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Decision 91-12-023 December 4, 1991

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 increase rates charged for water service.	Application 91-02-082 (Filed February 18, 1991)

McCutchen, Doyle, Brown & Enersen, by William J. Newell, Attorney at Law, for San Jose Water Company, applicant.
Lawrence O. Garcia, Attorney at Law, for the Division of Ratepayer Advocates.
Donald R. McCrea, for the Water Branch, Commission Advisory and Compliance Division.

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O P I N I O N

Statement of Facts

San Jose Water Company (SJWC), a California corporation, for the past 125 years has been providing water service to the general public in portions of Santa Clara County. At present it serves residential, commercial, industrial, and public customers in 134 square miles of the county, including Los Gatos, Saratoga, Monte Sereno, and Campbell, portions of San Jose, Cupertino, and Santa Clara, and in territory within the county surrounding and adjacent to these municipalities. Through 199,616 active services it delivers 40,706,300 gallons of water annually to serve a population of 750,000. The system has 54 different pressure zones serving elevations ranging from 35 feet to 1,120 feet above sea level. A major portion of its water supply is obtained from 148 wells. Part of the balance is obtained from the diversion and storage of runoff from the watersheds of the Los Gatos and Saratoga Creeks. The remainder is purchased from facilities of the Santa Clara Valley Water District under a contract to expire in the year 2051. It is the company's intention that all supplemental water required to meet new growth be purchased, thereby stabilizing production from local surface water and ground sources at approximately the present level to avoid long-term overdrafting of the underground as well as land surface subsidence and permanent loss of capacity of the aquifer. Within predetermined parameters of control, all supply, pumping, and sterilization operations, except leased wells and distant surface supply facilities, are controlled automatically by means of computer-oriented supervisory telemetry control system. In 1989 SJWC's utility plant, valued at $226.6 million, produced revenues of $56 million.

The Notice of Intent and Application

SJWC filed a Notice of Intent to file a rate increase on January 2, 1991. Thereafter, the utility's workers' compensation insurer provided the utility with its estimate of insurance for 1991 which showed a significant increase. In filing this present application on February 18, 1991, the company revised its administrative and general expense estimates upwards by $136,000 in 1991, $144,000 in 1992, and $151,000 in 1993 to reflect the increase in insurance costs.

Taking into consideration Decision (D.) 90-08-045 issued August 8, 1990, which established the current rate case plan for Class A water utilities, and in accordance with current Commission practice, SJWC is proposing step rates for three future years. Because of the time required to prepare a rate case application plus processing time, no increase in rates is being requested for 1991. The company is seeking increased rates based on summaries of estimated earnings for both the second and third test years, and is requesting a third step based on the indicated operational attrition between the test years. Consumption has decreased as a result of implementation of mandatory rationing in Santa Clara County. The same inflationary factors affecting the general economy also impact SJWC's operating costs and administrative expenses. Proposed improvements in plant are estimated to exceed 10% of rate base. These include projects to replace the spillway at the company's Austrian Dam, which was damaged by the October 1989 earthquake, and to relocate company facilities to accommodate Measure A highway projects, including the Route 85 and Route 101 freeway constructions.

By the present filing, SJWC proposes to increase its revenues by $11,134,000 (15.91%) in 1992, and by additional amounts of $824,000 (0.99%) and $1,149,000 (1.37%) in 1993 and 1994, respectively. These increases are calculated to produce a rate of return on rate base of 11.16% in 1992, 11.20% in 1993, and 11.28% in 1994. This represents a constant return on equity of 13.00% for each of these years. SJWC asserts this is the minimum return necessary to maintain its credit standing, attract necessary new capital at a reasonable cost, and provide a fair and reasonable return on equity. The requested increases would cause the monthly bill for a residential customer using 1,700 cubic feet of water per month to increase $3.88 (17.62%) from $22.02 to $25.90.

Pursuant to the provisions of The Rate Case Plan for Class A Water Utility General Rate Applications (1990) 37 CPUC 2d 175, following notice to customers by bill inserts and notices in local newspapers, a public meeting was held the evening of April 16, 1991 in the San Jose auditorium of Caltrans. Twelve out of 200,000 customers attended. Questions were posed and answered relating to drought, drought effects on utility billings, repair work on a utility dam, free water for SJWC employees, the funding of facility relocations caused by Caltrans highway construction, leaks, and the taste and odor comparison of treated water compared to pumped ground water. Thirty-one customers wrote letters opposing an increase. Of these, 19 opposed increases related to drought-reduced sales, three believed industrial customers should pay more, two opposed free water to utility employees, four opposed rate increases exceeding the cost of living, and another wanted rates comparable to those of neighboring tax-exempt city-owned utilities.

In the years 1989 and 1990 SJWC received a total of 955 service complaints (371 re billing, 348 re water rationing, 82 re service, and 154 re miscellaneous problems). The record indicates that these were investigated and resolved by the utility within a reasonable period of time. Staff recommends that we find SJWC's service satisfactory.

The Public Hearing

Duly noticed public hearings were held June 17, 1991 in San Jose, and June 18 and 19, 1991 in San Francisco before Administrative Law Judge (ALJ) John B. Weiss. One customer appeared. That individual was interested in pursuing further questions he had raised earlier in this and another proceeding.

Among his questions were those pertaining to ownership of the water in the aquifer, "lost" water, free water to SJWC employees, nonrefundable developer monies, the cost of dam spillway repairs not covered by reserves, city vs public utility rates, "rental" of meters, and shareholder dividend growth.

Answers to consumer questions were provided during the course of the hearing, primarily by SJWC's vice-president for regulatory affairs. The gist of these answers was as follows:

Apart from that half of its source water purchased from the Santa Clara County Water District, the utility obtains surface water from dams it owns and has constructed in watershed lands it owns in the mountains. Ground water is pumped from the aquifer below the wells it owns or leases on the valley floor. The basic costs for the water from these latter two sources include purchased power, pumping and booster facilities, storage facilities, treatment plants, and taxes. These are costs passed through to the consumer in the rate structure.

The utility's loss rate for "unaccounted for water" is 9%, generally accepted as a normal rate representing not only leakage, but also fire protection and hydrant flushing. Some leakage is underground and while providing no revenue, drifts back into and recharges the aquifer.

1"Free watch" to the employees is part of SJWC's benefit package which SJWC asserts is customary in the business. All employees are metered and are achieving rationing levels consistent with those of the public. Exceptions are notified and then subject to disciplinary action.

Advances for construction are included in an account that is refunded to the developer over 40 years at the rate of 2-1/2% per year - a straight line refund. The liability portion of the account is not included in rate base; only the paid out or refunded portion is added to rate base as it is paid. On the other hand, contributions in aid of construction are not refunded, are not included in rate base, and the company does not earn on these amounts.

Dams are necessary to trap and store surface water, the lowest cost water. Spillways are a safety feature of the dams, and without replacement of the Austrian Dam spillway damaged by the Loma Prieta earthquake, SJWC would have been required by the Division of Dams to destroy and remove the dam. Carrying full insurance or reserves against all possible loss is not in the best interests of the ratepayers and therefore is not allowed by the Commission.

City-owned utilities may charge lesser rates in some instances because municipal utilities pay no taxes, can borrow needed funds at lower rates based on the full faith and credit of the municipality, and municipalities frequently receive preferential source charges as governmental entities.

Meters do not belong to the customer as they are neither sold nor leased. The cost to furnish, maintain, test, and replace meters is merely a small component of the overall fixed utility costs which make up the service charge. This charge is made for the basic service of having water always available on demand - whether used or not.

As to dividend growth, SJWC pointed out that it is well below the expected 4.5% inflation level; that the utility's stock, currently selling below book value, is trading at one of the lowest market-to-book ratios of all major water companies; that the return on the equity must be sufficient to assure confidence in the utility's financial integrity so as to maintain its credit and attract the investment capital required to operate the business; and that without growth the customers would soon have to pay more for service.

During the three days of hearing the parties entered 24 exhibits into the record, including a Stipulation resolving numerous material issues. The Stipulation, Exhibit 23, was accompanied by a Comparison Exhibit, Exhibit 24.

The Stipulation and Comparison Exhibit

After receiving each other's reports, SJWC and staff met a number of times in efforts to resolve or narrow disputed issues. For the majority of issues their efforts were successful, and at the hearing their respective attorneys advised the ALJ that agreements had been reached and would be memorialized in Stipulation form to be jointly introduced as an exhibit supported by a Comparison Exhibit. This was accomplished and the exhibits were accepted into evidence. As a consequence of the Stipulation, only two issues remained for decision.

The first of these remaining issues is the utility's estimates of transportation expense and rate base which involve the 14 company cars where the personal use mileage exceeded 50%. Staff would exclude these costs as in SJWC's last rate case decision (Re San Jose Water Co. (1989) 33 CPUC 2d 302). However, while the Commission expressed concern in San Jose about apparent high levels of personal use of vehicles on which the utility also earns a rate of return, it did not foreclose future showings, stating that the utility was welcome to make a clear and convincing showing in its next rate proceeding. And then, several months later, in Re California Water Service Co. (1990) 35 CPUC 2d 428, the Commission, as a guide for prospective filings concerning the personal use of automobiles, offered suggestions for what an acceptable showing must establish, with emphasis on the total compensation package. In its present showing, SJWC's evidence is designed to demonstrate the reasonableness of its overall compensation package and the cost-effectiveness of permitting personal use of company cars consistent with the guidelines of Cal. Water Service. Accordingly, the evidence was received over tacit staff objection.

The second remaining issue is the appropriate return on common equity to be authorized.

There initially was a third issue which the Stipulation and time have resolved. The Stipulation Comparison sets forth a 1992 test year rate base difference of $2,610,900. Of this $204,000 represents the transportation issue. The remaining $2,406,900 represents additional working cash requirements that are estimated to result should the Legislature authorize the Santa Clara County Water District could change its pump tax collection schedule. After these hearings concluded, the Legislature did so, and the District on July 30, 1991 changed its schedule. This changes the lead-lag days from 40 to 124, a major component. Under the Stipulation, staff agreed that the ALJ should use the utility's estimate if the Legislature and District did indeed act.

