The user then verifies that this estimate is reasonable.

Both SJW and CACD used the Bean Method in this proceeding, yet derived a different estimate for commercial customer consumption. However, SJW and CACD agree that the normal temperature for the past 30 years calculated under the Bean method is 60 degrees and the normal rainfall is 13.54 inches. Drought years were not excluded from these averages.

The Bean model generated the following actual rainfall, temperature and consumption:

Year	Rain (inches)	Temperature (degrees)	Consumption (Ccf/yr.)
1977	8.19	59.6	216
1978	17.14	60.9	238.8
1979	15.12	60.4	247.5
1980	14.04	60.4	253.6
1981	15.58	61.3	261.2
1982	19.57	59.2	247.8
1983	24.25	60.9	256
1984	11.55	60.7	283.3
1985	10.69	59.7	279.2
1986	13.61	61.6	278.4
1987	10.34	61.5	286.8

(Exhibit 4, p. 2)

The Bean model generated the following estimated consumption for the corresponding periods:

Years	Consumption (Ccf/yr.)	Reg.[1/]	Inverse McSee[2/]
1977-87	284.5	0.935	0.035
1978-87	283.0	0.971	0.019
1979-87	281.6	0.966	0.019
1980-87	280.7	0.961	0.021
1981-87	278.9	0.963	0.022
1982-87	268.2	0.976	0.020
1983-87	271.7	0.997	0.007

1/ Regression coefficient. The number closest to 1.000 is the curve best fitted to the data input.

2/ Standard error divided by the mean. The smaller the number, the better the correlation to the data input.

(Exhibit 4, p.2)

Mr. Houck, witness for SJW, selects 271.7 hundred cubic feet (Ccf) per customer as the most accurate estimate generated by the Bean model. In comparing Bean estimates with actual consumption in 1982, 1983, 1986 and 1987, actual consumption is higher than predicted by the Bean model. SJW asserts actual consumption is higher because these were not normal years. SJW relies on the premise that consumption is low when there is more than average rainfall and consumption is high when temperatures are higher than normal. In 1983 the rainfall was higher than normal. In 1986 and 1987 there was less rainfall and higher temperatures than normal. Based upon its presumption, SJW considers this estimate reliable and adopts it for an estimate of consumption in both 1989 and 1990.

Ms. Hood, witness for CACD, agrees that 271.7 Ccf is an accurate calculation under the Bean method. However, CACD does not consider the Bean estimate to be reliable because Bean estimates of 1984, 1985, and 1987 consumption were lower than actual consumption. In D.84-01-042, CACD and the utility used the Bean Method to produce estimates for years 1984 and 1985 consumption of 256.4 Ccf per customer. For 1987, the Bean Method produced an estimate of 271.5 Ccf for commercial customers. Recorded consumption was 283, 279, and 287 Ccf for commercial customers, respectively, in the same years. Therefore, CACD rejects the Bean estimate for 1989 and uses an alternative approach, which is the procedure advised in Bean guidelines. CACD's alternative approach is to average recorded consumption for the most recent three years, 1985-1987. CACD recommends that 281.3 Ccf be used for commercial customer consumption in 1989 and 1990. CACD diagrams historical commercial customer consumption to support its recommendation.

consumption in 1982, 1983, 1986 and 1987, actual consumption is higher than predicted by the Bean model. SJW asserts actual consumption is higher because these were not normal years. SJW relies on the premise that consumption is low when there is more than average rainfall and consumption is high when temperatures are higher than normal. In 1983 the rainfall was higher than normal. In 1986 and 1987 there was less rainfall and higher temperatures than normal. Based upon its presumption, SJW considers this estimate reliable and adopts it for an estimate of consumption in both 1989 and 1990.

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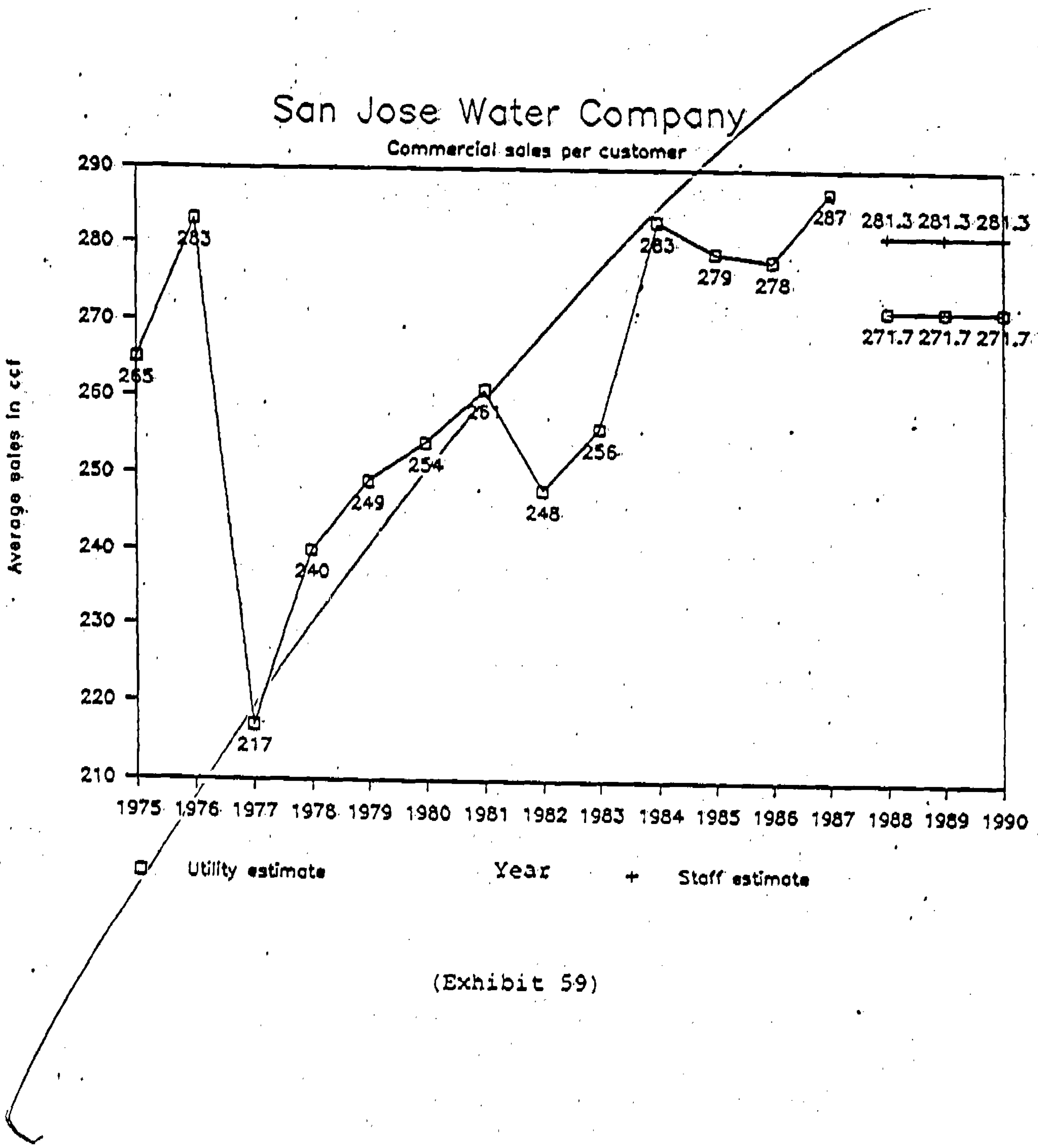
San Jose Water Company
Commercial sales per customer
290
280
270
260
250
240
230
220
210
Average sales in ccf
265
283
217
240
249
254
261
248
256
283
279
278
287
281.3 281.3 281.3
271.7 271.7 271.7
1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990
Year
Utility estimate
Staff estimate

(Exhibit 59)

In SJW's opinion, CACD's averaging of actual consumption for three years is a rejection of temperature and rainfall data and the Commission-approved method of estimating consumption that has prevented prolonged litigation of this issue in rate proceedings for the past 20 years. By using a high consumption estimate, SJW believes CACD is attempting to penalize SJW for high earnings in the dry years, 1986 and 1987. Should the Commission adopt CACD's estimated consumption, SJW requests consideration be given for the additional expenses incurred during the past three years for delivering purchased water which is more expensive than delivering water from its reservoirs. SJW bases this request on the difference in its costs to deliver water when rainfall is low, which occurred in 1985-1987. SJW calculates surface supplies were short an average of 1,230 million gallons (mg) per year during this period.

Discussion

In reviewing the commercial consumption trend diagrammed by CACD and shown above, we also believe the Bean estimate of 271.7 Ccf is unreliable. SJW finds this estimate reasonable based upon a presumption that when rainfall is high, consumption is lower than normal; and when temperatures are high, consumption is higher than normal. SJW includes the drought year of 1977 and years following the drought in its estimate of a normal year.

We find this presumption is not true for 1983 when the temperature was roughly normal (60.9 degrees) and rainfall was at its highest level in ten years (24.25 inches). In 1983 consumption increased (256 Ccf) over its 1982 level (247.8), not decreased. In addition, SJW's normal year includes 1977 which should be excluded under Bean guidelines as a unique year. It is very likely that the years 1978 and 1979 should also be excluded as an adjustment period after the drought.

In analyzing CACD's diagram of customer usage from 1975 to 1987, we see a marked change in the usage trend from the periods of 1979-1983 and 1984-1987 which is not entirely explained by the lower rainfall in the latter period. In comparing 1980 consumption of 254 Ccf with 1986 consumption of 278 Ccf, the consumption in 1986 is significantly higher even though these are the two years closest to the Bean normal rainfall and temperature. Therefore, we conclude SJW's estimate of 271.7 Ccf is unreliable, based upon the recent different trend in usage.

Under the circumstances of having a marked shift in the consumption trend, we believe the three-year average of recorded consumption is more reliable. We do not consider this conclusion to be a rejection of the Bean method but an application of alternatives when a Bean estimate does not appear reasonable. Therefore, we adopt CACD's estimate for commercial customer consumption.

We find it unreasonable to grant SJW's request for additional distribution expenses incurred from 1985-1987. This issue is one to be resolved in a future proceeding which reviews SJW's memorandum account and issues surrounding the drought.

