

Decision 96-07-036 July 17, 1996

Background

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA
In the Matter of the Application
of SAN JOSE WATER COMPANY
(U-168-W), a corporation, for an Application 95-08-038
order authorizing it to increase (Filed August 14, 1995)
rates charged for water service.

ORIGINAL

Robert A. Loehr, Attorney at Law,
for San Jose Water Company, applicant.

Francis S. Ferraro, for California Water
Service Company, interested party,
Peter G. Fairchild, Attorney at Law,
and Sung Han, for the Division
of Ratepayer Advocates.

INTERIM OPINION

Summary of Decision

This decision authorizes the following rate increases to
San Jose Water Company (SJWC):

	Amount	percent
	(in thousands of dollars)	
1996	790.7	0.836
1997	1,211.6	1.27
1998	1,404.3	1.45
1999	1,404.0	1.45

These increases are based on rates of return on ratebase of 9.28%

and 9.25% for the years 1996 and 1997, respectively. The increases

for 1998 and 1999 are to offset operational and financial attrition.

The filing was for a three-year or 36-month period beginning
Case Plan for Class A Water Utilities, (1990) 37 CP0224 175. The
plan provides that for utilities with a July filing, the calendar
year following the year of filing is the first test year, and
attrition filings are permitted for both the full calendar year
following the second test year and for the following partial year.

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Background

SJWC is a public utility corporation with headquarters in San Jose, California. It provides water service to domestic and industrial customers in Los Gatos, Saratoga, Monte Sereno, Campbell, and portions of San Jose, Cupertino, and Santa Clara, and in (U) territories within the County of Santa Clara surrounding and adjacent to these municipalities. A description of S JWC's operations is included in Chapter 3 of SJWC's Report on the Results of Operation (Exhibit 1). At the end of 1994, SJWC served 205,522 customers.

On August 14, 1995, SJWC filed this application to increase water rates for test years 1996 and 1997 and attrition year 1998.¹ Specifically, SJWC requested \$3,867,000 (or 4.16%) for 1995, \$4,348,000 (or 4.43%) for 1996, and \$1,713,000 (or 1.67%) for 1997. SJWC requests approval of rates to produce rates of return on ratebase of 10.38% in 1995, 10.34% in 1996, and 10.34% in 1997. These rates of return are based on a constant return on equity of 12.25% for each year. SJWC states that it will be unable to achieve the requested rate of return for 1995 because the proposed rates cannot become effective under the Commission's rate case plan until March 1996. SJWC believes that its requested rates of return are the minimum rates of return recovery to enable SJWC to maintain its credit rating and attract new capital.

1995	3,867,000	4.16%
1996	4,348,000	4.43%
1997	1,713,000	1.67%

The filing was for a three-year or 36-month period beginning in mid-1996 and extending through mid-1999, pursuant to the Rate Case Plan for Class A Water Utilities, (1990) 37 CPUC2d 175. The plan provides that for utilities with a July filing, the calendar year following the year of filing is the first test year, and attrition filings are permitted for both the full calendar year following the second test year and for the following partial year.

According to SJWC, the rate increases are necessary to cover increases in operating expenses, particularly water-quality expenses, and in ratebase since SJWC's last general rate case.

Public Meeting

A duly noticed public meeting on the application was conducted by Division of Ratepayers Advocates' (DRA) Project Manager Sung Han on September 28, 1995, in San Jose. The meeting was attended by only 10 members of the public, four of whom were representatives of the Santa Clara Valley Water District and other water utilities which work closely with SJWC. Members of the public were allowed to provide their comments. The people who provided comments were opposed to the proposed increase. They asked that the Commission deny the increase.

Based on Sung Han's memorandum about the meeting, it was decided that a public participation hearing was not necessary.

DRA's Reports

DRA conducted its investigation of the requested rate increase. Based on its investigation, DRA prepared its reports on SJWC's results of operation and cost of capital. DRA concluded that SJWC's current rates were excessive and recommended that SJWC's rates be reduced for test years 1996 and 1997.

Evidentiary Hearing

Evidentiary hearings were held from December 11, 1995 through December 18, 1995 in San Francisco before Administrative Law Judge (ALJ) Anand Gardé. Other than DRA and SJWC, only California Water Service Company (CWS) appeared as an interested party. At the hearing, SJWC and DRA announced that they had reached agreement on all issues except the following:

1. Disbursement of funds received from the City of San Jose (City) pursuant to a billing contract.
2. Rate of return on common equity.

3. Treatment of interest during construction.

CWS did not object to the agreement reached between SJWC and DRA. Further, CWS stated that the two issues of interest to it were Issues 1 and 3 listed above.

Evidence on the contested issues was taken during the hearing. SJWC and DRA provided testimony. During the hearing the ALJ concluded that additional information on the issue of treatment of interest during construction was needed to develop a complete record. Accordingly, it was agreed that further hearing on the issue will be held in the second phase of the proceeding. The first phase of the proceeding which addressed all the remaining issues was to be submitted upon filing of concurrent reply briefs on January 19, 1996.