<u>SJWC Witnesses</u>

At the hearing SJWC called three witnesses, Fred R. Meyer, Vice-president for Regulatory Affairs, John Johansson, Personnel Manager, and Angela Yip, Regulatory Affairs Supervisor.

Besides providing answers to questions raised by the public, Meyers testified on results of operations, water conservation matters, and financial requirements. Meyer also described the dramatic decline in SJWC cash reserves (from $9.1 million at beginning 1989 to $2.0 million at the end of 1990) due primarily to the drought. Meyer stated that the company was in considerably worse shape financially than when its last rate case was before the Commission in 1989; he added that the market has recognized that SJWC has one of the lowest market-to-book ratios, and at 9, the lowest price earnings ratio of the 13 comparable water companies nationwide in the Turner list used by our staff (the list average is 11.5). Meyers pointed out that drought water conservation cut sales; and, although there were compensating memorandum account recoveries authorized by the Commission, these applied only to mandatory rationing, so that the company did not come close to its authorized rate of return and consequently has and continues to suffer a loss. Even assuming the Commission grants further relief this year on the drought problem, such relief, Meyer testified, will not make SJWC whole for its losses. While serious, the financial difficulties would be less significant from a ratepayer view were SJWC not about to engage in a series of bond financings, according to Meyer. For the period 1990-1994 it plans to issue $47 million of bonds ($16 million refunding bonds) in contrast to outstanding bond indebtedness of $37 million. Meyer testified that due to Commission delay on the drought relief, SJWC narrowly avoided an effective 50-basis point penalty by delaying financing a $10 million series "AA" bond issue, and that it is again faced with the same issue, which is another factor justifying a return on equity of not less than 12.25%.

In presenting SJWC's evidence, Meyer made corrections to the basic data used by staff; these corrections necessarily resulted in a higher return range than staff obtained when the data was used in a discounted cash flow (DCF) analysis. Meyer also asserted that staff arbitrarily failed to give appropriate weight to the comparable utility group average dividend, earnings, and sustainable growth rates in determining the growth rate to be used in the analysis. Meyer also testified that even though staff placed little reliance on its risk premium model, the model it did use was flawed beyond redemption because of unnecessary "back-casting," too short a term, and inclusion of an excessive number of negative risk premia. Summarizing on return, Meyer presented evidence that a return of less than 12.25% would be inconsistent with Commission-authorized returns over the past two years, and specifically over the last six months.

In addition, Meyer testified concerning SJWC's policy of assuring the 24-hour availability of certain managers and supervisors to meet problems and emergencies by providing each with a company car which in off hours may be taken home and used personally. He presented evidence that this practice is the most cost-effective and reasonable method of accomplishing the company's twin goals of assuring off-hours emergency availability of key employees and providing additional compensation, all within a competitive and reasonable total compensation package.

Witness Johansson testified that SJWC has undertaken comprehensive local competition surveys on compensation and benefits for administrative personnel, including middle management and supervisors, and that the utility's benefits package, including pensions, auto use, traditional benefits, and overall compensation, are comparable.

Witness Yip testified regarding the independent national market survey of water utility management and staff conducted by Sibson and Co. of 22 investor-owned water utilities. She testified that 95% of the senior managerial group in the survey received use of a company car as part of their compensation package. The method of evaluation of the benefit was the lease value method prescribed by the IRS. Yip testified that this personal use benefit approximates 3-1/2% of an employee's salary. Her general conclusion from the survey was that SJWC's management and staff salaries, including the personal use in off-hours compensation, are below the survey average, and that the arrangement whereby SJWC allows personal use of company cars assigned to certain key personnel as part of that employee's total benefit package is the most efficient and economical arrangement, both to assure personnel availability for emergency need and to augment compensation.

Staff Witnesses

The Commission staff called four witnesses: Donald McCrea, Senior Utilities Engineer, Commission Advisory and Compliance Division (CACD), Water Utilities Branch (Branch), and Project Manager; Tayeb K. Mogri, Utilities Engineer, CACD-Branch; Patrick E. Hoglund, Junior Utilities Engineer, CACD-Branch; and Junaid Khan, Public Utilities Regulatory Analyst II, Division of Ratepayer Advocates (DRA) Financial and Economics Branch.

Witness Mogri's evidence was set forth largely in the staff's report and covered utility plant in service, depreciation reserve, and rate base. The differences between staff's estimates and those of the utility were - with one exception - reconciled in the Stipulation, and were principally centered in programmer expense in billing, deletion of a Dampers project, repairs to the Ostwald Dam, inclusion of construction work in progress (CWIP) in the Austrian Dam, lower hydrant costs, allowance of meter route software and training, reduced main replacements and allowance of certain new mains, immediate repairs to Vickery Reservoir, allowance for unforeseen Project A work and realignment scheduling of costs of the project. The unresolved issue was for transportation involving 14 cars. Mogri objected to characterization of the cost of these 14 cars as part of compensation, contending that compensation, as represented by these car costs incurred from personal usage over 50% of total mileage, should not be allowed for ratemaking purposes; that personal use is not a utility function, and that with or without inclusion of these costs as compensation, company employees are not underpaid. Mogri testified that staff was not denying recovery for cars partially used for personal use, only for the 14 where personal mileage exceeded 50%.

Witness Hoglund's evidence in staff's report covered staff's estimates of operating and maintenance expense, administrative and general expense, and taxes. Differences in consumption and sales were reconciled in the Stipulation as were those in operation and maintenance expense and application of the escalation factor for Purchased Services.

Witness Khan's evidence on the cost of capital and rate of return was presented in staff's report. Khan testified that DRA's recommended 11.75% rate of return on common equity was derived by considering qualitative factors such as industry and company specific factors, financial risk as well as current economic conditions in addition to results from market-based financial models. He stated that water utilities are generally perceived as less risky than electric utilities, with a more stable and reliable revenue stream, and that SJWC's risk for drought and mandatory rationing has been significantly mitigated by D.90-08-055, so that investors are aware that water utilities are allowed to recover reasonable costs. He concluded that SJWC demonstrates a favorable sales environment and superior financial performance. Given the tenuous state of the economy and lower expectations of various industries, Khan concluded that water utility investors expect lower returns.

Khan compared selected financial data of SJWC with that of a dozen in- and out-of-state water utilities from the C. A. Turner Report, concluding that SJWC's investors over the past ten years have benefited from higher than average earnings, dividends, and sustainable growth rate, higher equity ratios, and lower payout ratios. Khan noted that DRA does not dispute SJWC's plans for a large capital investment program, nor the accompanying debt financing which projects common equity ratios of 50.75% in 1992, 49.15% in 1993, and 48.81% in 1994. Staff also concluded that the expected coupon rates and effective cost of the proposed long-term debt was reasonable.

Khan testified that his DCF is not merely an arithmetic one, but attempts to measure expected return for equity investors given the particular situation and prevailing economic conditions. Staff's comparable water industry group averages, once its standard of 70% from operations in water-related areas was met, looked to all income, both utility and nonutility, over the ten-year period of the analysis. But when the DCF analysis was applied to SJWC specifically to ascertain an indicated rate of return, Khan discounted the company's actual dividend growth, earnings growth, and sustainable growth[1] rates in determining the growth rates to be applied to the company's current yields for the component three- and six-month periods, and substituted his own "estimated" lower growth figure producing a rate of return on equity range of 11.55 to 12.37%. Khan justified this growth figure substitution by stating it appears unlikely that SJWC could maintain its historical growth rate. On cross-examination he conceded that it was an element of judgment; that there was no specific weighting or mathematical calculation involved in the growth rates he elected to use; that he did not consciously accord any specific weight to any of the factors. His general approach was "to study the generic conditions prevailing."

Khan then employed a risk premium model as a check against his DCF result. His analysis, using realized returns rather than expected returns, over the short ten-year span (1981-1990) he considered sufficient (as it covered one business and one interest cycle with two recessions and swings in interest rates) resulted in very high risk premiums in some years and rather substantial negative risk premiums in 1988 and 1989 when interest rates were relatively moderate. Khan's risk premiums, when added

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1 Until recently the growth rates used in Commission DCF Model Summaries included only dividend growth rates and earnings growth rates as components. While historical growth rates provide useful surrogates for future growth projections when the underlying conditions which supported past growth patterns are expected to continue, past growth may reflect changes in underlying relevant variables that cannot be expected to continue, or which may fail to capture new information known. Accordingly, DRA developed and has included the concept of sustainable growth to this analysis. The sustainable growth rates indicate that present market conditions may or may not reasonably support the historical rate of growth. DRA has believed it reasonable to blend historical and sustainable growth rates for use in the DCF Model Summary. In its revision exhibits introduced at the hearing, SJWC conformed, and also incorporated sustainable growth rates.

to the projected interest rates for 1992-1994, resulted in a projected rate of return ranging from 11.34 to 11.69% for the comparable water company group. Accordingly, taking the results from the market-based financial models in conjunction with his overall risk assessment, Khan recommended a 11.75% rate of return, within his 11.50 to 12.00% range.

Finally, Project Leader McCrea's evidence, also set forth largely in the staff report, covered Summary of Earnings, Net-to-Gross Multiplier, Customer Service and Conservation, and Rate Design. McCrea also testified on some staff recommendations, including one that the utility be allowed to use the new payment schedule with its impacts on additional working cash requirements, if the Legislature passed certain pump tax legislation after hearings concluded but before a draft decision is completed. McCrea also recommended that the decision allow SJWC to file an advice letter in 1992 to recover 1991 costs if these exceed $3 million once the rebuilding of the Austrian Dam spillway is completed. McCrea further recommended elimination of the utility's fire hydrant schedule.