We order the following estimated number of customers in each customer category and the consumption by each category which we authorize in this decision to be used in the calculation of SJW's authorized memorandum account from the date it was approved in D.89-04-041:

Authorized Customers and Consumption

Customer Category	Total Customers		Est. Avg. Consumption (Ccf)	
	1989	1990	1990	1991
Commercial	197,999	199,299	281.3	281.3
Public Authority	1,448	1,486	3,000	3,000
Industrial	84	84	11,619	11,619
Other	245	245	0.3	0.3
Other Utilities	28	28	11.1	11.1
Subtotal	199,804	201,142	14,912	14,912
Private Fire Protection	2,082	2,182		
Total	201,886	203,324		

Unbilled Revenues

SJW includes a credit in revenues and a corresponding expense for unbilled revenues of $2.65 million in 1989 and $2.67 million in 1990. CACD removed these amounts. The parties agreed to resolve this issue as dictated by a decision on the California Water Service Company/SJW Joint Petition for Modification of D.88-01-061 in I.86-11-019. (This investigation explored utility recovery in rates for additional tax expense related to the removal of tax credits and deductions in 1986.) We recently denied the joint petitioners' request in D.89-05-065. Accordingly, we remove the credit in revenues and corresponding additional tax expense in this proceeding.

CPUC Reimbursement Fee

SJW included $918,000 for 1989 and $925,000 for 1990 in revenues and expenses representing the amount of regulatory fees paid under Public Utilities Code § 401 et seq., the annual fee collected by the utility and remitted for Commission administration. CACD removed these amounts based upon our policy to exclude these fees from rates. SJW did not dispute this issue.

We adopt CACD's treatment of this fee as appropriate and reasonable.

<u>Allocation of Administrative and General Expenses</u>

Although the parties stipulated to the amount of Administrative and General (A&G) expenses, CACD recommends additional allocation procedures. SJW management estimates employee time spent on capital projects. SJW presented no documentation to support its estimates. CACD recommends that SJW be ordered to develop procedures for the allocation of A&G expenses to capital accounts.

SJW disputes this recommendation. SJW witness Meyer testified that allocation of A&G expenses is based upon employee estimates of the time spent on these projects. No records of employee time devoted to each project are maintained. The work performed on these projects is intermingled within the average work schedule. In Meyer's opinion, the ratepayer is not disadvantaged by either an overestimate or underestimate of allocated construction costs. An overallocation increases the rate base and depreciation; an underallocation increases the current expense and removes the amount from earnings in rate base.

We agree that documentation of employee hours and other relevant records should be maintained to support amounts allocated to capital accounts. We will order SJW to develop such procedures and present for CACD's review within 90 days from the effective date or this decision.

<u>Allocation of Common Expenses</u>

SJW, SJW Corp., and SJW Land share the same facilities, staff, and expenses. SJW does not allocate expenses or charge for its sister company's use of SJW facilities. Both parties agree that these charges are minimal. However, CACD requests that an allocation procedure be developed and used.

Meyer, SJW's witness, opposed CACD's recommendation that allocation procedures be developed for expenses shared by SJW Corp. and SJW Land. Meyer considered this recommendation premature since these expenses are minimal for SJW Corp. and nonexistent for SJW Land. It is not known whether these companies will have staff or an office. An allocation of projected expenses by these companies is made at the beginning of the year. Expenses are controlled by these set percentages.

We agree that the ratepayer should not be charged for facilities, staff, or expenses used or incurred by sister subsidiaries, even though these charges are small. We believe an allocation procedure should be in place now and for use in the future should the amount of these expenses increase. We will order SJW to develop procedures to allocate common expenses incurred by SJW to its sister-subsidiary and holding company.

Conservation Plan

The Utilities Water Management Planning Act requires utilities with over 3,000 customers to prepare and adopt a water management plan for conservation. In D.86-05-064, we required water utilities to present a conservation plan pursuant to the Act. SJW presented its plan in this proceeding for our approval.

SJW coordinates conservation efforts with its retail suppliers, the Santa Clara Valley Water District (District) and the City of San Jose (City). The District sponsors conservation films and speakers to schools and service clubs. Conservation information is distributed to public schools. The City supplies and installs conservation kits in all city residences. The kits contain low flow shower heads and toilet dams to reduce water capacity in toilets. The City contacts businesses and industrial users to encourage conservation. SJW sends conservation reminders in water bills and provides a history of usage on the bill. SJW instituted an Employee Award Program for identifying unaccounted for water loss which has reduced such usage.

CACD has no objections to SJW's conservation plan. We find the plan to be reasonable.

Operation and Maintenance Expenses

SJW's estimates for purchased services and transportation expenses are disputed by CACD.

Other Operation and Maintenance Expenses

	CACD 1989	CACD 1990	Utility 1989	Utility 1990
All Other Operations				
Op. Transp.	$ 577,000	$ 614,800	$ 649,000	$ 703,000
Op. Purch. Serv.	1,264,200	1,338,100	1,557,000	1,630,000
Total	1,841,200	1,952,900	2,206,000	2,339,000
All Other Maintenance				
Maint. Purch. Serv.	1,001,100	1,059,700	1,100,000	1,155,000
Total	$2,842,300	$3,012,600	$3,306,000	$3,494,000

(Exhibit 16, p. 3-5)

Purchased Services

Certain SJW's Operation and Maintenance (O&M) services are purchased by contracts with outside vendors ("Op. Purch. Serv." and "Maint. Purch. Serv." above). SJW estimates these O&M expenses for 1989 and 1990 based upon its recorded expenses for 1983-1987 as $2.66 million and $2.79 million, respectively. SJW adds 5% inflation for each test year to its recorded 1987 expenses to derive its projection.

CACD disputes this methodology. CACD derived an expense-per-customer factor for each of the years 1978 to 1987. These factors were adjusted for inflation based on the constant 1987 dollar, then averaged. The ten-year average was then multiplied by the predicted number of customers and nonlabor inflation factors for 1989 and 1990 to estimate expenses of $2.27 million and $2.40

Delete Table

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Inflation Factors

	CACD		Utility	
	Labor	Nonlabor	Labor	Nonlabor
1988	1.040	1.054	1.050	1.050
1989	1.046	1.053	1.050	1.050
1990	1.046	1.051	1.050	1.050

(Exhibit 16, p. 3-1)

SJW rebuts CACD's position by testimony from Ms. Yip and Mr. Yoo that water testing expenses and expenses for water quality equipment are underestimated in its application. It is the opinion of these witnesses that pending EPA regulation and new legislation mandating increased water testing will increase testing expenses in the future. These witnesses cannot estimate the increased testing or facility expenses until these regulations are final.

SJW argues that its requested purchased services expenses for 1989 and 1990 are already invalidated by 1988 recorded expenses, which are higher. SJW alleges that 1988 recorded expense levels will continue in 1989 and 1990. SJW considers CACD's constant dollar method, an average of 1978-1987 expenses, too low of a starting point for 1989 and 1990 estimates. SJW points out that CACD's estimate for 1988 is also below recorded expenses for 1985-88. This is true for both O&M expenses. SJW concludes that both its estimates and those of CACD are too low but makes no recommendation for higher estimates.

Discussion

We envision that any increased testing, main protection or additional facilities required by new EPA regulations will affect all California water utilities. If this occurs, our normal

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Discussion

We envision that any increased testing, main protection or additional facilities required by new EPA regulations will affect all California water utilities, and when this occurs, our normal practice is to issue a separate investigation into the matter and/or derive special procedures at the Commission to allow all utilities an opportunity to recover unexpected expenses. However, we also believe that these expenses will not decrease in practice is to issue a separate investigation into the matter and/or derive special procedures at the Commission to allow all utilities an opportunity to recover unexpected expenses. The fact that these expenses may occur does not justify an award of higher expenses in this proceeding. SJW gives no estimated amount of additional expenses to award. Therefore, we must base purchased service expense estimates on recorded expenses plus inflation.

We find that CACD's constant dollar method is a more accurate and reasonable method of estimating purchased service expenses because it levelizes historical expenses to minimize fluctuations and applies nonlabor inflation factors which are more specifically related to the O&M services being purchased by SJW. We adopt CACD's estimate for O&M purchased services.

Transportation Expenses

SJW requests approval of the total transportation expenses for 28 company vehicles and the corresponding purchase price for the vehicles in rate base. SJW pays maintenance, insurance, and gasoline expenses for these vehicles. These vehicles are assigned to designated SJW managers to conduct utility business during the day and provide employee availability 24 hours a day to respond to after-hour emergencies or attend business meetings. There are no restrictions on the use of the vehicles. Personal use of the vehicles occurs before and after business hours. (Personal use of company vehicles during business hours would result in an employee being disciplined or fired.)

A mileage log is kept by each employee assigned a company vehicle which indicates whether the daily use of the vehicle is for business or personal use. These logs are maintained by SJW primarily for tax purposes. The personal use of these vehicles is reported to the Internal Revenue Service (IRS) as part of an employee's gross income.

According to SJW, this policy is cheaper than compensating the designated employees for transportation costs and the near future. Since current expenses are already in excess of either forecast we will accept SJW's forecast for purchased sevice expenses. Therefore, we base purchased service expense estimates on recorded expenses plus inflation.

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CACD recommends a transportation expense reduction of $38,120 representing all personal usage and rate base exclusion of $133,123 for 57% of the purchase price of related vehicles for each test year based upon an average of 57% personal use of 18 company vehicles. During the hearing, CACD increased its transportation expense disallowance by $5,555 based upon SJW witness Meyer's testimony of greater personal usage miles associated with the 28 vehicles, raising the CACD recommended transportation expense reduction to $43,675.

CACD's vehicle-related reductions are based upon a review of mileage logs of 18 vehicles. The total number of personal use miles, 194,109, is multiplied by 22.5 cents. The mileage allowance of 22.5 cents was prescribed by the IRS and the State Franchise Tax Board in 1987.

CACD recommends a rate base disallowance of $16,000 representing 50% of the purchase price of the company president's luxury vehicle. CACD considers this expense unreasonable. Consistent with its personal use recommendations for other vehicles, CACD recommends that all personal use of this vehicle ($9,200) be excluded from transportation expense.

In connection with these expenses, CACD recommends that SJW record better details of the business purpose, transaction conducted, and person contacted in mileage logs in the future.