On February 14, 1996, SJWC, DRA and CWS filed a joint motion for adoption of a settlement. At the evidentiary hearing, parties had agreed to file the motion on or before January 4, 1996. However, since the joint motion for adoption of the settlement was not filed until February 14, 1996, the submission of the first phase of the proceeding was delayed to that date.

The Settlement--Results of Operations

The settlement refers to resolution of all issues, except the three issues stated above, as set forth in late-filed Exhibit 16. The original estimates of SJWC and DRA, as well as agreed-upon estimates for results of operations are shown in Tables 1 and 2.

Other elements of ratemaking are included in Appendix O.

Water Service Company (CWS) appeared as an interested party. At the hearing, SJWC and DRA announced that they had reached agreement on

all issues except the following:

- 1. Disbursement of funds received from the City of San Jose (City) pursuant to a billing contract.

- 2. Rate of return on common equity.

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

Excludes Captz. INTEREST

Test Year 1996

Present Rates	Original	Revised	Difference	Revised	Proposed Rates	
					Original	Adopted
Operating Revenues	\$92,549.3	\$93,577.3	\$1,028.0	\$93,577.3	\$94,953.3	\$93,577.3
Other water revenues	626.0	626.0	0.0	626.0	626.0	626.0
Def. Rev. CIAC	397.0	397.0	0.0	397.0	397.0	397.0
Total Revenues	\$93,572.3	\$94,600.3	\$1,028.0	\$94,600.3	\$95,976.3	\$94,600.3
Operating Expenses						
Purchased Water	\$18,837.0	\$18,837.0	\$0.0	\$18,837.0	\$18,940.0	\$18,837.0
Pump Taxes	17,050.0	18,961.0	\$1,911.0	\$18,961.0	18,940.0	18,961.0
Purchased Power	5,700.0	5,720.4	\$20.4	\$5,720.4	5,830.0	5,720.4
Payroll	14,767.7	11,767.0	(\$3,000.7)	\$11,767.0	13,946.0	11,729.0
Billing Contract	-150.0	-150.0	0.0	-150.0	-244.0	-200.0
Chem & Water Quality	1,615.4	773.0	(\$842.4)	\$773.0	768.0	773.0
Other Oper. & Maint. Exp.	6,413.6	5,450.2	(\$963.4)	\$5,228.3	5,150.0	5,314.1
Admin. & General	6,391.7	4,877.1	(\$1,514.6)	\$4,913.1	4,451.6	4,913.1
Ad Valorem Taxes	1,973.5	1,974.0	\$0.5	\$1,967.7	1,967.7	1,967.7
Payroll Taxes	883.0	863.0	(\$20.0)	\$863.0	871.0	863.0
Depreciation & Amort.	8,469.5	8,451.8	(\$17.7)	\$8,429.8	8,063.8	8,429.8
subtotal	\$61,952.5	\$75,534.5	\$13,582.0	\$75,216.3	76,706.1	75,306.1
Uncollectible	210.0	213.4	\$3.4	\$212.5	215.7	212.5
Local Franch. tax	269.5	273.6	\$4.1	\$272.4	276.9	272.4
Business Licenses	31.8	31.8	0.0	\$31.8	31.8	31.8
State Income Tax	567.2	967.7	\$400.5	\$1,058.8	1,244.5	979.7
Federal Income Tax	2,394.2	3,748.8	\$1,354.6	\$3,933.1	4,745.3	3,802.2
Total Operating Expenses	\$85,425.2	\$90,769.8	\$5,344.6	\$90,724.9	\$93,220.3	\$90,606.7
Net Operating Revenue	\$8,147.1	\$13,830.5	\$5,683.4	\$13,875.4	12,756.0	13,993.6
Weighted Avg. Rate Base	\$158,383.9	\$155,782.7	(\$2,601.2)	\$155,092.6	146,961.2	155,092.6
Rate of Return %	5.14	8.88	3.74	8.95	8.68	9.02
Proposed Rates						
Operating Revenues	\$100,414.3	\$97,418.3	(\$2,996.0)	\$93,739.3	\$90,575.2	\$94,280.5
Other water revenues	976.0	976.0	0.0	976.0	976.0	976.0
Def. Rev. CIAC	397.0	397.0	0.0	397.0	397.0	397.0
Total Revenues	\$101,787.3	\$98,791.3	(\$2,996.0)	\$95,112.3	\$91,948.2	\$95,653.5
Operating Expenses						
Purchased Water	\$18,837.0	\$18,837.0	\$0.0	\$18,837.0	\$18,940.0	\$18,837.0
Pump Taxes	17,050.0	18,961.0	\$1,911.0	\$18,961.0	18,940.0	18,961.0
Purchased Power	5,700.0	5,720.4	\$20.4	\$5,720.4	5,830.0	5,720.4
Payroll	14,767.7	11,767.0	(\$3,000.7)	\$11,767.0	13,946.0	11,729.0
Billing Contract	-150.0	-150.0	0.0	-150.0	-244.0	-200.0
Chem & Water Quality	1,615.4	773.0	(\$842.4)	\$773.0	768.0	773.0
Other Oper. & Maint. Exp.	6,413.6	5,410.0	(\$1,003.6)	\$5,410.0	5,168.6	5,314.1
Admin. & General	6,391.7	4,913.1	(\$1,478.6)	\$4,913.1	4,451.6	4,913.1
Ad Valorem Taxes	1,973.5	1,974.0	\$0.5	\$1,967.7	1,967.7	1,967.7
Payroll Taxes	883.0	863.0	(\$20.0)	\$863.0	871.0	863.0
Depreciation & Amort.	8,469.5	8,451.8	(\$17.7)	\$8,429.8	8,063.8	8,429.8
subtotal	\$61,952.5	\$75,520.3	(\$13,532.2)	\$75,398.0	76,724.9	75,346.1
Uncollectible	228.7	222.0	(\$6.7)	\$213.9	231.7	214.2
Local Franch. tax	325.0	285.0	(\$40.0)	\$274.2	297.6	274.7
Business Licenses	31.8	31.8	0.0	\$31.8	31.8	31.8
State Income Tax	1,018.3	1,368.3	\$350.0	\$1,036.1	657.0	1,052.9
Federal Income Tax	3,956.1	5,277.8	\$1,321.7	\$4,011.0	2,471.0	4,078.4
Total Operating Expenses	\$87,512.5	\$92,705.0	\$5,192.5	\$92,740.0	\$90,965.0	\$90,965.0
Net Operating Revenue	\$14,271.8	\$16,065.3	\$1,793.5	\$14,147.3	11,534.2	14,392.9
Weighted Avg. Rate Base	\$158,383.9	\$155,782.7	(\$2,601.2)	\$155,092.6	146,961.2	155,092.6
Rate of Return %	9.01	10.33	1.32	9.12	7.85	9.28