Upon submission of concurrent briefs on July 11, 1991, the matter was submitted for decision, leaving open the stipulation item on the Pump Tax Payment Schedule for possible modification if the Legislature acted. By a letter dated August 5, 1991 from SJWC enclosing a July 31, 1991 letter from the Santa Clara County Water District, the Pump Tax and related items left open for possible modifications were resolved. However, subsequently it became evident to the parties that the estimated timing for required work on the Austrian Dam had changed, resulting in decreases in the Rate Base. On August 23, 1991, the parties executed a Further Stipulation for Settlement to reflect the Rate Base adjustments. By an ALJ ruling on August 27, 1991, the ALJ reopened the proceeding to accept into evidence as Exhibit 25, the August 23, 1991 Further Stipulation for Settlement. On August 27, 1991, staff furnished the ALJ with the finally resulting Summaries of Earnings, tax calculations, and Tariff Sheet Appendices.

Apart from the present proceeding, in late May of 1991, SJWC filed Advice Letter No. 233 to recover the increase in costs imposed by the Santa Clara County Water District for water purchased by the utility from the district. By Commission Resolution No. 3582 dated June 19, 1991, the utility was authorized to increase its rates beginning July 1, 1991 to cover this increased cost. These costs were not reflected in Comparison Exhibit 24.

Discussion

The Stipulation and Comparison Exhibit

Desiring to avoid the expense, inconvenience, and uncertainty that would attend litigation on a number or essentially subordinate issues in this proceeding, issues relating to utility plant components, consumption and sales, residual conservation, operations and maintenance expenses, the escalation factor to be used for purchased services, and administrative and general expenses, the utility and staff worked to reconcile their differences, memorializing the results in a Stipulation submitted to the ALJ during the hearing as an exhibit accompanied by a Comparison Exhibit. Their reconciliations of these differences as set forth in the Stipulation are reasonable in light of the entire record, consistent with law, and are in the public interest. Accordingly, we will accept the Stipulation and the Comparison Exhibit (Exhibits 23 and 24, respectively). It is not necessary to discuss them in detail. The Comparison Exhibit follows as Table 1 and is applicable to Test Years 1992 and 1993:

Table 1
San Jose Water Company
Comparison of Applicant's and Staff's Summary of Earnings
Test Year 1992

	Applicants Estimates				CPUC Staff Estimates		
PRESENT RATES	Original Filing (Exh. 1)	Adjust.	Final Applicant Position	Difference	Final Staff Position	Adjustmnt and Correct.	Original (Exh. 17)
Operating Revenues	69,987.0	(1,522.8)	68,464.2	0.0	68,464.2	(3,454.5)	71,918.7
Operating & Main. Expenses:							
Purchased Water	16,660.0	0.0	16,660.0	0.0	16,660.0	0.0	16,660.0
Purchased Power	5,356.0	(131.6)	5,224.4	0.0	5,224.4	(544.5)	5,768.9
Pump Tax	10,594.0	(594.8)	9,999.2	0.0	9,999.2	(1,411.6)	11,410.8
Chemicals & water quality	32.0	0.0	32.0	0.0	32.0	0.0	32.0
Other -	7,396.9	(13.6)	7,383.3	(0.0)	7,383.3	725.7	6,657.6
Maintenance	3,969.0	(140.4)	3,828.6	0.0	3,828.6	15.6	3,813.0
Customer Accounts- postage	530.1	0.0	530.1	0.0	530.1	0.0	530.1
Transportation	939.7	0.0	939.7	74.7	865.0	60.0	805.0
General & Administrative:							
Payroll	1,536.0	0.0	1,536.0	0.0	1,536.0	0.0	1,536.0
Other	3,029.0	(86.0)	2,942.0	0.0	2,943.0	(12.0)	2,955.0
Employee's Pensions	2,253.0	0.0	2,253.0	0.0	2,253.0	0.0	2,253.0
Dues	~~81.0~~	~~0.0~~	~~81.0~~	0.0	81.0	0.0	81.0
Rent	57.0	0.0	57.0	0.0	57.0	0.0	57.0
Admin transferred	(520.0)	0.0	(520.0)	0.0	(520.0)	0.0	(520.0)
Payroll tax	719.2	0.0	719.2	0.0	719.2	0.0	719.2
Ad valorem tax	1,726.3	(17.5)	1,708.8	0.0	1,708.8	19.5	1,689.3
Depreciation & amortization	6,117.0	(151.1)	5,965.9	0.0	5,965.9	21.9	5,944.0
Balancing Account	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subtotal	60,476.2	(1,135.0)	59,341.2	74.7	59,266.5	(1,125.4)	60,391.9
Uncollectibles	148.3	(3.2)	145.1	0.0	145.1	(7.3)	152.4
Business/Franchises	186.8	21.9	208.7	0.0	208.7	(7.8)	215.5
Regulatory Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State Income	261.0	25.5	286.5	(6.9)	293.4	(185.8)	479.2
Federal Income	1,335.2	14.7	1,349.9	(25.5)	1,375.4	(910.5)	2,196.0
Total Operating Expenses	62,407.5	(1,076.1)	61,331.4	42.3	61,289.1	(2,136.9)	63,426.0
Net Operating revenues	7,579.5	(446.7)	7,132.8	(42.3)	7,175.1	(1,317.6)	8,492.7
Rate Base	125,511.2	(3,021.4)	122,489.8	2,610.9	119,878.9	4,278.5	115,600.4
Rate of Return	6.04%		5.82%	-0.17%	5.99%		7.35%
PROPOSED RATES							
Operating Revenues	81,396.3	(2,067.9)	79,328.4	0.0	79,328.4	(3,687.6)	83,016.0
Operating Expenses:							
Subtotal	60,476.2	(1,135.0)	59,341.2	74.7	59,266.5	1,125.4	60,391.9
Uncollectibles	172.5	3.4	175.9	0.0	175.9	(7.8)	175.9
Business/Franchise tax	212.8	28.7	241.5	0.0	241.5	(8.3)	241.5
Regulatory Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State income tax	1,317.0	(20.1)	1,296.9	(6.9)	1,303.8	(202.9)	1,506.7
Federal income tax	5,210.7	(154.0)	5,056.7	(25.5)	5,082.2	(523.1)	5,605.3
Total Operating Expenses	67,389.2	(1,277.0)	66,112.2	42.3	66,069.9	383.3	67,921.3
Net Operating Revenues	14,007.1	(790.9)	13,216.2	(42.3)	13,258.5	(4,070.9)	15,094.7
Rate Base	125,511.2	(3,021.4)	122,489.8	2,610.9	119,878.9	4,278.5	115,600.4
Rate of Return	11.16%		10.79%	-0.27%	11.06%		13.06%

Table 1-A
San Jose Water Company
Comparison of Applicant's and Staff's Summary of Earnings
Test Year 1993

PRESENT RATES	Applicants Estimates: Original Filing (Exh. 1)	Revised	Final Applicant Position	Difference	CPUC Staff Estimates: Final Staff Position	Adjustmnt and Correct.	Original (Exh. [illegible])
Operating Revenues	71,607.0	(281.4)	71,325.6	0.0	71,325.6	(2,303.8)	73,629.4
Operating & Main. Expenses:							
Purchased Water	11,150.0	(36.0)	11,114.0	0.0	11,114.0	(36.0)	11,150.0
Purchased Power	5,499.8	(25.0)	5,474.8	0.0	5,474.8	(457.5)	5,932.3
Pump Tax	10,893.0	(113.2)	10,779.8	0.0	10,779.8	(969.2)	11,749.0
Chemicals & water quality	32.0	0.0	32.0	0.0	32.0	0.0	32.0
Other	7,599.4	(74.2)	7,625.2	0.0	7,625.2	667.2	6,958.0
Maintenance	4,182.0	(129.6)	4,052.4	0.0	4,052.4	14.4	4,038.0
Customer Accounts- postage	532.8	0.0	532.8	0.0	532.8	0.0	532.8
Transportation	1,003.0	0.0	1,003.0	74.7	928.3	84.3	844.0
General & Administrative:							
Payroll	1,617.0	0.0	1,617.0	0.0	1,617.0	0.0	1,617.0
Other	3,194.0	(115.0)	3,079.0	0.0	3,079.0	36.0	3,043.0
Employee's Pensions	2,439.0	0.0	2,439.0	0.0	2,439.0	0.0	2,439.0
~~Dues~~	84.0	0.0	84.0	0.0	84.0	0.0	84.0
Rent	57.0	0.0	57.0	0.0	57.0	0.0	57.0
Admin transferred	(554.0)	0.0	(554.0)	0.0	(554.0)	0.0	(554.0)
Payroll tax	751.5	0.0	751.5	0.0	751.5	0.0	751.5
Ad valorem tax	1,811.1	(25.1)	1,785.0	0.0	1,785.0	25.3	1,759.7
Depreciation	6,509.7	(236.2)	6,273.5	0.0	6,273.5	64.0	6,209.5
Balancing Account	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Subtotal	62,901.3	(755.3)	62,146.0	74.7	62,071.3	(571.5)	62,642.8
Uncollectibles	151.7	(0.6)	151.1	0.0	151.1	(4.9)	156.0
Business/Franchises	190.8	26.5	217.3	0.0	217.3	(5.2)	222.5
Regulatory Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State Income	146.9	109.8	256.7	(6.9)	263.6	(114.1)	377.7
Federal Income	889.7	322.7	1,212.4	(25.5)	1,237.9	(641.1)	1,879.0
Total Operating Expenses	64,280.4	(296.9)	63,983.5	42.3	63,941.2	(1,336.8)	65,278.0
Net Operating Revenues	7,326.6	15.5	7,342.1	(42.3)	7,384.4	(967.0)	8,351.4
Rate Base	130,705.1	(3,757.1)	126,948.0	2,386.3	124,561.7	4,334.0	120,227.7
Rate of Return	5.61%		5.78%	-0.15%	5.93%		6.95%
PROPOSED RATES							
Operating Revenues	83,963.0	(718.5)	83,244.5	0.0	83,244.5	(2,459.3)	85,703.8
Operating Expenses:							
Subtotal	62,901.3	(755.3)	62,146.0	74.7	62,071.3	(571.5)	62,642.8
Uncollectibles	177.9	2.8	180.7	0.3	180.4	(1.2)	181.6
Business/Franchise tax	218.6	30.1	248.7	0.4	248.3	(1.3)	249.6
Regulatory Commission	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State income tax	1,291.2	74.0	1,365.2	(6.9)	1,372.1	(123.6)	1,495.7
Federal income tax	4,735.0	199.6	4,934.6	(25.5)	4,960.1	(639.2)	5,599.3
Total Operating Expenses	69,324.0	(448.8)	68,875.2	43.0	68,832.2	(1,336.8)	70,169.0
Net Operating Revenues	14,639.0	(269.7)	14,369.3	(43.0)	14,412.3	(1,122.5)	15,534.8
Rate Base	130,705.1	(3,757.1)	126,948.0	2,386.3	124,561.7	4,334.0	120,227.7
Rate of Return	11.20%		11.32%	-0.25%	11.57%		12.92%

The Transportation Issue

The issue before the Commission is whether or not personal use of vehicles is a legitimate expense for ratemaking purposes. In SJWC's last rate case we stated that personal use was not legitimately a ratepayer expense. However, we allowed SJWC to to attempt make a clear and convincing showing in its next rate case that we should reverse this position.