SJW argues that the Commission has never made a disallowance to transportation expense or rate base such as recommended by CACD in a Class A water utility rate proceeding. SJW cites the California American Water Company-Monterey District (Cal-American) rate order, D.89-02-067, as a recent case where the

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Commission rejected a similar transportation disallowance proposed by CACD.

SJW witness Meyer testified that SJW has 28 company vehicles, not 18. Using 28 mileage logs, SJW's calculation of the apportionment of 1987 business and personal use is: 53% business and 47% personal use.

CACD agrees that this calculation is correct if 28 mileage logs are used. This varies from its calculation of 43% business and 57% personal use because it used a sample of 18 mileage logs. Should the Commission choose SJW's method to calculate usage, CACD recommends an additional $3,000 reduction in 1989 and $19,000 in 1990 for transportation expense due to the different methodology and that the percentage of usage be multiplied by the total cost of 27 vehicles, or $290,704. (CACD calculates expense and rate base disallowances for the luxury vehicle separately.) This total does not include the purchase price of five vehicles which is unavailable. As an alternative, CACD recommends imputing an average purchase price of $12,000 per vehicle for these five vehicles, which results in a total purchase price of $350,704 for 27 vehicles, CACD's alternate recommendation if SJW's method is adopted.

SJW agrees to the CACD recommended exclusion from rate base of $16,000 for the purchase of a luxury automobile for its president's use. SJW does not agree that the personal use of this vehicle or any vehicle should be excluded from transportation expense or rate base.

Meyer testified that a reimbursement of $.09 per mile is the appropriate factor to use in calculating any disallowance. Meyer alleges this is the same factor used by the IRS.

Meyer opposed CACD's recommendation to maintain additional records of business use. Meyer considered such additional record-keeping unnecessary and burdensome. He testified apportionment of 1987 business and personal use is: 53% business and 47% personal use.

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Meyer opposed CACD's recommendation to maintain additional records of business use. Meyer considered such additional record-keeping unnecessary and burdensome. He testified that the IRS had not objected to applicant's present records of business and personal use contained in its mileage logs.

<u>Discussion</u>

We cannot agree that our recent Cal-American rate case order, D.89-02-067, shows this Commission's blind endorsement of that the IRS had not objected to applicant's present records of business and personal use contained in its mileage logs.

Discussion

We cannot agree that our recent Cal-American rate case order, D.89-02-067, shows this Commission's blind endorsement of all personal use of company-owned vehicles. All such policies are subject to our continuing review for necessary revisions and abuses. We do not find the facts regarding personal use in the Cal-American proceeding to be comparable with those in this proceeding. In Cal-American, personal use of three company-owned vehicles was 6.1%, 12.49%, and 26% but the propriety of these levels of personal use was not explored. (In Cal-American, CACD recommended that all personal use be disallowed, a position which we rejected.)

In this proceeding, total personal use of vehicles is approaching the 50% threshold allowed by the IRS for business deductions. (26 U.S.C.A. § 280 F(b) (1984); Int. Rev. Code of 1988, § 280 F(b).) Twelve of the 28 vehicles exceed this limit. While the percentage of personal use of company vehicles was small in the Cal-American proceeding, we consider this issue a legitimate inquiry in this proceeding where personal use is significantly higher. The amount of personal use being requested by SJW warrants reasonable justification.

Although SJW alleges this policy is cheaper than a policy of transportation expense reimbursement, it offers no analysis to support this allegation.

SJW argues that its personal use is a reasonable salary incentive. However, SJW gives no analysis to support this allegation. SJW did not show the salaries of its designated employees nor the additional salary expenses it would need to incur in order to compensate such employees for loss of use of their company-owned vehicles. Without this evidence we cannot find that all personal use of company-owned vehicles. All such policies are subject to our continuing review for necessary revisions and abuses. We do not find the facts regarding personal use in the Cal-American proceeding to be comparable with those in this proceeding. In Cal-American, personal use of three company-owned vehicles was 6.1%, 12.49%, and 26%, but the propriety of these levels of personal use was not explored. (In Cal-American, CACD recommended that all personal use be disallowed, a position which we rejected.) However, more recently in the San Gabriel Water Company case, D.89-09-048, we found that commuting expenses for executives were not an expense which the ratepayers should bear.

In this proceeding, total personal use of vehicles is approaching 50%. Twelve of the 28 vehicles exceed this limit. While the percentage of personal use of company vehicles was small in the Cal-American proceeding, we consider this issue a legitimate inquiry in this proceeding where personal use is significantly higher. The apparantly high level of personal use being requested by SJW requires a substantial showing of ratepayer benefit to be justified.

Although SJW alleges this policy is cheaper than a policy of transportation expense reimbursement, it offers no analysis to support this allegation.

SJW argues that its personal use is a reasonable salary incentive. However, SJW gives no analysis to support this allegation. SJW did not show the salaries of its designated employees nor the additional salary expenses it would need to incur in order to compensate such employees for loss of use of their company-owned vehicles. Without this evidence we cannot find that SJW's personal use policy is, as it contends, cheaper than increasing salaries.

SJW alleges the assignment of vehicles is to assure the availability of supervisory personnel on a 24-hour basis in case of a utility emergency. On cross-examination, SJW's witness Meyer was asked about the use of the assigned vehicles. Meyer admitted that few employees assigned vehicles responded to emergencies. These employees used company cars after business hours for business

SJW's personal use policy is, as it contends, cheaper than increasing salaries.

SJW alleges the assignment of vehicles is to assure the availability of supervisory personnel on a 24-hour basis in case of a utility emergency. On cross-examination, SJW's witness Meyer was asked about the use of the assigned vehicles. Meyer admitted that few employees assigned vehicles responded to emergencies. These employees used cars for business purposes only on occasion. The option of a car pool for company-owned vehicles has not been considered by SJW. Emergency crew members are not assigned a company car.

Based upon this testimony and lack of statistical analysis of its policy, we find that SJW has not carried its burden of proof to justify the existing percentage of personal use of 12 company-owned vehicles. In addition, the evidence of CACD is also insufficient to show that our existing policy to allow a small percentage of personal use should be reversed. Since we have insufficient evidence to agree with either party, SJW or CACD, we shall disallow all transportation expenses on each vehicle where personal use is 50% or greater and reduce the rate base by the purchase price of these vehicles. According to IRS standards, these vehicles do not meet the requirement of 50% business use for purposes of business deductions. Under such circumstances, these expenses are unreasonable for ratemaking purposes. This reduction involves the 12 following vehicles in Exhibit 7, p. 1:

purposes only on occasion. The option of a car pool for company-owned vehicles has not been considered by SJW. Emergency crew members are not assigned a company car.

Based upon this testimony and lack of statistical analysis of its policy, we find that SJW has not carried its burden of proof to justify the existing percentage of personal use of 12 company-owned vehicles. We agree with CACD on the issue of transportation expense, and we will disallow all personal use miles. Further, for each vehicle where personal use is 50% or greater we will reduce the rate base by the purchase price of these vehicles. Under such circumstances, these expenses are unreasonable for ratemaking purposes. This reduction involves the 12 following vehicles in Exhibit 7, p. 1:

Car No.	Total Miles	Business Use	Personal Use	Personal Use as a % of Total Miles
13	23,616	5,941	17,675	75%
997	10,119	1,956	8,163	81
27	13,126	4,728	8,398	64
951	11,145	3,587	7,558	68
28	11,678	5,132	6,546	56
51	9,086	3,472	5,614	62
11	13,159	5,874	7,285	55
969	13,293	5,411	7,882	59
18	26,801	6,482	20,319	76
959	10,430	3,660	6,770	65
61	11,475	2,983	8,492	74
60	8,292	2,958	5,334	64
Total	162,220	52,184	110,036	

IRS instructions for business deductions specify that a taxpayer may use a standard mileage rate of 22.5 cents a mile for the first 15,000 miles of business use of an automobile that is not fully depreciated. This standard mileage rate is a simplified method of calculating all the operating and fixed costs of the

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IRS instructions for business deductions specify that a taxpayer may use a standard mileage rate of 22.5 cents a mile for the first 15,000 miles of business use of an automobile that is not fully depreciated. This standard mileage rate is a simplified method of calculating all the operating and fixed costs of the automobile. Where transportation expenses are deductible as a medical expense the standard mileage deduction is 9 cents. SJW witness Meyer explained the latter deduction does not include all operating costs.

The record shows that SJW pays all operating costs for the vehicles assigned to employees. Therefore, 22.5 cents is the appropriate mileage rate to use in this proceeding. Accordingly, the total mileage for vehicles with personal use which exceeds 50% shall be multiplied by 22.5 cents. We calculate this transportation expense reduction to be $36,500 (162,200 miles x $.225).

The rate base reduction for the purchase price of vehicles with 50% or greater personal use involves the same vehicles listed above. The purchase prices for these vehicles which we adopt are listed in Exhibit 66, p. 1 (column 4) and p. 4.

automobile. Where transportation expenses are deductible as a medical expense the standard mileage deduction is 11 cents. SJW witness Meyer explained the latter deduction does not include all operating costs.

The record shows that SJW pays all operating costs for the vehicles assigned to employees. Therefore, for the twelve vehicles 11.0 cents is the appropriate mileage rate to use in this proceeding. Accordingly, the total mileage for vehicles with personal use which exceeds 50% shall be multiplied by 11.0 cents. We calculate this transportation expense reduction to be $12,104 (110,036 miles x $.11). For the other 16 vehicles, 22.5 cents is used. The transportation expense reduction is $18,916 (84,073 miles x $.225). Total transportation expense adjustment is $31,020 ($12,104 + $18,916).

The rate base reduction for the purchase price of vehicles with 50% or greater personal use involves the same vehicles listed above. The purchase prices for these vehicles which we adopt are listed in Exhibit 66, p. 1 (column 4) and p. 4. This CACD exhibit provides more complete information than SJW's Exhibit 7:

Car No.	Should Be In Company's Exhibit 7
13	$ 14,464
997	14,414
27	14,496
951	14,272
28	11,009
51	13,807
11	14,464
969	32,054
18	14,364
959	10,729
61	14,975
60	14,974
Total Purchase Price	$184,022

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18	14,364
959	10,729
61	14,975
60	14,974
Total Purchase Price	$184,022

We adopt a rate base disallowance of $184,022. (The luxury vehicle is one of the vehicles with 50% or greater personal use; therefore, it is included in our calculation of transportation expense reduction and rate base disallowance.)