San Jose Water Company
 TABLE 2
 Adopted Summary of Earnings
 (Dollars in Thousands)

Present Rates	Test Year 1997		Utility Exceeds		Original	Adopted
	Original	Revised	Difference	Revised		
Operating revenues	\$ 92,676.0	\$ 93,694.0	\$ 1,018.0	\$ 93,694.0	\$ 95,202.9	\$ 93,694.0
Other water revenues	626.0	640.0	14.0	640.0	626.0	640.0
Def. Rev. CIAC	418.0	418.0	0.0	418.0	418.0	418.0
Total Revenues	93,720.0	94,752.0	1,012.0	94,752.0	96,246.9	94,752.0
Operating Expenses						
Purchased Water	18,837.0	18,837.0	0.0	18,837.0	16,954.0	18,837.0
Pump Taxes	17,050.0	16,977.0	(73.0)	16,977.0	19,020.0	16,977.0
Purchased Power	5,703.0	5,723.0	20.0	5,723.0	5,842.0	5,723.0
Payroll	14,768.7	11,797.0	(2,971.7)	11,797.0	13,946.0	11,797.0
Billing Contract	-150.0	-150.0	0.0	-150.0	-244.0	-200.0
Chem. & Water Quality	1,512.0	794.0	(718.0)	794.0	765.0	794.0
Other Oper. & Maint. Exp.	5,204.3	5,704.3	500.0	5,704.3	5,105.0	5,801.3
Admin. & General	5,081.7	4,938.9	(142.8)	4,938.9	4,618.9	4,937.6
Ad Valorem taxes	1,973.5	2,047.1	73.6	2,047.1	1,974.0	2,041.8
Payroll taxes	883.1	891.0	7.9	891.0	879.0	891.0
Depreciation & Amort.	8,655.2	8,634.6	(20.6)	8,634.6	8,063.8	8,613.3
subtotal	79,518.5	76,193.9	(3,324.6)	76,193.9	76,943.7	76,213.0
Uncollectible	210.0	225.0	15.0	225.0	216.3	212.8
Local Franch. tax	301.3	272.8	(28.5)	272.8	278.2	272.8
Business Licenses	31.8	31.8	0.0	31.8	31.8	31.8
State income tax	474.0	869.9	395.9	869.9	1,155.6	869.3
Federal Income Tax	1,782.5	3,272.4	1,489.9	3,556.8	4,439.0	3,374.6
Total Operating Expenses	82,318.1	80,865.8	(1,452.3)	81,037.5	83,063.3	80,974.3
Net Operating Revenue	11,401.9	13,886.2	2,484.3	13,714.5	13,183.6	13,777.7
Weighted Avg. Rate Base	165,452.6	161,312.3	(4,140.3)	160,643.8	149,526.2	160,643.8
Rate of Return %	6.89	8.54	1.65	8.54	8.82	8.55
Proposed Rates						
Operating revenues	\$ 102,254.9	\$ 98,719.5	\$ (3,535.4)	\$ 95,085.5	\$ 91,472.2	\$ 95,355.5
Other water revenues	976.0	819.4	(156.6)	819.4	819.4	819.4
Def. Rev. CIAC	418.0	418.0	0.0	418.0	418.0	418.0
Total Revenues	103,648.9	99,956.9	(3,692.0)	96,322.9	92,709.6	96,602.9
Operating Expenses						
Purchased Water	18,837.0	18,837.5	0.5	18,837.5	18,837.5	18,837.0
Pump Taxes	17,050.0	16,976.5	(73.5)	16,976.5	16,976.5	16,977.0
Purchased Power	5,700.0	5,723.0	23.0	5,723.0	5,710.0	5,723.0
Payroll	14,768.7	11,797.0	(2,971.7)	11,797.0	13,005.0	11,797.0
Billing Contract	-150.0	-150.0	0.0	-150.0	-244.0	-200.0
Chem. & Water Quality	1,615.4	794.0	(821.4)	794.0	768.0	794.0
Other Oper. & Maint. Exp.	5,204.0	5,890.0	686.0	5,890.0	5,105.0	5,801.3
Admin. & General	5,081.7	4,938.9	(142.8)	4,938.9	4,611.5	4,937.6
Ad Valorem taxes	1,973.5	2,047.1	73.6	2,047.1	2,046.1	2,041.8
Payroll taxes	883.1	891.0	7.9	891.0	878.0	891.0
Depreciation & Amort.	8,655.2	8,634.6	(20.6)	8,634.6	8,098.3	8,613.3
subtotal	79,818.6	76,380.4	(3,438.2)	76,259.0	75,791.9	76,213.0
Uncollectible	232.9	224.6	(8.3)	224.6	219.3	217.0
Local Franch. tax	330.3	287.9	(42.4)	287.9	277.7	278.2
Business Licenses	31.8	31.8	0.0	31.8	31.8	31.8
State income tax	1,018.3	1,324.2	305.9	1,324.2	789.8	1,040.4