In a later decision, Cal. Water Service Co. (1990) 35 CPUC 2d 428, we acknowledged that personal use of vehicles may be appropriate as part of the general compensation package for employees. To the extent that personal vehicle use is necessary as compensation, those costs are appropriately included in rates.

SJWC has the burden to make a clear and convincing showing in this proceeding that these costs should be allowed. SJWC argues that the vehicles provide a reliable transportation for managers and supervisors who must respond to emergencies, and a compensation package for officers of the company. Further, SJWC argues that its officers' base pay is less than comparable firms in a national survey as well as a local survey of organizations which compete for employees with SJWC. We must determine whether or not SJWC has met it burden.

SJWC operates 135 company-owned vehicles including passenger autos in its business of providing water service in a 134-square mile service territory serving 750,000 people. Twenty-seven of these company cars are assigned to employees, including certain managers and supervisors, who have an ongoing daily need to have an auto at hand when problems and emergencies arise, in order to respond promptly, day or night.[2] Therefore, to assure that these particular employees will always be able to respond at any time with immediately available and reliable transportation, the company allows these employees to take their assigned vehicles

2 Staff did not contend that any of these cares were inappropriately assigned.

home. During work hours when the cars are at the company yard, they are used as pool cars, and during the lunch period, because of the lack of nearby lunch facilities, they are used for car pooling.

We must conclude that vehicles which are provided to employees for service reliability are properly included in rates. The primary role of a public utility is reliable service at reasonable rates. SJWC's unrebutted testimony that vehicles are provided for reliability reasons is persuasive on this issue. However, we still express some concern about vehicles provided for reliability which appear to be used primarily for personal use. While we will accept these vehicles and the total mileage for ratemaking purposes in this order, we expect a showing in SJWC's next rate case that personal miles on vehicles provided for reliability are cost effective. We expect this showing to include any additional liability insurance costs related to personal use of these vehicles, the related depreciation of vehicles because of personal mileage, and the safety history of company cars being used for personal use. These and any other related costs should be included in an explicit comparison with alternatives reviewed by the company when determining that this is a cost effective manner to provide transportation reliability. We will again consider whether or not to disallow all personal use miles for these cars in that proceeding as well as a rate base adjustment if appropriate.

Not all of the vehicles at issue relate to reliability. Some of the SJWC vehicles are provided to officers of the company who presumably do not regularly respond to emergency situations such as broken mains. SJWC argues that these vehicles are appropriately considered part of the compensation package for these officers. SJWC presented two salary surveys indicating that SJWC officers receive less base compensation than the survey groups. SJWC also testified that vehicles are routinely provided to officers of other companies.

Branch challenged the company allegation by pointing out that we have previously held that personal use is not an appropriate ratepayer expense, and that the company showing was not complete. Among other things, according to DRA, the company surveys showing vehicles as compensation did not clarify whether personal use was allowed for the vehicles. The surveys also compared only base compensation and not total compensation, which would be a more meaningful comparison.

We find SJWC's showing sufficient to establish that vehicles are appropriately provided to officers of the company. SJWC's showing generally complied with our guidelines in the California Water Service case. However, this matter has not been completely set to rest. We have remaining questions concerning compensation and the showing made by SJWC. Among these questions are whether or not SJWC's total compensation, not just base compensation, is comparable to the national survey data. We also are struck by the fact that of all of California's Class A water utilities, only California Water Service Company was surveyed by SJWC in determining local competition for employees. A comparative showing for all California's Class A utilities would be informative and useful for the Commission. We will expect our staff to prepare such exhibits in future rate cases for all California Class A water utilities.

Capital Structure

The capital structure of a utility reflects the sources of its capital costs. SJWC's capital structure is composed of long-term debt and common equity. For the 1992-1994 test period, SJWC's capital structure is projected to change because of a decline in the common equity component ratio from its comparatively high ratio in 1990 of 61% to 50.75% in 1992, 49.15% in 1993, and 48.81% in 1994. The decline between 1992 and 1994 is partly a consequence of SJWC's plans for a large capital investment program with an accompanying need for debt financing which is expected to increase outstanding long-term first mortgage bonds 91% from $38,100,000 on December 31, 1990 to $72,900,000 by December 31, 1994. DRA does not dispute the company's projected equity ratios, and we adopt them.

Long-Term Debt Cost

SJWC plans to issue $37 million in new debt between 1991 and 1994. It estimates the average effective cost of this new debt to be 9.96% based on an estimated issue rate of 9.75% adjusted by 21 basis points to account for the estimated issuance costs. The cost of long-term debt is the aggregate interest cost on embedded and estimated long-term debt outstanding during the test period. Averaging the year-end debt cost of embedded and estimated new debt for the beginning and end of each year results in average effective costs of debt of 9.25% for 1992, 9.45% for 1993, and 9.64% for 1994.

Financial Risk

The level of a utility's financial risk is associated with the proportions of its debt and equity capital. The higher the debt ratio, the higher the cost of servicing the debt and the greater the fixed proportion of revenue required to make debt payments. A utility can lower its financial risk by increasing equity, but this tends to dilute earnings per share as the number of shares increase. From the ratepayers' viewpoint, debt financing is less expensive than equity financing because interest on debt is tax deductible whereas return on common equity is not. Thus, the balance we must strike is between the risks associated with debt versus equity to arrive at a reasonable cost of capital.

The financial stability of a utility can be measured by bond ratings made by agencies such as Standard & Poor's. The rating agencies review financial information in the categories of: total debt to permanent capital, pretax interest coverage, net cash flow to permanent capital, and net cash flow to capital expenditures. In 1989, during SJWC's last general rate proceeding, the utility's bond rating ranked "AAA" on all Standard & Poor's benchmarks for water utilities (the highest rating). At that time SJWC's high ratio of common equity (57.51%) would have produced an estimated return which would have generated a surplus cash flow. In Re San Jose Water Co. (1989) 33 CPUC 2d 302, 310, we stated that under those circumstances, maintenance of a top level bond rating would be important only were it needed to obtain a low interest rate on new debt issuance. Further, we realized that SJWC's high equity ratio denied ratepayers the advantages of a more balanced capital structure and adopted DRA's recommended imputation of a lower common equity ratio to reduce revenue requirement. We thereupon adopted a declining imputed common equity ratio that phased down to DRA's recommended imputed 53% ratio in the last year, while applying a phased increase in the rate of return (11.75-1989, 12.00-1990, 12.25-1991). As is clear from SJWC's current capital structure, our decision to give SJWC an incentive to reduce its high equity position produced the desired result.

SJWC argues that today's situation is substantially changed. SJWC will be refinancing as well as issuing a large volume of new debt - financing that will almost double its outstanding bond debt. The ratio of common equity will decrease markedly to 50.75% in 1992, 49.15% in 1993, and 48.81% in 1994.

We recognize SJWC's new debt load in reviewing the proposed capital structure stipulated to by the company and DRA. Capital structure is only one of the factors which we review in determining the reasonable rate of return. Further, we must look to financial markets and expectations in those markets. We must also look to the unique features of the applicant and make any necessary adjustments for that firm's circumstances.

When this proceeding was submitted interest rates had increased above the level which prevailed in 1989 when SJWC last had a rate case decision. Despite the small increase in interest rates, it was clear that expectations are for lower interest rates through the remainder of the year, and perhaps continuing to decline well into 1992. While this expectation is important, it is not determinative of the rate of return.

We are also well aware that a recession has been present in California throughout 1991. During recessions the expected returns on equity fall. We believe that water utility investors are no different than other investors, and have a realistic expectation that rates of return will decline. Indeed, utility stocks are a traditional haven for investment during recessions.

Consistent with DRA's recommendation, we conclude that financial market conditions support a reduction in the rate of return for SJWC.

We now turn to specific SJWC issues which may affect our determination of the appropriate return on equity. SJWC argued that the increase in debt expected over the life of this rate cycle has made it a riskier utility than when it filed its application. We concur with the principle that increased debt tends to increase risk, though in an imprecise and variable manner.

SJWC also notes that due to the drought in California, its earnings have been severely impacted by lost water sales due to mandatory rationing. We agree that revenues were substantially reduced from mandatory rationing. Our recent decision in the

Drought Investigation, D.91-10-042, made clear that the establishment of drought memo accounts not only protected utility shareholders from drought related sales fluctuations due to mandatory rationing, but also reduced utility risk. While SJWC is just now collecting the monies from the memo accounts, the company is collecting the monies. Over the course of the next year SJWC will have collected these balances. We can not conclude that SJWC has been made riskier from the drought related mandatory conservation. Indeed, with the memorandum account the utility has experienced a reduction in risk. We also believe that recovery of these monies will substantially improve the financial ratios which SJWC has argued have deteriorated so dramatically.

We must also recognize that during part of the past three years, that SJWC has experienced voluntary conservation which may have lead to SJWC earning less than its authorized rate of return. This is no more or no less than the standard utility risk under current ratemaking practices. It is clear that SJWC's earnings over recent years have been very good. Only in the last year and a half may SJWC have had difficulty in earning the authorized return because of conservation. Under our ratemaking process for water utilities we would expect to see years when authorized returns are exceeded and years when firms do not earn the full authorized returns. Taking into account that SJWC and Branch stipulated to a conservation number for purposes of forecasting, we conclude that voluntary conservation is included in the forecast of sales adopted today and should not be considered a source of future inability to achieve the authorized rate of return. In summary, we believe that SJWC's recent fluctuation is consistent with current ratemaking practice and does not merit an increase to its return.