We agree that SJW's mileage summaries are incomplete for our purposes of verifying the business and personal use of company vehicles. These mileage summaries contain space to record the purpose of each trip. However, no details other than "business" or "personal" is recorded. We believe CACD's request for more complete information on the mileage summary is reasonable to track the use of SJW vehicles. To accommodate CACD's request for better record-keeping, a new form is not needed. SJW need only adopt better procedures for completing its existing form. Accordingly, we will order SJW to provide details of the business purpose, transaction conducted, and person contacted on these existing mileage forms. Each trip need not be listed with a mileage separately. The present practice of totaling miles is satisfactory if a summary of purpose(s), transaction(s), and person(s) contacted is added.

We adopt a rate base disallowance of $184,022. (The luxury vehicle is one of the vehicles with 50% or greater personal use; therefore, it is included in our calculation of transportation expense reduction and rate base disallowance.)

We are concerned about the apparantly high level of personal use for these vehicles on which the utility also earns a rate return. We have disallowed these vehicles from rate base in this decision. However, if SJW wishes to make a showing in its next rate case application that Commission policy should allow vehicles and personal usage in rates, they are welcome to make that showing. We also put all other water utilities on notice that personal milage and vehicles used as personal vehicles will not necessarily be found prudently included in rates, and that a clear and convincing showing will be required to include such costs in the future.

We agree that SJW's mileage summaries are incomplete for our purposes of verifying the business and personal use of company vehicles. These mileage summaries contain space to record the purpose of each trip. However, no details other than "business" or "personal" is recorded. We believe CACD's request for more complete information on the mileage summary is reasonable to track the use of SJW vehicles. To accommodate CACD's request for better record-keeping, a new form is not needed. SJW need only adopt better procedures for completing its existing form. Accordingly, we will order SJW to provide details of the business purpose, transaction conducted, and person contacted on these existing mileage forms. Each trip need not be listed with a mileage separately. The present practice of totaling miles is satisfactory if a summary of purpose(s), transaction(s), and person(s) contacted is added.

Rate Base

SJW and CACD disagreed on two rate base expenses: plant additions and working cash.

Plant Additions

CACD analyzed SJW's 1989 construction budget and excluded an electronic cash processing project ($11,300) which was canceled in 1988. CACD moved the replacement of bowl units ($13,500) from 1988 to 1989 based upon SJW's rescheduling of this project. We find these plant account adjustments reasonable because they reflect more updated SJW planning of these projects.

CACD recommends amounts for the contingency construction budget, which are $164,700, $153,500, and $141,200 lower than SJW in 1988, 1989, and 1990. Contingencies are unexpected expenditures, such as facility failures or plant relocation mandated by government agencies.

SJW bases its estimate on historical budgets yet presented no basis for this method. CACD used the average of the past three years' recorded expenses, 1985-1987, and added inflation factors recommended by the CACD Advisory Branch. CACD used a three-year average because these expenses fluctuate and are somewhat unpredictable. We consider CACD's estimate for contingency expenses as reasonable and adopt it.

Working Cash

SJW includes an average bank balance of $650,000 per month in its working cash allowance. SJW calculates this is the monthly amount needed to pay bills and generate bank credits to pay the larger portion of bank charges for the account. CACD reduces this amount to $200,000 arguing that the reduced amount is sufficient for operating purposes.

SJW maintains accounts at three banks: Security Pacific, for daily operations; Bank of America, for investments; and First Interstate, for amounts to be refunded to ratepayers for advances. In March or April, 1987, SJW moved its operating account from Bank

Other Operation and Maintenance Expenses

	ADOPTED 1989	1990
All Other Operations		
Op. Transp.	$ 615,000	$ 653,000
Op. Purch. Serv.	1,557,000	1,630,000
Total	2,172,000	2,283,000
All Other Maintenance		
Maint. Purch. Serv.	1,100,000	1,155,000
Total	$3,272,000	$3,438,000

Add Table

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SJW bases its estimate on historical budgets yet presented no basis for this method. CACD used the average of the past three years' recorded expenses, 1985-1987, and added inflation of America to Security Pacific where requirements for a line of credit and bank charges are lower. Bank of America required a customer with a line of credit to maintain as a cash balance 10% of the line of credit, or $650,000 in SJW's case. Security Pacific does not have this requirement. It allows applicant to accumulate 6.27% interest on its balance as a credit toward payment of bank charges. SJW estimates that a minimum average balance of $650,000 will generate sufficient credits to pay the majority of bank charges. In 1987, SJW maintained a minimum average balance of $650,000 at Security Pacific generating $68,751 in total credits. However, monthly credits in excess of monthly charges may not be accumulated. The total bank charges were $78,430. SJW applied the allowable credits and paid the difference, $17,425, in cash.

In the test years, SJW intends to keep the operating account balance as low as possible with a $650,000 minimum average balance. This minimum average is based upon its monthly revenues and outstanding bills. Any excess cash will be invested at Bank of America to earn 7% interest.

In rebuttal to CACD's recommendation, SJW presented Exhibit 8, a list of 1987 checks drawn on the operating account. All of the checks are for amounts greater than $200,000. In SJW's opinion, this balance will be insufficient to meet most monthly bills outstanding. With such a balance, SJW alleges it will not earn enough credits to pay monthly bank charges.

Should the Commission adopt a minimum cash allowance of $200,000, both SJW and CACD agree that the allowance for bank expenses should be increased by $26,590. In addition, for any day this account was overdrawn, applicant would be charged the prime rate daily on the overdraft. No calculation of these charges was made.

We agree with CACD that paying $26,590 in additional bank charges is significantly cheaper for the ratepayer than $650,000 in cash deposits. However, we are persuaded by Meyer's testimony and

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We agree with CACD that paying $26,590 in additional bank charges is significantly cheaper for the ratepayer than $650,000 in cash deposits. However, we are persuaded by Meyer's testimony and Exhibit 8 that a minimum balance of $650,000 is needed to pay debts as they become due. CACD presented no evidence to show that a $200,000 balance is sufficient to pay monthly debts. Therefore, we adopt SJW's requested cash balance of $650,000.

Rate Design

The parties have reached agreement on the following rate design issues which we find reasonable and adopt:

1. Increases in revenues are to be applied uniformly to the General Metered Schedule (No. 1) and Resale Service (No. 6). SJW proposes a 200% increase in rates for private fire protection service (Schedule No. 4). CACD recommends the use of industry standards to establish rates per inch of service connection diameter of $3.00 in 1989, $3.50 in 1990, and $4.00 in 1991. SJW did not dispute CACD's recommendation. We find CACD's recommendation to be reasonable.

2. Total revenue from service charges under authorized rates shall not exceed 50% of the fixed costs, pursuant to D.86-05-064.

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2. Total revenue from service charges under authorized rates shall not exceed 50% of the fixed costs, pursuant to D.86-05-064.

3. Lifeline rates are to be eliminated, pursuant to D.86-05-064.

4. Service charge rates for 3/4 inch meters are to be eliminated and substituted with charges to customers at 5/8 x 3/4-inch meter rates.

Tariff Rule Changes

We have reviewed the proposed tariff rule changes and arguments of the parties regarding these rules. We find the following tariff rule changes reasonable and authorize their implementation as follows:

1. Rule 9B shall include the imposition of a $4.75 service charge on a customer who submits a check which is returned because of insufficient funds. This charge offsets the bank charge to SJW for such a transaction. This change was not disputed.

2. Rule 11 B.1, paragraph 1 shall include a collection charge when it is necessary to discontinue service due to

nonpayment of the bill. This charge was authorized by the Commission in D.83-06-065, OIR 7, our order revising and clarifying water utility tariff procedures and practices for terminating service in response to the Public Utilities Regulatory Policies Act (PURPA). This charge was not disputed.

3. Rule 11 C.1 shall contain an increase in the restoration of service charge from $10 to $15 during regular working hours and $15 to $20 during other hours when service is restored during these hours at the customer's request. SJW represented that other companies have this charge. SJW complained that CACD had agreed to the increase but objected to pursuing this request without a review of General Order (GO) 103. In response, SJW requested a review of the Commission's procedure and if CACD prevails that a special investigation into GO 103 be ordered so this change can be made. We do not agree that a generic investigation is needed to authorize an exception to our regulations in GO 103. Should this GO need revising, CACD may recommend a special investigation.

4. SJW proposes a new construction and temporary metered service policy. CACD requests that SJW provide, by advice letter, a proposed standard form for this rule. We authorize this advice letter filing.

SJW agreed to withdraw its request for a $7.50 service restoration charge.

<u>Gain on Sale of Land</u>

SJW requests approval of a transfer to ratepayers of the $534,000 gain from the sale of utility property. In 1987, SJW sold over 4.5 acres of utility property to SJW Land for $2,242,000, or approximately $9.70 per square foot. At the time of the sale, the book value of the property was $1,140,465. The land consisted of 4.5 acres adjacent to SJW's offices near downtown San Jose and a parcel across the street from the offices of approximately 35,763 square feet. In compliance with D.85-06-023, the order approving

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4. SJW proposes a new construction and temporary metered service policy. CACD requests that SJW provide, by advice letter, a proposed standard form for this rule. We authorize this advice letter filing.

SJW agreed to withdraw its request for a $7.50 service restoration charge when, to avoid discontinuance of service, a customer makes payment in full at the time a SJW employee arrives to post a 24 or 48 hour notice of discontinuance.

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CACD requests adjustments in the gain calculation raising the amount to $647,455 and asserts that the valuation of the property is inadequate. CACD requests that $647,455 be transferred to the ratepayers over the next three years in this proceeding and that SJW be ordered to provide three additional independent appraisals of the property by appraisers certified by the American Institute of Real Estate Appraisers (Member, Appraisal Institute or MAI) within three months to determine the value of the property on December 31, 1986. In a future advice letter filing, the difference between SJW's appraisal and the average of the three additional appraisals would be transferred to the ratepayer.

In CACD's investigation of property value, it found:

1. Moore had insufficient documentation of his property valuation. The valuation was dated one year prior to the sale.

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In CACD's investigation of property value, it found:

1. Moore had insufficient documentation of his property valuation. The valuation was dated one year prior to the sale. Moore's use of the income approach in his property valuation is unsubstantiated. Moore did not include all rental income in his income analysis. Moore did not consider future development plans in his valuation. CACD also contends that the comparable sales approach is equally as applicable as Moore's income approach. Moore is not MAI-certified.