Federal Income Tax	3,956.1	4,981.7	1,025.6	5,061.1	2,971.3	3,955.3
Total Operating Expenses	85,156.2	83,298.9	(1,857.3)	81,431.6	80,042.0	81,743.9
Net Operating Revenue	18,492.7	16,658.0	(1,834.7)	14,507.9	12,662.6	14,859.0
Weighted Avg. Rate Base	165,452.6	161,312.3	(4,140.3)	160,643.8	149,537.9	160,643.8
Rate of Return %	11.18	10.33	(0.85)	9.03	8.47	9.25

A brief explanation of the resolution of the differences between the parties is included in Appendix D.

In addition to the stipulation about results of operations, parties also agree that SJWC should be authorized to adjust its rates for 1998 and 1999 to offset the effects of operational and financial attrition. Operational attrition is the change in rate of return on ratebase from 1996 to 1997, as calculated by using present rates for those years shown in Tables 1 and 2. Financial attrition is the difference between the authorized rates of return on ratebase for 1996 and for 1997.

We are presented with a proposed settlement. Except for three issues, the settlement has the unanimous support of all active parties. We will adopt those portions of the settlement which are supported by all parties. We find that those portions of the settlement meet the criteria for approval of all-party settlement set forth in our decision in San Diego Gas & Electric Company's general rate case Decision (D.) 92-12-019.

(a) The settlement commands support of all active parties to this proceeding;

(b) Each party was adequately represented. We are confident that DRA adequately represents the interests of the ratepayers;

(c) Our independent review has revealed that no terms of this settlement contravene any statutory provision or any decision of the Commission and

(d) This settlement, with its tables and explanations conveys to us sufficient information to permit us to discharge our future regulatory obligations with respect to the parties and affected

ratepayers. By adopting this stipulation, we fulfill our primary obligation of setting just and reasonable rates.

We will discuss the unresolved issues below. Contract with the City

In August 1993, SJWC entered into a contract with the City to perform the billing and cash receipts functions for the City's Recycle Plus Program (garbage services). The City also contracts with private garbage collection companies to collect and dispose of 160,000 city residents' garbage. The City provides all service and recordkeeping functions related to garbage service and provides SJWC with a billing file for all bills to be rendered each day of the month. SJWC then produces and mails the bills and receives and applies all cash receipts. This contract allows SJWC to recover the cost of some of its excess capacity. The contract is in the second year of a one-year renewable contract and can be terminated by the City or SJWC upon notice.

The contract provides approximately \$244,000 in annual revenues with associated costs of \$200,000. These are "sunk" costs which means they will continue unabated if SJWC did not participate in this billing contract.