Business Risk

In this proceeding, as in recent past proceedings, SJWC contends that water utilities face the same, if not greater degrees of technological change and risk as electric utilities. The difference between previous filings and this one is that SJWC no longer argues that it is as risky as energy utilities, evidently conceding that gas utilities are riskier than water utilities. SJWC cites the fact that electric utilities have full balancing accounts which remove the product mix, while water utility balancing accounts for purchased water and power do not include product mix, leaving water utilities penalized in droughts when higher percentages of their more costly water must be used. SJWC asserts that electric utilities are entering a period of surplus cash flow and reduced construction budgets, while water utilities face aging plant and the stringent and potentially costly provisions of the Safe Drinking Water Act. While we note these concerns about uncertainties surrounding the water industry, we are not ready to agree that the degree of risk facing water utilities can be compared to that facing the electric utilities. We have addressed this argument many times in the past several years and have consistently rejected it. We do so again.

We must point out for completeness, that in response to industry concerns that we have not appropriately considered water industry risk, we have instituted an investigation into the risk associated with water utilities, I.90-11-033. SJWC is well aware of this proceeding and that I.90-11-033 is the proper place to bring up its arguments concerning relative risk issues. We encourage all water utilities to focus their energies concerning relative risk between energy utilities and water utilities on that proceeding where the issue can be considered generically.

Rate of Return

Rate of return on common equity (ROE) is the major issue in the present proceeding. ROE determinations are not matters of absolute precision, and many factors, both quantitative and qualitative, must be considered. The legal precedents for determining a fair ROE for regulated public utilities are found in the U.S. Supreme Court decisions in Bluefield Water Works and Improvement Co. v. The West Virginia Public Service Commission (1923) 262 US 679, and the Federal Power Commission v. Hope Natural Gas Co. (1944) 320 US 591. In Hope the court stated that "the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests," and that "From the investor or company point of view it is important that there be enough revenue not only for the operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital." Two distinct standards ensued from these landmark cases, a standard of capital attraction, and a standard of comparable earnings. The capital attraction standard concentrates on investor expectations and is applied using market value methods such as the DCF model and the risk premium (RP) analysis.[3] The

3 The Discounted Cash Flow model is a financial market value technique based on the premise that the current market price of a share of common stock equals the present value of the expected future stream of dividends and the future sale price of a share of stock, discounted at the investor's discount rate. By translating this premise into a mathematical equation and transposing the

(Footnote continues on next page)

comparable earnings standard concentrates on expectations derived from comparisons with similar enterprises with similar risks.

Both SJWC and DRA used the DCF and RP financial model analyses relying on comparisons between SJWC and a dozen other sizable water utilities, publicly traded, both within and outside of California, to justify their respective ROE recommendations. The parties derived different conclusions based upon their applications of the methodologies.

<u>SJWC's Application ROE Representations</u>

Using its comparable dozen water utilities,[4] SJWC applied the DCF model to each utility's earnings and dividend growth over the 10-year period 1979-1989 to develop an expected ROE for each. These ROEs were then averaged, with and without including SJWC, to obtain an average ROE of 13.72% and 13.98%,

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(Footnote continued from previous page)

equation, the investor's expected rate of return equals the expected dividend yield (the next expected dividend divided by the current market price) plus future dividend growth.

The <u>Risk Premium</u> model is a risk-oriented financial market value technique which recognizes that there are differences in the risk and return requirements for investors holding common stock as compared to bonds. A risk premium analysis determines the extent by which the historical return received by equity investors in utilities comparable to the utility at issue exceeds the historical return earned by investors in stable long-term bonds. This difference, or "risk premium" is then added as a premium to the estimated cost of long-term debt to derive average expected return on equity for the test periods. To mitigate the effect of unstable observed historical premiums derived from volatile bond market conditions in the 1986-1990 period, an average premium is calculated over an extended time period selected to include more than one business and interest rate cycle.

4 The same list of water utilities as staff used, but excluding Philadelphia Suburban, which staff included, while excluding Southwest Water, which SJWC included. Staff selected the 70% cutoff criteria.

respectively. In addition, for company specific results, SJWC did a DCF analysis for SJWC using an estimated 4.5% inflation rate and a Gross National Product deflator based on the Urban Consumer Price Index, for the same 10-year period, to obtain yields of 11.33% on earnings and 15.62% on dividends, for an average of 13.5%.

To verify its above DCF analyses results, SJWC did three RP analyses. The first, an industry specific analysis based on 1989-1990 regulatory ROE decisions of 3 in-state and 11 out-of-state water utilities, produced an average 13.20% ROE (contrasted by SJWC to 13.43% for six 1989 California energy utilities decisions). The second, company specific to ROEs actually granted by this Commission to SJWC over the period 1975 to 1984, produced a range of 12.32% to 15.33% with the average being 13.82%. The third RP analysis, using a "normal" RP range of 3 to 5% produced a range of 12.82% to 14.87%.

From these market value analyses, SJWC concluded in its application that a range of 11.33% to 15.62% was indicated. It concluded that an average of 13.5% should apply and that an ROE of not less than 13% was required. The utility's chief witness stated that SJWC has always attempted to match dividend growth to the inflation rate - except in times of uncommonly high inflation rates. That witness testified that anything less than 13% would require it to lower its retention ratio to sustain growth in dividends.

<u>DRA's ROE Representations</u>

In DRA's report applied a DCF Model Summary to SJWC specifically, and to avoid the bias that can result when the analysis is applied on a company-specific basis to a utility with exceptionally high growth rates, it also applied the analysis to its comparable group of a dozen companies from the Turner Report. DRA Used current dividend yields at three and six months of 6.53% and 6.90%, respectively, for the company-specific analysis, and 7.00% and 7.25%, respectively, for the comparable group of water utilities' averages. At this point DRA applied "qualitative" factors for growth rates for both the company-specific and the comparative utilities group rather than the actual derived rates. This substitution was based up on its view of current and forecasted economic conditions, as indicated by interest rates and other factors, listing the current recession, swings in oil prices, the Middle East war, rising unemployment, the savings and loan crisis, banking uncertainties, governmental budget deficits, the real estate doldrums, and lower retail sales and corporate profits. DRA concludes that, while many forecast a short-lived recession, given the tenuous state of the economy and lower expectations, undoubtedly investors in what appear to be "recession proof" water utilities will also expect lower earnings. These qualitative factors lead DRA to conclude that neither the water utility industry nor SJWC can maintain their historic growth rates. Therefore, instead of applying actual dividend, earnings, and sustainable growth rates for the comparables or SJWC, DRA applied a judgmental estimate of 4.25% to 4.75% to both the three and six months' estimates to obtain its range of 11.06% to 11.98% ROE to SJWC and 11.55% to 12.37% ROE to the comparables.

DRA also used a version of an RP financial model to verify its DCF results. It did not apply this RP analysis to SJWC specifically because it considers SJWC's high historical growth rate an anomaly. It did apply it to the comparable group. Based upon the average group yield, average group growth rate, and return on equity each year 1981-1990 compared to average annual yields each year for 30-year T-Bonds and "AA" utility bonds, it calculated the respective risk premiums, obtaining a 10-year average premium relative to 30-year T-Bonds of 2.63% and 1.20% relative to "AA" rated utility bonds. When added to projected interest rates for 1992-1994, these result in a projected range of 11.34% to 11.65% for the comparable group.

Applying its DCF and RP financial models to the issue at hand, DRA concluded that a range on common equity between 11.50% to 12% was appropriate for SJWC, and specifically recommended 11.75% as the ROE to be adopted.

<u>**Analysis**</u>

Both SJWC and DRA based their recommendations on data contained in the C. A. Turner Utility Reports. DRA's criteria for inclusion of any specific utility was that at least 70% of revenues had to have been derived from water operations, and that the stock had to be regularly traded. SJWC challenged DRA's derivation of earnings growth and sustainable growth rates from comparable companies. SJWC noted that one utility, Philadelphia Suburban, was included but did not meet staff's own criteria since over some of the years considerably less than 70% of its earnings came from water operations. SJWC prepared and introduced Exhibits 12 and 13 and derived growth data for Philadelphia Suburban in line with DRA's 70% guideline. These exhibits showed significant adjustments to the comparable group's derived earnings growth rate and sustainable growth rate (from 6% to 6.64%, and 3.49% to 3.60%, respectively). One option was to exclude Philadelphia Suburban entirely which would have raised the respective percentages from 6% to 6.97%, and 3.49% to 3.72%. SJWC argued that Philadelphia Suburban could be included or excluded, but that the appropriate data should be used. Evidently, SJWC had not notified DRA of its information concerning Philadelphia Suburban prior to hearing.

In response, DRA elected not to use the growth rates derived from the compiled data, such as dividend growth rate, earnings growth rate, and sustainable growth rate. Although it has been the practice in the recent past to blend historical and sustainable growth rates, DRA decided to apply subjective growth rates of 4.25% to 4.75% applicable to both SJWC specifically and comparable utilities' DCF Model Summaries. On cross-examination, DRA's witness explained that the comparable water utilities have stable customer bases, and generally consistently increase revenues, dividends, and retained earnings, factors which are still prevailing. He also tended to agree that the recession will be short-lived. We have consistently considered the growth rates to be used in the DCF analysis calculations to be the key factors. We also have consistently recognized that the values chosen for inclusion in the model are not necessarily precise mathematical derivations. DRA's witness candidly explained that the values chosen were based upon his informed judgement. We agree with DRA's witness that water utility revenues tend to be stable, that earnings growth tends to be stable, and that retained earnings growth tends to be stable. We also must recognize the tremendous growth which has taken place in the San Jose area during the 1980s. It is clear that SJWC has benefited from this unprecedented growth which is reflected in the outstanding financial performance of SJWC throughout this period. We must also recognize that the current recession and slowing effects upon growth in California that these trends are not expected to continue over the life of this rate case. Even if the recession ended today, it will be some time before the recent population explosion in San Jose could be expected to resume. We find DRA's growth rates of 4.25% and 4.75% to be reasonable under current conditions and will adopt them.