2. The transaction was not at arm's length. Moore and Weinhardt, SJW's president, are social acquaintances. Moore has represented SJW in past real estate transactions and would be hired for such matters in the future.

3. The recording of the transaction is confusing and circular. The transaction was for SJW Land to advance the amount of the purchase price to SJW for construction projects. However, the construction projects were on the books of SJW Land. The funds advanced by SJW Land were obtained by a "capital contribution" from SJW Corp. The funds were obtained by SJW Corp. from SJW's dividend payments.

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4. In 1986 parcels comparable with the land sold were sold for \$13.74 to \$30.02 per square foot.

CACD considers the transaction between affiliates to warrant close scrutiny and appraisal by independent, MAI-certified appraisers. CACD contends that the valuation performed by SJW's real estate consultant, Moore, was outdated and lower than the market value of the property indicated in CACD's investigation.

SJW agrees to CACD's adjustments to its gain calculation to eliminate a 6% sales commission, raise the state income tax rate from 9.3% to 9.6%, and deduct the state income tax expense in calculating federal income tax expense to increase the gain to \$647,455. SJW does not dispute CACD's recommendation to apply the gain to rates over a three-year period. However, SJW contests CACD's recommendation for new appraisals.

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SJW considers its consultant one of the most qualified in the San Jose area. Moore has 20 years of experience in the commercial real estate market for downtown San Jose and is a licensed real estate broker and member of the San Jose Board of Realtors. Moore has recently worked on projects for Barclay's Bank, the Housing Authority of Santa Clara County, the Garden Alameda, Santa Clara Savings and Loan, and Bradfore Manufacturing Company. He has an excellent reputation in the business community.

SJW contends that its consultant has already submitted a correct property valuation based upon three independent appraisals. Moore used the same methods and information as an MAI-certified appraiser. His evaluation is based upon three verifying opinions from other appraisers who valued the property at $6.85 to $12 per sq. ft. At the time of the evaluation, future development plans were unknown and existing zoning classifications were used. The existence of continuing water rights and access to SJW wells on the property sold distinguishes it from the parcels CACD considers comparable. Several of the comparable properties used by CACD had buildings at the time of the sale of SJW vacant land, making them commercial real estate market for downtown San Jose and is a licensed real estate broker and member of the San Jose Board of Realtors. Moore has recently worked on projects for Barclay's Bank, the Housing Authority of Santa Clara County, the Garden Alameda, Santa Clara Savings and Loan, and Bradfore Manufacturing Company. He has an excellent reputation in the business community.

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SJW requests that CACD's recommendation for additional appraisals be rejected because neither this Commission nor state law requires that appraisals of utility property be performed by MAI certified appraisers.

Discussion

We agree that neither this Commission nor state law requires that property be valued by MAI-certified appraisers. We do not find that the facts in this proceeding to warrant such a requirement. SJW's consultant Moore is qualified to appraise SJW property sold to SJW Land based upon his real estate licensing and 20 years of experience in commercial real estate transactions. The additional requirement that such an appraiser be MAI-certified does not guarantee a more reasonable appraisal.

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SJW requests that CACD's recommendation for additional appraisals be rejected because neither this Commission nor state law requires that appraisals of utility property be performed by MAI certified appraisers.

__Discussion__

We agree that neither this Commission nor state law requires that property be valued by MAI-certified appraisers. We do not find that the facts in this proceeding to warrant such a requirement. SJW's consultant Moore is qualified to appraise SJW property sold to SJW Land based upon his real estate licensing and 20 years of experience in commercial real estate transactions. The additional requirement that such an appraiser be MAI-certified does not guarantee a more reasonable appraisal.

We do not find that Moore's association with SJW's president in the past or in the future disqualifies his opinion in this proceeding. We believe his evaluation is reasonable because it includes the opinion of three other independent appraisers. We cannot accept CACD's valuation because of the distinctions between its comparable properties and the property sold. The existence of water rights and access to utility wells on the property sold is a significant impediment to a future buyer, affecting the selling price of the property. Likewise, the existence of structures on property affects the property value. There is no indication from SJW witnesses testifying on this issue that a development plan changing the value of the property existed in 1987, as implied by CACD.

CACD criticizes SJW's recording of the transaction, yet it is not clear what abuse has occurred. Since these are corporate affiliates, we do not find it unusual that money paid by SJW Land is advanced by SJW Corp. or that these funds were dividends derived from SJW. We believe the important transaction to review is the

While we do not find that Moore's association with SJW's president in the past or in the future disqualifies his opinion in this proceeding, it is this Commission's policy to closely review all transactions between utilities and their affiliates. This issue has risen in prominence as California's utilities have diversified into other areas. The issue of transferring land from a utility to its corporate land development company has arisen before. When PacBell requested to transfer property from rate base to another Pacific Telesis affiliate in the business of real estate business, the Commission stated in D.86-01-026,

> "We will adopt McCrary's recommendation to order PacBell to openly solicit competitive bids in disposing of owned real property which has been in its rate base, aside from instances where it is sold through condemnation. We believe this is a minimal step but one vital to ensure PacBell's ratepayers are protected from potential abuses from self-dealing inherent with the diversified Telesis corporate structure."

We believe this is a sound policy which should be continued to assure ratepayers are protected. It is our belief that market bids will provide better information as to the correct value of this land. Consistent with D.86-01-026, we will order SJW to establish and operate under a competitive bidding process and procedure for disposing of land which is removed from ratebase, and it shall dispose of such property under that procedure so long as it has an affiliate in the real estate business. Staff will review the program SJW adopts for receiving competitive bids and present any recommendations it may have on whether SJW's program should be modified in the next phase of these proceedings.

We understand that the properties in this proceeding have already been transferred to SJW Land under the terms of the order permitting SJW to diversify into the real estate business.

The purpose of this condition was to allow the Commission to review SJW's program in operation. By this Decision we order that the transferred properties be submitted for public bid under the terms of the property transfer program to be established in the next phase of this proceeding.

The second phase of this proceeding will review the property transfer program, and the appropriate expenses and rate treatment for related costs.

Attrition Year 1991

SJW does not dispute CACD's recommendation for 1991 attrition allowances. We find these recommendations to be our normal policy on attrition and, therefore, reasonable. The revenue requirement for 1991 is computed by adding the operational and receipt of the proper amount by SJW for the property. SJW provided these canceled checks for review in the proceeding. Therefore, we have no basis upon which to void the transaction.

We find CACD's adjustments to the gain of $534,000 to be reasonable. We will authorize the transfer of $647,455 to the ratepayer. However, if this gain is credited to the ratepayer monthly in equal increments over a three-year period, 1989-1991, it is miniscule. Therefore, we authorize the entire amount to be credited to customer bills over the next 12 months.

Attrition Year 1991

SJW does not dispute CACD's recommendation for 1991 attrition allowances. We find these recommendations to be our normal policy on attrition and, therefore, reasonable. The revenue requirement for 1991 is computed by adding the operational and financial attritions to the adopted rate base for 1990 and the net-to-gross multiplier.

The adjustment is computed as follows:

[(Oper. Attr.) + (Fin. Attr.)] [1990 Rate Base]
[net-to-gross multi.]
= [(0.0061) + (0.0016)] [107,238,700] [1.6812]
= $1,388,200

Levelized Rates

Based upon our adopted Summary of Earnings, we could order a reduction in rates in 1989 of $3,105,400 or 4.1%, and authorize rate increases of $1,977,400 or 2.9% in 1990, and $1,388,200 or 2.0% in 1991. However, an alternative is to order one set of revenue requirement calculations for the three-year period based upon a constant, levelized reduction in revenues of $1,324,400 or 1.9% for this period. This method was ordered in our previous D.88-01-025 for Southern California Water Company. This alternative will result in better administrative efficiency and economy for SJW, its customers, and the Commission. This levelized constant rate reduction will be adopted. Average customer bills financial attritions to the adopted rate base for 1990 and the net-to-gross multiplier.

The adjustment is computed as follows:

[(Oper. Attr.) + (Fin. Attr.)] [1990 Rate Base]
[net-to-gross multi.]
= [(0.0061) + (0.0016)] [107,238,700] [1.6812]
= $1,388,200

Levelized Rates

Based upon our adopted Summary of Earnings, we could order a reduction in rates in 1989 of $3,105,400 or 4.1%, effective for 3 1/2 months in 1989, and authorize rate increases of $591,200 or 0.83% in 1990, and $1,388,200 or 2.0% in 1991. However, an alternative is to order one set of revenue requirement calculations for the three-year period based upon a constant, levelized reduction in revenues of $1,324,400 or 1.9% for this period. This method was ordered in our previous D.88-01-025 for Southern California Water Company. This alternative will result in better administrative efficiency and economy for SJW, its customers, and the Commission. This levelized constant rate reduction will be adopted. Average customer bills will be reduced by approximately 0.40% per month under this plan. (Appendix D.)

Findings of Fact

1. SJW provides satisfactory water service and the water furnished meets current state drinking water standards.

2. SJW has complied with our order in D.86-05-064 to submit in its next rate proceeding a reasonable water management plan for conservation and with our order to institute report card billing.

3. SJW and DRA have a minor difference of .11% in the estimated average debt costs for 1990. DRA's method of calculating is reasonable.

4. SJW is comparable with DRA's list of publicly traded water companies for purposes of establishing a common equity ratio. SJW's 1987 level of common equity is 16% greater than the

will be reduced by approximately 1.2% per month under this plan. (Appendix D.)

Findings of Fact

1. SJW provides satisfactory water service and the water furnished meets current state drinking water standards.

2. SJW has complied with our order in D.86-05-064 to submit in its next rate proceeding a reasonable water management plan for conservation and with our order to institute report card billing.

3. SJW and DRA have a minor difference of .11% in the estimated average debt costs for 1990. DRA's method of calculating is reasonable.

4. SJW is comparable with DRA's list of publicly traded water companies for purposes of establishing a common equity ratio. SJW's 1987 level of common equity is 16% greater than the comparable group average of 42%. The highest level of common equity within the comparable group, excluding SJW Corp., is 53%. Imputing a level of 53% common equity is more reasonable than imputing the group average of 42%.