According to SJWC, all risks related to this contract are borne by SJWC and should the City not renew the contract, SJWC will suffer the loss not only of its share in this contract, but also the water ratepayers' share. For rate-making purposes, the ratepayers are guaranteed the benefits of the contracts until the rates produced by a next General Rate Case (GRC) are in effect. Therefore, SJWC has taken the position that the cost-savings benefits of this contract should be shared between SJWC and its ratepayers. SJWC believes a 75-25 split of the cost

reduction between the water customers and the utility is not equitable under the circumstances. For this reason, SJWC has only reduced its revenue requirement by \$150,000 for each of the test years.

DRA disagrees with SJWC's position. DRA contends that since the ratepayers pay for all expenses, overheads, and return on the equipment and plant in connection with the billing contract, the ratepayers should receive a credit for the full amount of revenues received by SJWC for providing the billing service. DRA recommends that SJWC's revenue requirement should be reduced by the full amount of \$244,000, instead of the \$150,000 proposed by SJWC, for each of the test years.

Discussion

SJWC contends that all risks related to the contract are borne by SJWC's shareholders. We agree.

One of the major concerns expressed by SJWC is that the City might terminate the contract during this rate case cycle. If that occurs SJWC will lose the \$244,000 revenue it receives from the City while the adopted rates could not be adjusted for the revenue loss until SJWC's next GRC. We recognize SJWC's concerns because the contract allows either party to terminate the contract upon notice.

The City of San Jose is currently pleased with SJWC's performance under the contract (see Roth's testimony, Vol. 4, Tr. 346). Still, this is not a guarantee that the contract will be continued and renewed. Should the City terminate the contract or refuse to renew it, SJWC's shareholders will risk sustaining a recurring revenue deficit until the next GRC establishes new rates.

Second, SJWC asserts that it bears additional risk due to the possibility of making errors in executing the contract,

i.e., making billing or other errors. According to the testimony provided by Roth, it is clear that errors could be made in the execution of the contract by SJWC's employees, which is evident from the following response by Roth to questions by the ALJ:

Q Earlier you testified that the City provides you the data through some electronic medium, that you use to do your billing; is that correct?

A Yes, sir.

Q Are you liable for errors made by the City in its data?

A No, we are not.

Q Then what other errors could you possibly make?

(Laughter.)

THE WITNESS:

Believe me, we could see things happen. The mail could get lost in our room, there could be (shaking head) - the bills maybe didn't go out. The tape could be mishandled, could be damaged during the retrieval of the data on the tape. You know, the envelopes could be--for this--could have the wrong coding on it and it could slow up the process of remitting the cash when it's actually returned to our facility. (Tr. Vol. 4, pages 34, 345.)

Second, SJWC asserts that it bears additional risk due to the possibility of making errors in executing the contract, sustaining a recurring revenue deficit until the next GRC establishes new rates.

We recognize that it could be possible for SJWC's employees to make errors in providing the billing service to the City. For this reason we acknowledge that SJWC's shareholders bear some risk in this regard. We do not believe, however, that ratepayers should be held responsible for errors made by SJWC's employees while performing unregulated business.

We do, however, believe that businesses conducted using regulated assets paid for by ratepayers should produce benefits to ratepayers. We find that SJWC's contract with the City is advantageous to ratepayers since the additional revenue generated by using excess capacity in billing lowers the overall operational costs of the billing process. The excess billing capacity had existed in SJWC's systems prior to SJWC's purchase of additional machinery. In fact, SJWC had successfully performed the City's billing for one year before new equipment was purchased. This indicates that SJWC's ratepayers would continue to pay for this excess capacity whether or not SJWC engaged in a revenue producing venture using the idle capacity. We believe SJWC's ratepayers stand to benefit from the utilization of the excess capacity.

Profit Sharing

We do not accept SJWC's 75-25 risk-sharing proposal related to the contract because in light of all the facts before us, the magnitude of risk identified by the company does not support a 75 percent allocation of benefits to SJWC's shareholders. On the other hand, we find DRA's proposal unfair to shareholders and unnecessarily penalizing SJWC's management for utilizing excess capacity to defray portions of operating costs. Management must be encouraged to increase efficiency and productivity to benefit ratepayers. For these reasons, we decline to adopt DRA's proposal.

We believe a 50-50 sharing of the profit accrued from utilization of excess capacity is fair to both ratepayers and shareholders. Ratepayers will receive dual benefit from reduced operating expenses in addition to allocation of profits which further reduces their rates. Shareholders will also benefit, albeit in small ways, since the profit will be shared equally with ratepayers.

SJWC identifies \$200,000 as the associated "unavoidable" sunk cost. The remaining \$44,000 is described by SJWC as profit. DRAC claims that on the record in this proceeding, SJWC has failed to carry its burden of showing that the Contract with the City of San Jose produces any profits over and above the costs already being underwritten by ratepayers. We agree with DRAC, in part, that the evidentiary record on this point is weak. However, we do wish to take this opportunity to support appropriate uses of excess capacity to the benefit of ratepayers and shareholders. Accordingly, we will require SJWC to reduce its revenue requirement by \$200,000 in the interim and direct it to file an advice letter within 60 days from the effective date of this decision to allocate the remaining \$44,000, or any such profit SJWC can identify and substantiate equally between shareholders and ratepayers.