Having found DRA's adjustments to its models at hearing reasonable, we also find DRA's range of recommended returns reasonable. The DRA recommendation of a return on equity of 11.75% is reflective of current economic and demographic condition, is sufficient to attract capital, and compensates investors for their perceived risks from investing in the firm.

SJWC's showing is mechanically based upon its mathematical models. We find such models useful in providing guidance about historical relationships and trends of key variables. However, informed judgement is still the key to in human decision making.

SJWC's models do not account for our current economic outlook. Nor does SJWC's showing satisfactorily account for demographic changes in its service area. We also must recognize that in recessionary periods rates of return fall on average throughout the economy. Investors must also expect that returns on utility investments will track this trend. SJWC's request for an increase in its authorized rate of return is simply out of step with today's economic reality.

We turn next to RP analysis differences, recognizing that in recent proceedings involving return on equity we have tended to accord this financial model the least weight. One of SJWC's three models presented using the technique adopted a 1989-1990 base rather than follow the traditional historical term pattern. That analysis showed that the average of the returns on equity granted by regulatory bodies in 1989 to 3 California and 11 out-of-state water utilities exceeded the 9.79% average rate on "A" rated utility bonds by 2.93%. When that 2.93% risk premium is added to the 10.27% 1990 three-month average return on "A" rated utility bonds, it produces an expected ROE of 13.20% for comparable water utilities. The serious difficulty with this short term application of RP analysis is that risk spreads tend to vary substantially over time. Review of a short term snap shot can not establish if the picture is an historic anomaly or part of a well established trend. This application necessarily is accorded little weight. The other two RP analyses by SJWC are too narrowly company-specific to carry much consideration.[5]

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5 SJWC's Exhibit 2, Schedule 10, showed, however, an average risk premium of 5.69% indicated by the returns allowed SJWC by Commission decisions between 1975 and 1985 when compared to SJWC's embedded cost of debt in those years.

While DRA also places little reliance on RP analysis other than to verify its DCF analysis, its results are interesting. DRA follows a short 10-year term historical basis (1981-1990) for its RP analysis. It obtains, year by year, an average return on equity for the comparable water utilities, and then compares these returns with the average yields each year on "AA" utility bonds and 30-year T-Bonds, to obtain for each year a respective risk premium. Averaging these yearly premiums, DRA obtained 10-year average risk premiums of 1.20% and 2.63%, which when added to the forecasted interest rates for 1992 projected ROE for 1992 of 11.34% to 11.65%. SJWC observes that RP analyses should always be conducted on the basis of expectations and not on the basis of realizations. As Meyer pointed out, the normal procedure is to use for extended periods of time, not less than 25 years, the actual rates of return on equity over that extended period to arrive at a true risk premium. In any given short period, Meyer asserts, one would not expect to have the risk premium result in what the expectation of the investor was when he made the investment, but over an extended period an investor could expect to have actual earnings begin to match expectations. The period of DRA's analysis is too short to allow investor expectations to be reflected in the analysis. This is, of course, similar to our problem with SJWC's one year time period for its RP analysis.

As we previously stated, RP analysis is generally given the least weight of the financial models we consider in establishing a rate of return on equity. We see nothing in this record to change our general policy and accord little weight to the RP analysis of SJWC and DRA in this proceeding.

We also take notice of D.91-11-069 in which we adopted a rate of return on equity for California-American Water Company of 12.0%. California American has a significantly higher ratio of debt to equity than SJWC, indicating that SJWC should receive a lower rate of return than 12.0%.

We are persuaded that a reduction in SJWC's authorized return is warranted. In SJWC's last rate case we established a different rate of return for each of the three years. The average of those three years was 12.0%. ((11.75 + 12.0 + 12.25)/3 = 12.0) A reasonable adjustment from this level is at least 25 basis points. In recognition that SJWC has increased its proportion of debt in response to Commission wishes, we find it inappropriate to reduce the rate of return more than 25 basis points. Accordingly we will adopt a return on equity for SJWC of 11.75%.

Return on Equity Conclusion

Based on consideration of the representations of the company and DRA, and our analysis, we conclude that a reasonable and just return on equity for the 1992, 1993, and 1994 test years of this proceeding would be 11.75%. Table 2 which follows shows the adopted Capital Structure and Rate of Return:

Table 2

San Jose Water Company

Adopted Capital Structure and Rate of Return

Component	Average Capital Amount	Ratio	SJWC Request Effect. Rate	ROE	DRA Recom. Effect. Rate	ROE	Adopted Effect. Rate	ROE
Test Year 1992								
Bonds	$ 63,720,000	49.25%	9.25%	4.56%	9.25%	4.56%	9.25%	4.56%
Common	65,648,027	50.75	13.00	6.60	11.75	5.96	11.75	5.96
Total	$129,368,027	100.00%		11.16%		10.52%		10.52%
Int. Cover				2.45		2.31		2.31
Test Year 1993								
Bonds	$ 69,375,000	50.85%	9.45%	4.81%	9.45%	4.81%	9.45%	4.805
Common	67,063,157	49.15	13.00	6.39	11.75	5.78	11.75	5.775
Total	$136,438,157	100.00%		11.20%		10.59%		10.58%
Int. Cover				2.33		2.20		2.20
Test Year 1994								
Bonds	$ 71,746,667	51.19%	9.64%	4.93%	9.64%	4.93%	9.64%	4.93%
Common	68,401,108	48.81	13.00	6.35	11.75	5.74	11.75	5.74
Total	$140,147,775	100.00%		11.28%		10.67%		10.67%
Int. Cover				2.29		2.16		2.16

<u>Adopted Summary of Earnings</u>

Table 3, our adopted Summary of Earnings, follows. Its "At Present Rates" reflects the quantities adopted from the initially presented summary quantities in the proceeding before (1) the July 1, 1991 Santa Clara Water District increase in the price of purchased water, (2) the pump tax increase of July 1, 1991 from the same district, and (3) the rate base revisions necessitated by the Further Stipulation for Settlement pertaining to the Austrian Dam revisions (the ALJ's August 27, 1991 Ruling). Its "At Rates Authorized" reflects inclusion of the item cost adjustments and changes in the franchise tax, uncollectibles, and income taxes, as well as the rate base changes necessitated by the three late developments stated above. Thus the Summary sets forth the operating revenues which would have been provided at the rates prevailing when this proceeding began, and those which will be required to produce the 11.75% return on equity we are authorizing for the test years.

Table 3

San Jose Water Company

Adopted Summary of Earnings
(Thousands of Dollars)

	Test Year 1992	Text Year 1993
At Present Rates		
Operating Revenues	68,464.2	71,325.6
Operating Expenses		
Purchased Power	5,224.4	5,474.8
Purchased Water	16,660.0	17,114.0
Purchased Chemical	32.0	32.0
Pump Tax	9,999.2	10,779.8
Payroll	1,536.0	1,617.0
Other O&M	12,681.7	13,213.4
Other A&G and Misc.	10,779.9	11,378.5
Ad valorem Taxes	1,708.8	1,785.0
Payroll Taxes	719.2	751.5
Uncollectibles	145.1	151.1
Bus./Franchise Tax	208.7	217.3
Income Taxes	1,636.4	1,469.1
Total Oper. Expenses	61,331.4	63,983.5
Net Revenue	7,132.8	7,342.1
Rate Base	122,489.8	126,948.0
Rate of Return	5.82%	5.78%
At Rates Authorized		
Operating Revenues	91,463.9	95,180.9
Operating Expenses		
Purchased Power	5,716.8	6,002.3
Purchased Water	22,576.0	23,239.4
Purchased Chemical	32.0	32.0
Pump Tax	14,941.0	16,182.3
Payroll	1,536.0	1,617.0
Other O&M	12,943.9	13,439.7
Other A&G and Misc.	10,591.9	11,282.3
Ad valorem Taxes	1,708.8	1,789.0
Payroll Taxes	719.2	751.5
Uncollectibles	193.8	201.7
Bus./Franchise Tax	205.9	214.3
Income Taxes	7,208.9	6,706.3
Total Oper. Expenses	78,345.9	81,457.8
Net Revenue	13,089.7	13,723.1
Rate Base	121,764.8	126,948.0
Rate of Return	10.52%	10.58%

The $5,916,000 additional operating revenues which were authorized by Commission Resolution No. 3582 with reference to SJWC's Advice Letter No. 233 to be effective July 1, 1991 to cover the increased charges for water purchases from the Santa Clara County Water District, and the $4,941,800 increased pump tax costs effective July 1, 1991 resulting from the same district's action after the expected legislative authorization, and the $640,200 in their various associated changes to the franchise tax, uncollectibles, and income tax components, as well as the Austrian Dam and Austrian Dam CWIP rate base adjustments under the further Stipulation for Settlement, served to produce a net increase in the Test Year 1992 "At Present Rates" Operating Revenues from $68,464,000 to $79,962,200.

The rates of return which we are authorizing SJWC by this decision will produce additional revenues of $10,991,800 over the present $79,962,200 for 1992, an increase of 14.3%. In test year 1993, an additional $3,702,500 will be produced, an increase of 4.1% over the revenues which the existing rates would produce. In conformity with our requirement that Class A water utilities not file general rate applications more frequently than once every three years, a third set of rates in the form of a step increase will be authorized for 1994 to allow for attrition, both operational and financial, after 1993. The operational component, as indicated by the decline in the rate of return at present rates is .04% (5.82%-5.78%). The financial component, as indicated by the difference of 0.06% between the adopted rates of return (10.58% and 10.52%). To offset this combined 0.10% (0.04% + 0.06%) operational and financial attrition we will authorize a 1994 step increase of $292,966, a 0.3% increase.[6]

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6 Using the formula: Rate Base x Rate of Combined Operational and Financial Attrition x Net-to-Gross Multiplier = Step Increase, we find: $126,948,000 x 0.10% x 1.7752 = $225,358.