5. SJW requests a common equity ratio of 58.80%, 58.75%, and 58.59% in 1989, 1990, and 1991, which is above the level of 56% authorized in its last rate decision, D.84-01-042. SJW provided little justification for increasing its common equity ratio level.

6. The financial stability of a company is measured by bond ratings. SJW's financial data for pretax interest coverage and internal cash flow for 1983-87 exceeds the level for AAA ratings for water utilities by Standard and Poor's. SJW's financial data for pretax interest coverage and internal cash flow for 1983-87 exceeds the level for AA ratings for electric utilities by Standard and Poor's.

7. SJW is financially stable according to Standard and Poor's financial indicators.

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7. SJW is financially stable according to Standard and Poor's financial indicators.

8. SJW could lower the levels of Standard and Poor's financial factors and still meet the requirements to retain its existing bond ratings.

9. High bond ratings are needed to obtain a low interest rate for new debt. SJW's ability to obtain low interest in the future should not be affected by lowering common equity.

10. Ratepayers do not benefit from exceeding the financial levels required to obtain the highest bond ratings.

11. DRA's comparable publicly traded water utilities are reasonable, yet SJW is more accurately compared with the comparable water utilities that rank above the financial averages of the group. SJW's historical growth and earnings exceed the group average.

12. In the last five years, SJW's ratio of cash to construction costs averaged nearly 120%, with cash available

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12. In the last five years, SJW's ratio of cash for construction cost to construction costs averaged nearly 120%, with cash available surpassing cash needs. SJW's construction needs for 1989 and 1990 do not justify the requested level of common equity.

13. SJW's dividend payout ratio of 63% compared to the group average of 70% helps to increase the high equity ratio.

14. SJW's calculations of 11.70% to 11.74% ROE and 11.95% ROE are based upon the existing capital structure, which DRA does not recommend.

15. DRA's recommended imputation of 53% common equity is reasonable, but does not allow SJW the opportunity to actually adjust its common equity to this level if this common equity is imputed in 1989.

16. SJW paid dividends to SJW Corp. in 1986 of $12.07 million, in 1987 of $9 million, and $5.25 million in 1988. SJW's common equity declined after these payments.

17. DRA's substitution of SJW Corp. for SJW in its comparative financial analysis is reliable since 98% of SJW Corp.'s revenues are derived from SJW.

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17. DRA's substitution of SJW Corp. for SJW in its comparative financial analysis is reliable since 98% of SJW Corp.'s revenues are derived from SJW.

18. SJW's DCF analyses based on a comparable group of electric, gas, and telephone utilities and its own historical financial data are unreasonable. DRA's comparable group is reasonable.

19. DRA's DCF analysis based on a comparable group of publicly traded water utilities, including SJW Corp., yielded an estimated ROE of 11.90% for a three-month dividend yield and 11.84% for a six-month dividend yield.

20. DRA's RP analysis based on a comparable group of publicly traded water utilities yielded an estimated ROE in the range of 11.95% to 12.53%.

21. SJW's DCF analysis based upon its own stock price, historical dividends, and growth yielded an estimated ROE of 13.62%-21.48% for 10-year growth and 15.89%-17.83% for 5-year growth.

18. SJW's DCF analyses based on a comparable group of electric, gas, and telephone utilities and its own historical financial data are unreasonable. DFA's comparable group is reasonable.

19. DRA's DCF analysis based on a comparable group of publicly traded water utilities, including SJW Corp., yielded an estimated ROE of 11.90% for a three-month dividend yield and 11.84% for a six-month dividend yield.

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21. SJW's DCF analysis based upon its own stock price, historical dividends, and growth yielded an estimated ROE of 13.62%-21.48% for 10-year growth and 15.89%-17.83% for 5-year growth.

22. SJW's RP analysis based on a comparable group of electric, gas, and telephone utilities yielded an estimated range of average historical ROE of 12.70-13.10% and average historical ROE of 12.81%.

23. SJW's RP analysis based on SJW's historical authorized ROEs yielded an average ROE of 13.02% and projected ROEs of 15.19%, 15.22%, and 15.29%.

24. SJW and DRA agree that the ROE varies inversely with the level of common equity under general finance principles.

25. A return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991, based upon the authorized level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

26. For ratemaking purposes, a level of common equity of 56%, 55%, and 53% for 1989, 1990, and 1991, respectively, will allow ratepayers to share in the financial health of SJW.

27. A return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991, based upon the DRA's comparative

22. SJW's RP analysis based on a comparable group of electric, gas, and telephone utilities yielded an estimated range of average historical ROE of 12.70-13.10% and average historical ROE of 12.81%.

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25. A return on common equity of 11.75% for 1989, 12% for 1990, and 12.25% for 1991, based upon the authorized level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

26. For ratemaking purposes, a level of common equity of 56%, 55%, and 53% for 1989, 1990, and 1991, respectively, will allow ratepayers to share in the financial health of SJW.

27. A return on rate base of 10.48% for 1989, 10.67% for 1990, and 10.83% for 1991, based upon the DRA's comparative analysis, judgment, and the level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

28. Contrary to Commission policy, SJW included in its revenue calculations the amount of reimbursement fees for Commission administration collected by SJW and remitted to the Commission pursuant to Public Utilities Code Section 401 et seq.

29. SJW provided insufficient documentation of amounts allocated from administrative and general expenses to its capital account. SJW provided insufficient documentation of expenses incurred by SJW which are common to SJW, SJW Corp. and SJW Land.

30. Weather adjusting CACD's estimate of annual commercial customer consumption of 281.3 Ccf to 272.8 Ccf more accurately reflects the recent trend in consumption and is more reasonable than the Bean estimate of 271.7 Ccf used by SJW to calculate operating revenues for 1989 and 1990.

analysis, judgment, and the level of common equity, is comparable to an investment in utilities selected by DRA as similar to SJW.

28. Contrary to Commission policy, SJW included in its revenue calculations the amount of reimbursement fees for Commission administration collected by SJW and remitted to the Commission pursuant to Public Utilities Code Section 401 et seq.

29. SJW provided insufficient documentation of amounts allocated from administrative and general expenses to its capital account.

30. SJW provided insufficient documentation of expenses incurred by SJW which are common to SJW, SJW Corp. and SJW Land.

31. SJW presented a conservation plan which accomplishes the goal of promoting water conservation in its service area.

32. SJW's request for other operation and maintenance purchased services is incomplete and speculative, unlike CACD's method of levelizing historical expenses to minimize fluctuations and applying nonlabor inflation factors specifically related to these services.

33. SJW does not justify transportation expenses or including in rate base the purchase price for 12 assigned vehicles with personal use of 50% or greater. CACD does not justify its request to reverse the existing Commission policy to allow a small percentage of personal use of company owned vehicles.

34. SJW's construction budget includes a project which has been canceled and a project which has been rescheduled. CACD removed the canceled project and placed the rescheduled project in the year in which the expense will be incurred.

35. SJW presented inadequate basis for its estimate of contingency construction expenses; CACD based its estimate on the average of recorded expenses for 1985-1987 and added inflation factors recommended by the CACD Advisory Branch.

36. SJW presented a summary of checks for amounts of $200,000 or greater to justify its estimate of maintaining an average bank

31. SJW presented a conservation plan which accomplishes the goal of promoting water conservation in its service area.

32. SJW's request for other operation and maintenance purchased services is based upon 1987 recorded expenses plus inflation, unlike CACD's method of levelizing historical expenses to minimize fluctuations and applying nonlabor inflation factors specifically related to these services.

33. SJW does not justify personal transportation expenses or including in rate base the purchase price for 12 assigned vehicles with personal use of 50% or greater.

33a) In D.89-09-048 the Commission policy was to disallow all commute expenses for executives associated with company owned vehicles.

34. SJW's construction budget includes a project which has been canceled and a project which has been rescheduled. CACD removed the canceled project and placed the rescheduled project in the year in which the expense will be incurred.

35. SJW presented inadequate basis for its estimate of contingency construction expenses; CACD based its estimate on the average of recorded expenses for 1985-1987 and added inflation factors recommended by the CACD Advisory Branch.

36. SJW presented a summary of checks for amounts of $200,000 or greater to justify its estimate of maintaining an average bank balance of $650,000. CACD based its estimate of the average bank balance on total expenses and presented no analysis of checking account transactions to justify its estimate of an average bank balance of $200,000.

37. SJW requests approval of an increase in the restoration of service charge from $10 to $15 during regular working hours and $15 to $20 during other hours when service is restored during these hours at the customer's request, based upon the same charges by other utilities. Contrary to CACD's assertion, we may authorize such case-by-case deviations from GO 103.

balance of $650,000. CACD based its estimate of the average bank balance on total expenses and presented no analysis of checking account transactions to justify its estimate of an average bank balance of $200,000.

37. SJW requests approval of an increase in the restoration of service charge from $10 to $15 during regular working hours and $15 to $20 during other hours when service is restored during these hours at the customer's request, based upon the same charges by other utilities. Contrary to CACD's assertion, we may authorize such case-by-case deviations from GO 103.

38. CACD requests that SJW's proposed new construction and temporary metered service policy contain a proposed standard form which will be presented in an advice letter in the future.

39. CACD's properties selected as comparable with 4.5 acres of land (which was not included in rate base) sold by SJW in 1987 are not sufficiently similar. It is not mandatory that property valuation be performed by appraisers certified by the American Institute of Real Estate Appraisers. SJW's income analysis performed by a qualified, experienced, licensed broker is sufficient to establish the value of this land. SJW requests that the gain on the sale of this land be transferred from a suspense account to the ratepayer. SJW does not dispute CACD's adjustment to the gain or its recommendation to spread the gain over a three-year period.

40. The amounts of operating revenues, operating expenses and rate base and each element thereof shown in Tables 1 and 2, "At Authorized Rates," represent a fair and reasonable determination of the revenue requirement for test years 1989 and 1990.

41. The reduction in annual revenue authorized by this decision in order to produce the adopted rates of return is $1,324,400 in 1989, 1990, and 1991.

38. CACD requests that SJW's proposed new construction and temporary metered service policy contain a proposed standard form which will be presented in an advice letter in the future.

39. It is the Commission policy that before utility land that has been in rate base can be transferred to an affiliated real estate company, that such land must be offered to public bid in order to determine the fair value of the land.