SJWC should in its advice letter adequately substantiate the profit it claims exists in the contract with the City of San Jose by including a detailed accounting of expenses related to the performance of billing and cash collection for the City of San Jose. If SJWC does not file an advice letter as described in this order, the Commission Advisory and Compliance Division will prepare a resolution for Commission's consideration to allocate the remaining \$44,000 included in the contract with the City of San Jose to be credited to ratepayers.

The sharing ratio adopted here depends heavily on the type of record that was developed in this case; and this effort did not benefit from a generic Commission policy for incentives, or from examples in prior water decisions of this type of revenue sharing. Until such policy is developed, individual cases will continue to reflect the totality of the circumstances, and will probably bring an increasingly sharp focus to factual issues allocating sunk costs, contract specific incremental costs, and contract profits. In light of these considerations, we note that our decision in this case should not be used as a precedent in future cases concerning the sharing of revenue and profits resulting from unregulated businesses in water cases by ratepayers and shareholders.

Cost of Capital Rate of Return

The capital structure of a utility generally consists of three components: long-term debt, preferred stock, and common equity. The ratio of the three components to total capital is known as the capital ratio. Rate of return is a composite value of capital costs expressed as the total weighted cost of long-term debt, preferred stock, and common equity. The determination of the cost of long-term debt and preferred stock is based primarily on recorded costs; however, estimates must be made for the costs associated with future debt or preferred stock financing. Determination of the cost of common equity is more difficult because of the need for consideration of additional factors, such as business and financial risks, investor expectations, ratepayer interest, and capital ratios.

SJWC and DRA have no disagreement regarding SJWC's capital structure, cost of long-term debt, and preferred stock costs for the years 1996, 1997 and 1998. The only disagreement involves the appropriate return on common equity (ROE). SJWC is

requesting a constant ROE of 12.25% for the three years. DRA recommends a ROE of 9.90% for the three years.

Table 3 shows the comparison of SJWC's and DRA's rates of return calculations.

From examples in water rate decisions or from examples in other water decisions, individual cases will be developed, such policy is developed, and will continue to reflect the totality of the circumstances, and will probably bring an increasingly sharp focus to actual issues.

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TABLE 3

SAN JOSE WATER COMPANY
(U-168-W)
COMPARISON OF SJWC REQUESTED AND DRA RECOMMENDED
RATE OF RETURN
FOR TEST YEARS 1996 AND 1997

SJWC Requested			DRA Recommended		
Capital Structure	Cost Factor	Weighted Cost	Capital Structure	Cost Factor	Weighted Cost
Debt	49.73%	8.34%	Debt	50.24%	4.17%
Common Equity	50.27%	12.25%	Common Equity	49.76%	6.10%
Total	100.00%	10.31%	Total	100.00%	10.27%
Test Year 1996			Test Year 1997		

E. WHAT

SJWC and DRA relied on two market-based financial models, the discounted cash flow model (DCF) and the risk premium analysis model (RP). These models provide a range of ROE appropriate for a utility. The DCF model measures an investor's expected rate of return on equity. The RP model measures the additional compensation that investors in common stock expect over investments in bonds.

SJWC conducted RP and DCF analysis specifically for SJWC and arrived at the following results:

Using a RP analysis with a RP factor of three percent above the cost of debt SJWC computed a ROE of 11.7%.

Based on DCF analysis using average of five- and 10-year historical data SJWC computed a ROE of 12.21%.

DRA determined a reasonable rate of return range for SJWC by applying the DCF and RP analysis to a group of comparable water utilities.

Based on its analysis, DRA concluded that a reasonable range of ROE is from 9.15% to 10.33% the midpoint of which is 9.8%.

Both SJWC and DRA claim that their respective analysis is superior and that the other's analysis is flawed.

SJWC's Position

SJWC states that the basis point spread in authorized ROEs between energy and water utilities, whether individually or as a group, represents an important benchmark in the determination of the ROE for SJWC in the current proceeding. According to SJWC, absent a structural change in the risk profile of either industry, investors expect the basis point spread in authorized ROEs to remain approximately the same. Therefore, the

2003-08-08

current and historical spreads between authorized ROEs for energy and water utilities, individually or as an average, are extremely important and useful in the determination of a ROE for SJWC in the current proceeding.

In November 1995, the Commission authorized a ROE of 11.6% for the energy utilities. SJWC's analysis, based on the traditional spread between the ROEs for energy utilities and water utilities, shows that SJWC should be authorized a ROE in the range of 10.65% to 10.82%.