On or after November 1 in the years 1992 and 1993, SJWC will be authorized to file advice letters with appropriate work papers, with reference to the Adopted Quantities in Appendix C, and in compliance with General Order 96-A, to justify implementation of the step increases herein postulated for each of years 1993 and 1994. These supplemental filings will permit review of achieved rates of return before each step rate is authorized.

Rate Design

Finally, turning to Rate Design, in D.86-05-064 in Order Instituting Investigation 84-11-014 we determined upon a rate design policy which, among other guidelines, included setting Service Charges to allow utilities to recover up to 50% of their fixed costs. By Resolution No. 3582 with reference to SJWC's Advice Letter No. 233 concerned with Purchased Water (supra) we approved Service Charges which approached the 50% goal of the guidelines. The Service Charges established in the Schedules in Appendices A and B to this decision meet this rate design policy while providing that no customer will receive an increase that is more than twice the system average increase. Any remaining revenue requirement has been applied to the commodity block.

Appendix A to this decision sets forth the rate structure approved to be made effective for the year 1992. Appendix B contains the step increases authorized for 1993 and 1994. In that rates very possibly will be revised through advice letter offsets in the period ahead, it is very possible that schedules for 1993 and 1994 predicated upon rates authorized for 1992 may not be the current rates at the time the step rate advice letter filings are to be made. Accordingly, the increases contained in Appendix B can be added to the rates that would otherwise be in effect on the date the particular step increase is to go into effect in order to develop the appropriate rates for filing. The compilation of adopted quantities and the adopted tax calculations are contained in Appendix C to this decision.

Comments on the Proposed Decision
of the Administrative Law Judge

As provided by Public Utilities Code § 311, the Proposed Decision of ALJ Weiss was served on the parties to this proceeding. Staff (Water Branch and DRA) submitted comments. SJWC submitted reply comments.

In commenting on the ALJ's ratemaking treatment of company cars where personal use exceeding 50% was allowed as a deliberately conceived part of an employee's total compensation package, staff asserts again that adoption of the ALJ's resolution of the issue would serve to annul several 1989 decisions to the contrary. Staff argues that the ALJ ignored these decisions and instead relied upon a 1990 decision which, staff asserts, did not really mean what it stated, but was merely affording due process.

But staff misreads the two earlier decisions as absolute prohibition. In the first,[7] we disallowed executive commute expenses considering the compensation paid, and absent any showing of responsibility for emergency calls. In the second,[8] the expense was disallowed because the personal use privilege had reached abusive levels. However, the decision left the door open for a future showing but warned that it would have to be a clear and convincing showing. And in the third and later decision,[9] we set forth suggestions in some detail as to what an acceptable showing must establish, considering the entire compensation package with reference to both local and national job markets. This is not merely affording due process. The ALJ after review of the extensive evidence concluded, as do we, that in this particular

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7 Re San Gabriel Valley Water Co. (1989) 32 CPUC 2d 423.

8 Re San Jose Water Co. (1989) 33 CPUC 2d 302.

9 Re California Water Service (1990) 35 CPUC 2d 428.

factual instance SJWC had presented sufficient facts, surveys, and circumstances to meet these requirements.

With regard to the return on equity capital issue, DRA asserts that the ALJ based his conclusions on misunderstood interpretations of the record. DRA also states that the quantitative determinations to support the conclusions are based on modifications to DRA's financial models which are derived from economic variables that can change. DRA states that the decisions reached by formalistic applications are only guidelines, and implies that the judgment of the analyst is the important factor.

In our order we have reversed the ALJ's proposed decision and adopted the DRA recommendation. We recognize that judgement forms an integral part of any determination of appropriate return on equity. We have found DRA's candid discussion persuasive. We have also taken notice of D.91-11-069 which most recently established a return on equity for California-American Water Company at 12.0%. Since California-American has a significantly higher debt ratio than SJWC, it is clearly reasonable to authorize a return on equity for SJWC less than 12.0%.

__Findings of Fact__

1. SJWC's service territory is efficiently served with satisfactory results and due concern for conservation.

2. SJWC requires additional revenues, but the rates it proposed would produce an unjustified rate of return.

3. SJWC and staff have resolved most areas of dispute, memorializing these agreements in a Stipulation jointly submitted, which Stipulation the ALJ and we determine to be in the public interest.

4. The nature of SJWC's service business requires 24-hour availability, 7 days a week, of certain managers and supervisors who must respond immediately to problems and emergencies; this need justifies availability and use of company vehicles by these individuals.

5. SJWC's policies, with regard to permitting personal use of these vehicles, are cost-effective and reasonable from both operational and total compensation package perspectives.

6. SJWC's aggregate compensation patterns, including compensation attributable to personal use of company vehicles, are below the aggregate average compensation patterns, including compensation attributable to personal use of company cars, of companies, nationally and locally, with which SJWC competes for managerial and supervisory personnel.

7. The adopted Summary of Earnings (Table 1 and 1-A) for test years 1992 and 1993, setting forth operating revenues and expenses at present rates and rate base, reasonably indicates the results of SJWC's operations which can be expected over the two test years.

8. DRA's substitution of a qualitatively based growth rate range for the actual comparable companies' growth rates range in its DCF analysis was justified by its economic and operational risk analysis.

9. Neither SJWC nor DRA provided a persuasive RP analysis.

10. Decision D.91-11-069 authorized California-American Water Company an ROE of 12.0% with an equity ratio of 41%.

11. SJWC has a significantly higher equity ratio than California American Water Company.

12. SJWC's last rate established an average ROE of 12.0%.

13. SJWC's ROE should be reduced from 12.0%.

14. An ROE of 11.75% at this time is just and reasonable as it provides reasonable coverage of the capital costs of the business, including service on the debt and dividends on the stock, while assuring confidence in the financial integrity of the utility, and providing balancing the interests of the investors and ratepayers.

15. SJWC and DRA agree on the capitalization ratios for the years 1992, 1993, and 1994, and it is reasonable to use them in this proceeding to compute rates of return.

16. Rates of return of 10.52%, 10.58%, and 10.66%, respectively, on SJWC's rate base for 1992, 1993, and 1994 are reasonable.

17. The adopted rate of return will require an increase of $10,997,800, or 13.8%, in annual revenue for 1992, an increase of $3,702,500, or 4.1% in 1993, and a further increase of $292,966 or 0.3% in 1994.

18. The adopted rate design is reasonable.

19. The increased rates and charges authorized herein, incorporated as they are with increases resulting from contemporaneous increases caused by the Santa Clara County Water District for purchased water and the pump tax, are justified and reasonable; and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

20. The further increases authorized, as set forth in Appendix B, should be appropriately modified in the event the rate of return on rate base, adjusted to reflect the rates then in effect together with normal ratemaking adjustments for the 12 months ended September 30, 1992 and/or September 30, 1993, exceeds 10.52% and 10.58%, respectively.

21. The calculation of adopted quantities and the adopted tax calculations are contained in Appendix C of this decision.

Conclusion of Law

The application should be granted to the extent provided by the following order, the adopted rates and charges being just, reasonable, and nondiscriminatory.

O R D E R

IT IS ORDERED that:

1. San Jose Water Company (SJWC) is authorized to file on or after the effective date of this order the revised rate schedules for 1992 included in Appendix A. This filing shall comply with General Order 96-A. The effective date of the revised schedules shall be January 1, 1992. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 1, 1992, SJWC is authorized to file an advice letter, with appropriate work papers, requesting the step rate increase attached to this order as Appendix B for the year 1993, or to file for a lesser increase in the event that SJWC's rate of return on rate base, adjusted to reflect the rates then in effect together with normal ratemaking adjustments for the 12 months ending September 30, 1992, exceeds the rate of return adopted in this proceeding for the test year 1992. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their compliance with the order in this application and shall go into effect upon the staff's determination of compliance. Staff shall inform the Commission if it finds that the proposed rates are not in accordance with the Commission's decision, and the Commission may modify them. The effective date of the revised rates shall be no earlier than January 1, 1993 or 40 days after the filing of the advice letter, whichever is later. The revised rates shall apply only to service rendered on or after their effective date.

3. On or after November 1, 1993, SJWC is authorized to file an advice letter, with appropriate work papers, requesting the step rate increase attached to this order as Appendix B for the year 1994, or to file for a lesser increase in the event that SJWC's rate of return on rate base, adjusted to reflect the rates then in effect together with normal ratemaking adjustments for the 12 months ending September 30, 1993, exceeds the rate of return adopted in this proceeding for the test year 1993. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their compliance with the order in this application and shall go into effect upon the staff's determination of compliance. Staff shall inform the Commission if it finds that the proposed rates are not in accordance with the Commission's decision, and the Commission may modify them. The effective date of the revised rates shall be no earlier than January 1, 1994 or 40 days after the filing of the advice letter, whichever is later. The revised rates shall apply only to service rendered on or after their effective date.

This order becomes effective 20 days from today.

Dated December 4, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

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

Neal J. Shulman

NEAL J. SHULMAN, Executive Director

pb

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

Quantity Rates:

Per 100 cu. ft.	$ 1.3070	(I)

Service Charge:

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$ 6.30	(I)
For 3/4-inch meter	6.30	
For 1-inch meter	10.50	
For 1-1/2-inch meter	26.30	
For 2-inch meter	42.10	
For 3-inch meter	78.90	
For 4-inch meter	131.50	
For 6-inch meter	263.00	
For 8-inch meter	420.80	
For 10-inch meter	604.90	(I)

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

SPECIAL CONDITIONS

1. Due to an undercollection in the balancing account, a surcharge of $0.20 per ccf is to be added to the quantity rate for twelve months from the effective date of the Tariff filed by Advice Letter No. 233.

2. Due to the gain on sale of property, a flat surcredit of $0.10 per service connection per month is to be subtracted from the bill for thirty-six billing cycles commencing with billing cycle one on April 3, 1991.

(continued)

Schedule No. 1

(continued)

SPECIAL CONDITIONS

3. Customers who received 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 or agricultural water, shall receive a credit of 50.1 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill.

4. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

SAN JOSE WATER COMPANY

Schedule No. 1A

GENERAL METERED SERVICE

RAINBOWS END

APPLICABILITY

Applicable to general metered water service for former customers of the City of Cupertino residing on Rainbows End in the City of Cupertino, pursuant to Decision 87-12-034 which states in part:

"...b. Service to Rainbows End. From the date the Lease commences through the date it is terminated, the Company will provide water service to any and all customers of Rainbows End (i) pursuant to its rules in effect and on file with the PUC from time to time and (ii) at its rates in effect and on file with the PUC from time to time or at the rates of City in effect from time to time, whichever shall be lower."

TERRITORY

Rainbows End in Cupertino.

RATES

Quantity Rates:

First 500 cu. ft., per 100 cu. ft.	$ 0.6280	(D)
501 - 1,800 cu. ft., per 100 cu. ft.	$ 1.0610	
1,801 - 8,000 cu. ft., per 100 cu. ft.	$ 1.0670	
8,001 - 65,000 cu. ft., per 100 cu. ft.	$ 1.0850	
Over 65,000 cu. ft., per 100 cu. ft.	$ 1.1040	(D)

Service Charge:

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$ 3.45	(D)
For 1-inch meter	8.65	(I)
For 1-1/2-inch meter	17.25	
For 2-inch meter	27.60	
For 3-inch meter	51.75	
For 4-inch meter	86.25	
For 6-inch meter	172.50	
For 8-inch meter	276.00	
For 10-inch meter	396.75	(I)

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

(continued)

Schedule No. 1A

(continued)

SPECIAL CONDITIONS

1. Due to the gain on sale of property, a flat surcredit of $0.10 per service connection per month is to be subtracted from the bill for thirty-six billing cycles commencing with billing cycle one on April 3, 1991.

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

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	
For	2-inch meter	$ 6.00	(I)
For	3-inch meter	9.00	
For	4-inch meter	12.00	
For	6-inch meter	18.00	
For	8-inch meter	24.00	
For	10-inch meter	30.00	(I)
For	12-inch meter	36.00	

SPECIAL CONDITIONS

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 to serve 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 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, are installed according to specifications of the utility, and are maintained to the satisfaction of the utility. The utility may install the standard detector type meter approved by the Board of Fire Underwriters for protection against theft, leakage or waste of water and the cost paid by applicant. Such payment shall not be subject to refund.

(continued)

Schedule No. 4

(continued)

4. For water delivered for other than fire protection purposes, charges shall be made thereof under schedule No. 1. General Metered service.

5. The utility undertakes to supply only such water at such pressure as may be available any time through the normal operation of its system.

6. The minimum diameter for fire protection service shall be two inches, and the maximum diameter shall be not more than the diameter of the main to which the service is connected.

7. Due to the gain on sale of property, a flat surcredit of $0.10 per service connection per month is to be subtracted from the bill for thirty-six billing cycles commencing with billing cycle one on April 3, 1991.

8. All bills 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

Quantity Rates:

Per 100 cu. ft.	$ 1.060	(I)

Service Charge:

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$ 5.40	(I)
For 3/4-inch meter	5.40	
For 1-inch meter	9.00	
For 1-1/2-inch meter	22.50	
For 2-inch meter	36.00	
For 3-inch meter	67.50	
For 4-inch meter	112.50	
For 6-inch meter	225.00	
For 8-inch meter	360.00	
For 10-inch meter	517.50	(I)

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

SPECIAL CONDITIONS

1. Due to an undercollection in the balancing account, a surcharge of $0.020 per ccf is to be added to the quantity rate for twelve months from the effective date of the Tariff filed by Advice Letter No. 233.

(continued)

Schedule No. 6

(continued)

SPECIAL CONDITION

2. Due to the gain on sale of property, a flat surcredit of $0.10 per service connection per month is to be subtracted from the bill for thirty-six billing cycles commencing with billing cycle one on April 3, 1991.

3. Customers who received 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 or agricultural water, shall receive a credit of 50.1 cents per 100 cubic feet on each water bill for the quantities of water used during the period covered by that bill. (T) (T)

4. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

(END OF APPENDIX A)

APPENDIX B

SAN JOSE WATER COMPANY

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase (or decrease) to the rate which would otherwise be in effect on that date.

	1993	1994
SCHEDULE NO. 1 - GENERAL METERED SERVICE		
Quantity Rate:		
For all water, per 100 cu.ft.	$ 0.0020	$ 0.0040
SCHEDULE NO. 1A - GENERAL METERED SERVICE - RAINBOWS END		
Quantity Rate:		
First 500 cu.ft., per 100 cu.ft.	$ 0.004	$ 0.0194
501 - 1800 cu.ft., per 100 cu.ft.	0.004	0.0328
1,801 - 8,000 cu.ft., per 100 cu.ft.	0.004	0.0330
8,001 - 65,000 cu.ft., per 100 cu.ft.	0.004	0.0335
Over 65,000 cu.ft., per 100 cu.ft.	0.004	0.0341
SCHEDULE NO. 6 - RESALE SERVICE		
Quantity Charge		
For all water used, per 100 cu.ft.	$ 0.0000	$ 0.0345

(END OF APPENDIX B)

SAN JOSE WATER COMPANY

ADOPTED QUANTITIES

Name of Company: San Jose Water Company

1. Net-to-Gross Multiplier:	1.7752
2. Federal Tax Rate:	34.12%
3. State Tax Rate:	9.3%
4. Local Franchise Rate:	0.2246%
5. Uncollectible Rate:	0.2119%

Offsettable Items	Test Years	
	1992	1993
6. Purchased Power		
A. Supplier - Pacific Gas & Electric Co. (effective 1/1/91)	.093952	.093952
B. Ccf/KWh - Electric Pump Electric Boosters	.965345	.965345
C. KWh (Total)	60,848,000	63,887,000
D. Average Cost/KWh	$ 0.093952	$ 0.093952
E. Total Cost of Power	$5,716,800	$6,002,300
7. Ad Valorem Taxes	$1,708,808	$1,789,000

8. Number of Services - Meter Size

	1992	1993
5/8 x 3/4	172,498	173,358
3/4	2,637	2,650
1	19,785	19,886
1-1/2	2,709	2,724
2	4,000	4,024
3	1,024	1,033
4	302	305
6	149	149
8	30	30
10	3	3
12	0	0
Total	203,137	204,162

9. Metered Water Sales
Ccf

All usage	53,452,600	56,123,000

SAN JOSE WATER COMPANY

ADOPTED QUANTITIES

10. Number of Services:

	No. of Services 1992	No. of Services 1993	Usage-KCcf 1992	Usage-KCcf 1993	Avg. Use-Ccf/yr. 1992	Avg. Use-Ccf/yr. 1993
Residential/Bus.	201,268	202,158	47,915	50,278	238	249
Industrial	84	84	939	981	11,176	11,673
Public Authority	1,554	1,579	4,152	4,409	2,680	2,799
Resale	31	31	357	365	1,156	1,174
Other	200	200	90	90	450	450
Subtotal	203,137	204,162	53,453	56,123		
Private Fire Prot.	2,169	2,229				
Total	205,306	206,391				
Water Loss:	9.0%	9.0%	5,286	6,550		
Total Water Produced (KCcf)			58,739	61,673		
Pumped Water (KCcf)			24,839	26,903		
Surface Supply			4,278	4,278		
Purchased Water (KCcf)			29,621	30,491		

SAN JOSE WATER COMPANY

INCOME TAX CALCULATIONS

	1992	1993
	(Dollars in Thousands)	
Total Revenue	$90,960.0	$95,180.9
Purchased Power	5,716.8	6,002.3
Purchased Water	22,576.0	23,239.4
Purchased Chemical	32.0	32.0
Pump Tax	14,941.0	16,182.3
Payroll	1,536.0	1,617.0
Other O&M	12,943.9	13,439.7
Other A&G	4,814.0	5,105.0
Ad Valorem Taxes	1,708.8	1,789.0
Payroll Taxes	719.2	751.5
Uncollectible	193.0	200.9
Business/Franchise Tax	204.3	212.7
Subtotal	$65,385.0	$68,571.4
Interest	5,573.0	6,132.0
Total Deductions	$70,958.0	$74,703.4
State Tax Depreciation	5,569.0	5,937.0
State Tax @ 9.3%	1,342.3	1,304.0
Federal Tax Depreciation	3,446.0	4,782.0
Federal Tax @ 34.12%	5,642.6	5,178.3
Total Income Tax	6,984.9	6,482.3

SAN JOSE WATER COMPANY

Comparison of typical bills for residential metered customers of various usage level and average usage level at present and authorized rates for the year 1992 without balancing account amortization.

General Metered Service

(5/8 x 3/4-inch meters)

1992

Monthly Usage	At Present Rates	At Authorized Rates	Percent Increase
(Cubic Feet)			
300	$ 8.11	$ 10.22	26.0%
500	10.62	12.83	20.8
1,000	16.88	19.36	14.7
2,000 (Average)	29.41	32.42	10.2
3,000	41.94	45.48	8.4
4,000	54.47	58.54	7.5
5,000	67.00	71.60	6.9

SAN JOSE WATER COMPANY

SUMMARY OF EARNINGS
(Dollars in Thousands)

At Authorized Rates	1992	1993
Operating Revenues	$90,960.0	$94,662.5
Operating Expenses		
Purchased Power	5,716.8	6,002.3
Purchased Water	22,576.0	23,239.4
Purchased Chemical	32.0	32.0
Pump Tax	14,941.0	16,182.3
Payroll	1,536.0	1,617.0
Other O&M	12,943.9	13,439.7
Other A&G and Misc.	10,591.9	11,282.3
Ad Valorem Taxes	1,708.8	1,789.0
Payroll Taxes	719.2	751.5
Uncollectible	193.0	200.9
Business/Franchise Tax	204.3	212.7
Subtotal	71,162.9	74,749.1
Net Before Taxes	19,797.1	19,913.4
Income Taxes	6,984.9	6,482.3
Total Operating Expenses	78,147.8	81,231.4
Net Revenue	$12,812.8	$13,431.1
Rate Base	121,764.8	126,948.0
Rate of Return	10.52%	10.58%

(END OF APPENDIX C)