40. The amounts of operating revenues, operating expenses and rate base and each element thereof shown in Tables 1 and 2, "At Authorized Rates," represent a fair and reasonable determination of the revenue requirement for test years 1989 and 1990.

41. The reduction in annual revenue authorized by this decision in order to produce the adopted rates of return is $239,100 for 1989, 1990, and 1991.

42. CACD's proposed rate design guidelines are consistent with D.86-05-064 in which we adopted a flatter rate design policy, and are reasonable.

43. SJW and CACD agreed to abide by the Commission's decision in the California Water Service Company/SJW Joint Petition for Modification of D.88-01-061. In D.89-05-065 we denied joint petitioners' request for additional tax expense for unbilled revenues.

44. The decreases in present rates and charges required by this decision are justified and are reasonable; present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

42. CACD's proposed rate design guidelines are consistent with D.86-05-064 in which we adopted a flatter rate design policy, and are reasonable.

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44. The decreases in present rates and charges required by this decision are justified and are reasonable; present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

Conclusions of Law

1. A constant reduction in revenues of $1,324,400 or 1.9% during 1989, 1990, and 1991 is reasonable based upon our adopted results of operations for SJW.

2. SJW has complied with the requirement in D.86-05-064 of filing a reasonable utility water management plan for conservation.

3. SJW's request to recover additional tax expense for unbilled revenues should be denied pursuant to D.89-05-065 which denied the same request.

4. Lifeline rates should be eliminated from SJW's rate design pursuant to D.86-05-064.

5. Total revenue from service charges under authorized rates should not exceed 50% of the fixed costs pursuant to D.86-05-064.

6. A utility's analysis of its own historical financial data is not sufficient comparative analysis to set a rate of return.

7. The application should be granted to the extent provided by the following order.

8. Because of length of hearings in this proceeding and the need to establish current rates immediately, this order should be effective today.

Conclusions of Law

1. A constant reduction in revenues of $239,100 or 0.34% during 1989, 1990, and 1991 is reasonable based upon our adopted results of operations for SJW.

2. SJW has complied with the requirement in D.86-05-064 of filing a reasonable utility water management plan for conservation.

3. SJW's request to recover additional tax expense for unbilled revenues should be denied pursuant to D.89-05-065 which denied the same request.

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5. Total revenue from service charges under authorized rates should not exceed 50% of the fixed costs pursuant to D.86-05-064.

6. A utility's analysis of its own historical financial data is not sufficient comparative analysis to set a rate of return.

7. The application should be granted to the extent provided by the following order.

8. Because of length of hearings in this proceeding and the need to establish current rates immediately, this order should be effective today.

9. Additional hearings are required to establish an appropriate program for SJW to transfer land from rate base to its affiliate SJW Land. Hearings are also appropriate to consider ratemaking treatment of deferred taxes on the land transfers.

ORDER

IT IS ORDERED that:

1. San Jose Water Company (SJW) shall immediately file for its company, to be effective 5 days after today, the reduced rate schedules and tariffs attached as Appendix A. This filing shall comply with General Order Series 96. The revised schedules shall apply only to service rendered on and after their effective date.

ORDER

IT IS ORDERED that:

1. San Jose Water Company (SJW) shall immediately file for its district, to be effective 5 days after today, the reduced rate schedules and tariffs attached as Appendix A. This filing shall comply with General Order Series 96. The revised schedules shall apply only to service rendered on and after their effective date.

2. Common equity of 56% shall be imputed in SJW's 1989 capital structure effective today. Common equity of 55% and 53% shall be imputed on January 1 for 1990 and 1991, respectively.

3. SJW is authorized to file an advice letter regarding a new construction and temporary metered service policy. SJW shall provide in this filing a proposed standard form for this rule.

4. SJW shall develop procedures, including standards for supporting documents, to allocate Administrative and General expenses to capital projects. The procedures shall be mailed for review within 90 days from the effective date of this decision to: Commission Compliance and Advisory Division, Auditing and Compliance Branch, 505 Van Ness Avenue, San Francisco, CA 94102.

5. SJW shall develop procedures to allocate common expenses to SJW Land and SJW Corp., including standards for supporting documents. The procedures shall be mailed for review within 90 days of the effective date of this decision to: Commission Compliance and Advisory Division, Auditing and Compliance Branch, 505 Van Ness Avenue, San Francisco, CA 94102.

6. SJW shall provide more information in its mileage logs by indicating the business purpose, transaction conducted, and person contacted for each trip or a summary of this information where it is appropriate.

2. Common equity of 56% shall be imputed in SJW's 1989 capital structure effective today. Common equity of 55% and 53% shall be imputed on January 1 for 1990 and 1991, respectively.

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6. SJW shall provide more information in its mileage logs by indicating the business purpose, transaction conducted, and person contacted for each trip or a summary of this information where it is appropriate.

7. The consumption estimates authorized in this decision shall be used in calculating any loss revenues in SJW's memorandum account from the date the account was approved in D.89-04-041.

8. SJW's request to recover additional tax expense for unbilled revenues is denied pursuant to D.89-05-065 which denied the same request.

9. Within 90 days from the effective date of this order, SJW will establish and operate under a competitive bidding process and procedure for disposing of land which is removed from rate base, and it shall dispose of all such land under that procedure so long as it has an affiliate in the real estate business. CACD shall

7. The consumption estimates authorized in this decision shall be used in calculating any loss revenues in SJW's memorandum account from the date the account was approved in D.89-04-041.

8. SJW's request to recover additional tax expense for unbilled revenues is denied pursuant to D.89-05-065 which denied the same request.

9. SJW shall transfer $647,455 from the existing suspense account to the ratepayer to reduce the revenue requirement under special conditions in the adopted tariff schedules in Appendix A.

This order is effective today.

Dated ___________________, at San Francisco, California.

review the program SJW adopts for receiving competitive bids and present any recommendations it may have on whether SJW's program should be modified in the next phase of of these proceedings.

10. SJW shall retain $647,455 in the existing suspense account until our final decision in this proceeding.

This order is effective today.

Dated OCT 1 2 1989, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

SAN JOSE WATER COMPANY

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to general metered water service.

TERRITORY

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

RATES

Service Charges:	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$4.35	
For 3/4-inch meter	4.35	(R)
For 1-inch meter	7.30	
For 1-1/2-inch meter	10.00	
For 2-inch meter	12.50	
For 3-inch meter	25.00	
For 4-inch meter	34.00	
For 6-inch meter	53.00	
For 8-inch meter	81.00	
For 10-inch meter	108.00	

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the Quantity Rates. (T) | (T)

Quantity Rate:

Per 100 cu. ft. 0.932 (R)

SPECIAL CONDITION

1. 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 agricultual water, shall receive a credit of 13.7 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill.

2. Due to the transfer to rate payers of the gain from sale of land, an amount of $0.266 is to be deducted from each water bill for twelve months from the effective date of this tariff filing. (N) | (N)

3. All rates are subject to the reimbursement fee set forth on Schedule No. UF. (L) (L)

APPENDIX A
Page 2

SAN JOSE WATER COMPANY

Schedule No. 6

RESALE SERVICE

APPLICABILITY

Applicable to all water service furnished for resale purposes.

TERRITORY

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

RATES

Service Charges:	Per Meter Per Month
For 5/8 x 3/4-inch meter	$3.85
For 3/4-inch meter	4.40
For 1-inch meter	5.90
For 1-1/2-inch meter	8.00
For 2-inch meter	10.50
For 3-inch meter	19.00
For 4-inch meter	28.00
For 6-inch meter	43.00
For 8-inch meter	66.00
For 10-inch meter	92.00

Quantity Rate:

Per 100 cu. ft. . . . . 0.677 (R)

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is to be added the charge for water used computed at the Quantity Rates. (T)

SPECIAL CONDITION

1. Due to the transfer to rate payers of the gain from sale of land, an amount of $0.266 is to be deducted from each water bill for twelve months from the effective date of this tariff filing. (N)

2. All rates are subject to the reimbursement fee set forth on Schedule No. UF. (L)

SAN JOSE WATER COMPANY

Schedule No. 4

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished to privately owned fire protection systems.

TERRITORY

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

RATES

	Per service connection Per month
2-inch service	$3.00
3-inch service	4.30
4-inch service	5.60
6-inch service	9.50
8-inch service	15.00
10-inch service	25.00
12-inch service	36.00

SPECIAL CONDITION

1. The fire protection service connection shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund. The facilities paid for by the applicant shall be the sole property of the applicant.

2. If a distribution main of adequate size a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a service main from the nearest existing main of adequate capacity shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund.

3. Service hereunder is for private fire protection systems to which no connections for other than fire protection purposes are allowed and which are regularly inspected by the underwriters having jurisdiction.

4. Due to the transfer to rate payers of the gain from sale of land, an amount of $0.266 is to be deducted from each water bill for twelve months from the effective date of this tariff filing. (N)
|
(N)

5. All rates are subject to the reimbursement fee set forth on Schedule No. UF. (L)
(L)

SAN JOSE WATER COMPANY

Table 16-A

Rule No. 9

RENDERING AND PAYMENT OF BILLS (Continued)

B. Payment of Bills

Bills for service are due and payable upon presentation, and payment may be made at the commercial office of the utility or to any representative of the utility authorized to make collections. Collection of closing bills may be made at the time of presentation. If a customer tenders a check in payment of any bill and such check is not honored by the customer's bank, the utility may assess the customer a bad check service charge of $4.75. (N)
(N)

SAN JOSE WATER COMPANY

Table 16-B

Rule No. 11

DISCONTINUANCE AND RESTORATION OF SERVICE (Continued)

B.1.1. The utility may require payment of a collection charge of $7.50 when Utility's representative makes a call at a customer's premises (a) to discontinue service for non-payment or (b) to post a 24 or 48 hour notice of discontinuance, and, to avoid discontinuance of service, the customer makes payment in full. (N)

(N)

SAN JOSE WATER COMPANY

Table 16-C

Rule No. 11

DISCONTINUANCE AND RESTORATION OF SERVICE (Continued)

C. Restoration of Service

1. Restoration of Service

Where service has been discontinued for violation of these rules or for nonpayment of bills, the utility may charge $15.00 for restoration of service during (I)
regular working hours or $20.00 for restoration of (I)
service at other than regular working hours when the customer has requested that the restoration be made at other than regular working hours.