SJWC states that as a single-district water company it faces higher business risk because sales volatility will impact the earnings ability of a single-district water company more than the earnings ability of a multidistrict water company. SJWC asserts that a ROE of 12.25% is necessary for SJWC to attract investors in its common stock.

DRA's Position

DRA believes that SJWC's proposed ROE of 12.25% is unrealistic because SJWC's own analysis does not support this high ROE.

DRA believes that its DCF and RP analyses for a group of comparable water companies provide a better result because they tend to correct company-specific aberrations. According to DRA, results derived from company-specific analysis can be biased.

DRA also takes issue with SJWC's attempt to determine a ROE on the basis of historical spread between the ROEs authorized for energy utilities and water utilities. DRA states that the Commission has never relied on any such spread to determine a reasonable ROE for an individual utility. DRA also points out that the spread between the authorized ROEs for energy utilities and water utilities ranges from 55 basis points to 185 basis

points. According to DRA, under the Commission's present method of practice, the search for a constant spread would prove futile because investors' perception of relative risks of the two industries is subject to continued change.

DRA recommends that, given its relatively low risk, SJWC should be authorized a return of equity of 9.90% or, if approximately the midpoint of the range investors would reasonably expect to earn from a comparable group of water utilities.

Discussion

Both DRA and SJWC relied on financial models in support of their recommendations. We believe that results of various financial models are good starting points as well as analytical guides for establishing ROE. However, the actual determination of a reasonable ROE is a matter of judgment.

In applying that judgment to the evidence before us, we give more weight to the recommendation of DRA. We agree, for example, that DCF and RP analyses for a comparable group of utilities provide better results because such analyses tend to correct company-specific aberrations. We also agree with DRA that there is no constant spread between the ROEs authorized for energy utilities and water utilities. There is no reason that ROEs for energy and water utilities should move in lockstep, because to do so ignores not only the underlying financial criteria (e.g., debt-equity ratios, interest coverage, etc.) but also the relative financial business risks faced by each utility sector. In the past we have considered water utilities to be lower risk investments than energy utilities. With the imminent restructuring of the electric industry, the difference in business risk between water utility sector and the electric utility sector may become even more significant from an

investor's point of view. Also, business risks of water utilities are minimized because a variety of mechanisms exist through the general rate case process to address any increased risks resulting from the costs of water shortage or water quality problems. These mechanisms include revising sales forecasts, inclusion of needed capital improvements in forecasted plant addition, and pass-throughs (through balancing account treatment) of any increase in cost of purchased water or power.

Based on the above, we conclude that a ROE of 10.20% is appropriate and reasonable for SJWC. We believe this ROE will fully recognize the company specific operating and business risks affecting the investment of SJWC's shareholders and the fact that SJWC is a single-district water utility. Accordingly, the adopted ROE is 30 basis points above DRA's recommendation.

This adopted ROE is comparable with the more recent adopted ROEs for other water companies. We will adopt a ROE of 10.20% for SJWC. This adopted ROE will produce overall rates of return on rate base of 9.28% and 9.25% for 1996 and 1997 respectively.

It was proposed to change its rate-making practices. SJWC followed the same procedure in its next GRC (1992) and again made no mention of capitalization of IDC on CWP.

In this proceeding, SJWC followed its practice of not

Recent authorized returns for Class A water utilities are:

	Decision	ROR	ROE
San Gabriel Valley	95-06-017	10.46	11.10
Cal-Water Service	95-08-058	9.84	11.05
Southern California Water	95-12-027	9.32	10.40
Apple Valley Ranchos	95-12-028	10.04	10.40
Suburban Water Systems	96-04-076	9.15	10.10
Cal-Water Service	96-06-034	9.32	10.30

Treatment of Interest During Construction

On November 14, 1986, the Commission issued its Order Instituting Investigation (I-86-11-019) into the ratemaking implications of the Tax Reform Act of 1986 (TRA 86). The Commission issued D.88-01-061 in I-86-11-019 which among other things, addressed the issue of capitalization of interest during construction (IDC) on construction work in progress (CWIP).

Before the enactment of the TRA 86, water utilities were authorized to include CWIP in ratebase. However, water utilities were not allowed to capitalize IDC in CWIP. For reasons yet unexplained, SJWC concluded that D.88-01-061 allowed it to capitalize IDC on CWIP and include CWIP plus capitalized IDC in ratebase. In its next GRC proceeding (1989 GRC), following the issuance of D.88-01-061, SJWC included CWIP plus capitalized IDC in its ratebase. SJWC compensated for capitalizing IDC by reducing its interest cost component in the cost of capital and rate of return calculation by a portion of the IDC capitalized. While SJWC made this significant change in the treatment of IDC, it did not alert DRA or the Commission that it was proposing to change its ratemaking practices. SJWC followed the same procedure in its next GRC (1992) and again made no mention of capitalization of IDC on CWIP.