SAN JOSE WATER COMPANY

Table 16-D

Rule No. ____

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE

APPLICABILITY (N)

Applicable to all portable metered water service furnished for construction and other temporary purposes.

TERRITORY

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

RATES

Currently effective monthly service charge for the applicable 3/4, 1, 2 and 3 inch meter and quantity rates listed in Schedule No. 1 General Metered Service will apply to service furnished under this schedule.

SPECIAL CONDITION

1. To obtain water service under this schedule an applicant must first apply for and obtain written permission from the utility.
2. Applicant will be required to deposit with the utility the amount, shown in the table below, which corresponds to the size and type of meter used.

Size of Meter	Refundable Deposit	Non-Refundable Handling Charge	Total Deposit
3/4 inch	$ 240.00	$10.00	$ 250.00
1-inch	390.00	10.00	400.00
2-inch	1,240.00	10.00	1,250.00
3-inch	1,540.00	10.00	1,550.00 (N)

SAN JOSE WATER COMPANY

Schedule No. _

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE

Special Condition - Continued (N)

The refundable deposit is based on two times the cost of the applicable meter. The refundable deposit less (a) the cost of any repairs other than those due to normal depreciation, and (b) any outstanding unpaid water bills, will be returned to the customer upon return of the meter to the utility.

3. On the last working day of each month the customer shall call-in or mail-in to the utility the readings on the meter or meters used by him. All such read information must contain the meter number and reading as of the last working day of the month. The utility will bill the customer monthly under its General Metered Service, Schedule No. 1 on the basis of such reading. Failure to so notify the utility will result in imposition of a monthly charge of $25.00 per meter in addition to the monthly charges under such Metered Service Schedule. Failure to so notify the utility for a period in excess of 60 days will result in loss of permit to retain such portable meter and forfeiture of meter deposit.

4. No such meter may be retained for a period in excess of one year. Failure to return a meter to utility at the end of one year will result in the denial in the future of such temporary service.

5. When a person takes water from a fire hydrant or other outlet without first having obtained written permission from the utility, the utility shall assess a fine of (N)

SAN JOSE WATER COMPANY

Schedule No. _

CONSTRUCTION AND OTHER TEMPORARY METERED SERVICE (Continued)

$200.00 per occurrence against such person and shall confiscate any connections used for such unauthorized taking. When a person has written permission to draw water from the utility's service area, but fails to use the meter supplied while drawing water, the utility shall assess a fine of $50.00 per occurrence against such person; the failure to use such meter a second time shall result in loss of permit to retain a portable meter, forfeiture of the meter deposit and denial in the future of such temporary service. (N)

San Jose Water Company

Temporary Water Service Deposit Receipt

Date ____________________

Account No. ____________________ Meter Size ____________________

Name of Depositor ____

Business Address ____

____

Billing Address ____

____

Person in Charge of Billing ____

Amount of Deposit ____

Location of job ____

Permission to use water until ____
on which date meter and couplings will be returned (see over)

Customer accepts the meter described above subject to the provisions of the attached Rule __ of San Jose Water Company. Customer further agrees to comply with the requirements attached.

Customer	Utility
I, ____________________	On behalf of SAN JOSE WATER
acknowledge receipt of meter	COMPANY, I ____________________
and couplings from San Jose	acknowledge receipt of the
Water Company and agree to	____________________
return meter and couplings on	deposit set forth above.
or before ____________________	SAN JOSE WATER COMPANY
____________________	
____________________	By ____________________
Customer	Utility

IMPORTANT INFORMATION - READ CAREFULLY

1. A deposit for temporary water service is required and is based upon the size of the water meter. The deposit, less the cost of any repairs, other than those due to normal depreciation, and any outstanding unpaid bills, will be returned to the customer upon return of the meter.

2. The Fire Department has asked that we remind customers requiring temporary water service to use only approved hydrant spanner wrenches when taking water from fire hydrants. See attached instruction on the hook-up to the fire hydrants.

3. The customer, by acceptance of this agreement, shall be responsible for any damage to fire hydrants, the water system, and/or water meter which results from the use herein authorized. The cost of repairs over the amount of the deposit shall be paid as soon as the amount thereof is known.

4. The customer shall defend, indemnify, and hold the water utility, its officers and employees, harmless from and against, all claims and/or liabilities for injury to person or persons, or damage to property arising out of the exercise of the permission herein given.

5. The customer shall cease using water at any time upon request of a utility or fire department representative.

6. The customer shall use the meter supplied by the utility at all times while drawing water. The drawing of water other than through the meter provided by the San Jose Water Company is subject to a $50.00 penalty per occurrence.

Repeated offense will result in loss of permit to obtain a portable meter and forfeiture of meter deposit.

7. TERMS:
The customer shall call-in or mail-in (post-marked) to the utility the meter readings on the last working day of each month. Failure to comply with this provision will result in a $25.00 monthly charge in addition to the monthly meter and quantity charges. Continued failure to comply with the meter reading requirement will result in loss of permit to obtain a portable meter and forfeiture of meter deposit.

8. Additional permits will not be granted to any person or entity which has not paid a past due account.

9. The customer shall return the meter to utility for an annual check-up and maintenance. Failure to return the meter annually will result in utility not granting a permit in the future.

(END OF APPENDIX A)

APPENDIX B
Page 1

SAN JOSE WATER COMPANY

(INTENTIONALLY LEFT BLANK SINCE A LEVELIZED CONSTANT RATE IS ORDERED BY THIS DECISION)

SAN JOSE WATER COMPANY

Adopted Quantities

San Jose Water Company	1989	1990
1. Water Production : KCcf		
Wells	35,025	35,330
Surface Supply	4,813	4,813
Purchased Water	27,632	27,807
Total	67,470	68,000
2. Purchased Water Expenses		
Santa Clara Valley Water Dist. (7-1-89)		
Purchased Water (MG)	20,670	20,801
Unit Cost ($/MG)	$644.47	$644.47
Total Cost	$13,321,195	$13,405,620
3. Pumped Tax		
Santa Clara Valley Water Dist. (7-1-89)		
Quantity (MG)	26,201	26,466
Unit Cost ($/MG)	$414.30	$414.30
Total Cost	$10,855,074	$10,964,864
4. Purchased Power		
Supplier - PG&E (1-1-89)		
Production (KCcf)	67,470	68,000
Kwhr per Ccf	0.9417	0.9423
Kwhr	63,540,798	64,076,230
Unit Cost ($/Kwhr)	0.088369	0.088333
Total Cost	$5,615,000	$5,660,000
5. Ad Valorem Taxes	$1,478,900	$1,521,800
Tax Rate	1.13%	1.13%

SAN JOSE WATER COMPANY

Adopted Quantities

6. Number of Services by meter size

	Schedule No.1 1989	Schedule No.1 1990	Schedule No.6 1989	Schedule No.6 1990
5/8 x 3/4 inch	169,649	170,765	0	0
3/4	3,186	3,206	1	1
1	19,199	19,328	4	4
1 1/2	2,491	2,510	3	3
2	3,809	3,792	14	14
3	974	1,038	4	4
4	292	296	1	1
6	145	146	1	1
8	30	32	0	0
10	1	1	0	0
	199,776	201,114	28	28

7. Meter Sales (Ccf)

	Schedule No.1		Schdule No.6	
0-3 ccf	6,690,611	6,735,290	0	0
Over 3 ccf	54,396,489	54,831,510	310,000	310,000
Total	61,087,100	61,566,800	310,000	310,000

8. Number of Service and Usage

	No. of Service 1989	No. of Service 1990	Usage - Kccf 1989	Usage - Kccf 1990	Ave Usage - ccf 1989	Ave Usage - ccf 1990
Commercial	197,999	199,299	55,697	56,063	281.3	281.3
Public Authority	1,448	1,486	4,344	4,458	3,000	3,000
Industrial	84	84	976	976	11,619	11,619
Other	245	245	70	70	0.3	0.3
Other Utilities	28	28	310	310	11.1	11.1
Subtotal	199,804	201,142	61,397	61,877	14,912	14,912
Priv Fire Prot.	2,082	2,182				
Total	201,886	203,324				
Water Loss	9.0%		6,073	6,123		
Total Water Produced			67,470	68,000		

9. Postage (effective June 30, 1988) - $0.205 per billing

APPENDIX C
Page 3

SAN JOSE WATER COMPANY

Income Tax Calculation

	1989	1990
	(Dollars in thousands)	
Operating Revenue (authorized rates)	67862.8	69840.2
Expenses		
Payroll	6,019.0	6,348.0
Purchased Power	5,615.0	5,660.0
Purchased Water	13,320.0	13,406.0
Pump Tax	10,855.0	10,965.0
Other O & M	3,530.0	3,709.0
Other A & G	5,260.0	5,489.0
Business License	30.0	30.0
Franchise Tax	151.3	155.7
Uncollectibles	157.4	162.0
Taxes Other than Income	2,045.7	2,126.2
Transp. Depreciation	(223.0)	(257.0)
Interest Expense	3,809.0	3,936.0
Other	(3.0)	(3.0)
Total Deduction	50,566.4	51,726.9
State Tax Depreciation	6,124.0	6,324.0
Net Taxable Income	11,172.4	11,789.4
State Corp. Franch. Tax 9.3%	1,039.0	1,096.4
Federal Tax Depreciation	4,715.0	4,869.0
State Income Tax	1,039.0	1,096.4
Less Deferred Revenue	104.6	130.5
Net Taxable Income	11,437.8	12,017.4
Fed. Income Tax 34.12%	3,902.6	4,100.4
Less ITC	(9.2)	(8.2)
Add Unrecov tax	5.9	5.9
Total Federal Income Tax	3,899.3	4,098.1
Total Income Tax	4,938.3	5,194.5

(END OF APPENDIX C)

APPENDIX D

SAN JOSE WATER COMPANY

Comparison of typical bills for residential metered customers of various usage level and average level at present and authorized rates for the year 1989.

General Metered Service
(5/8 x 3/4-inch meters)

Monthly Usage (Cubic Feet)	At Present Rates	At Authorized Rates	Percent Increase
500	$8.54	$9.01	5.53%
1000	13.41	13.67	1.92
2000	23.16	22.99	-0.75
2340 (Average)	26.48	26.16	-1.19
3000	32.91	32.31	-1.83
5000	52.41	50.95	-2.79
10000	101.16	97.55	-3.57

(END OF APPENDIX D)