In this proceeding, SJWC followed its practice of not mentioning the capitalization of IDC on CWIP. However, this time the DRA analysts discovered that SJWC was capitalizing IDC on CWIP, and challenged SJWC on this issue. DRA contends that SJWC is receiving a return on CWIP twice, and that ratepayers are adversely affected by SJWC's treatment of IDC.

SJWC contends that its treatment of IDC simplifies bookkeeping. As to the impact on ratepayers of this treatment, SJWC contends that capitalization of IDC on CWIP does not change

SJWC's revenue requirement because an adjustment is made to the interest cost component in the cost of capital and rate of return calculations.

In addition to SJWC, CWS is interested in this issue and would like to follow SJWC's procedure of capitalizing IDC on CWIP in its future GRCs.

At the evidentiary hearing in Application 95-08-038, SJWC failed to convince the assigned ALJ that capitalization of IDC on CWIP does not change SJWC's revenue requirement for

ratemaking purposes. To allow SJWC and CWS an opportunity to demonstrate that its treatment of IDC on CWIP is revenue neutral, the assigned ALJ established a second phase of this proceeding to address this issue.

For setting rates in this phase of the proceeding, it was agreed that DRA's method of excluding IDC from CWIP in ratebase will be used. It was also agreed that SJWC will be allowed to establish a memorandum account to track the difference of revenues collected by SJWC between using DRA's treatment and SJWC's treatment of IDC on CWIP in ratebase. The disposition of the memorandum account will be determined in the second phase of the proceeding.

Comments on ALJ's Proposed Decision

ALJ's proposed decision was filed and mailed to the parties on March 27, 1996. SJWC and CWS filed comments on the proposed decision. DRA filed reply comments. The alternate decision by Commissioner Neepser was filed and mailed to parties on June 28, 1996. Comments were filed by DRA and SJWC. After reviewing the comments, we have made changes to the authorized ROE and the treatment of profits from the contract with the City of San Jose. These changes are discussed under the appropriate headings. In addition, we are correcting certain errors in the proposed decision.

Findings of Fact

1. As set forth in Exhibit 16 and the motion for adoption of settlement, SJWC, DRA, and CWS have reached settlement on all contested issues except the following:

(a) Disbursement of funds received from the City pursuant to a billing contest.

(b) Rate of return on common equity.

(c) Treatment of interest during construction.

2. The terms of the settlement do not contravene any statutory provision or any decision of the Commission.

3. The Summaries of Earnings for 1996 and 1997 included in the settlement set forth reasonable estimates of the levels of revenues and expense likely to occur in those years.

4. In August 1993, SJWC entered into a contract with the City to perform billing services for the City's garbage service.

5. The contract can be terminated by either party upon notice.

6. The total proceeds from the contract between SJWC and the City are \$244,000 of which \$200,000 are sunk costs, i.e.,

these costs will continue to occur even if SJWC did not have the contract with the City.

7. SJWC's proposes to split the \$200,000 sunk costs related to the contract between ratepayers and shareholders on 75%/25% basis.

8. DRA contends that all proceeds of the contract should go to the ratepayers and that SJWC's revenue requirement should be reduced by the full amount of \$244,000 for each of the test years.

In addition, we are correcting certain errors in the

9. While SJWC's shareholders have benefited from the proceeds of the contract since August 1993, SJWC's rates do not reflect these additional revenues.

10. It is unlikely that the City will terminate the contract during this GRC cycle.

11. Even if the City terminates the contract during this GRC cycle, SJWC would still have recovered more revenues than reflected in its rates.

12. SJWC contends that it is liable for any errors made in executing the contract.

13. Ratepayers should not reimburse SJWC's shareholders for errors made by SJWC's employees.

14. SJWC has not provided any justification for its proposal of splitting the proceeds from the contract between ratepayers and shareholders.

15. A ROE of 10.20% for SJWC is comparable with the more recent adopted ROEs for other water companies.

16. SJWC contends being a single-district utility, it faces greater business risk from sales fluctuations.

17. An increment of 30 basis points over the DRA-recommended ROE of 9.90% should account for the business risks affecting SJWC's shareholders, and the fact that SJWC is a single-district water company.

18. Water utilities do not face the same business risk as energy utilities.

19. A ROE of 10.20% will produce over all rates of return of 9.28% and 9.25% for the years 1996 and 1997, respectively.

20. Not all details pertaining to capitalization of IDC on CWIP were available during the evidentiary hearing.

21. Parties have agreed to address the issue of treatment of IDC in the second phase of this proceeding.

22. Parties have agreed to use DRA's treatment of IDC for this phase of the proceeding and to allow SJWC to establish a memorandum account to track the difference of revenues collected by SJWC based on DRA's treatment and SJWC's treatment of IDC on CWIP.

Conclusions of Law

The settlement should be adopted.

2. SJWC's rates should be increased to allow it to earn rates of return of 9.28% and 9.25% for the years 1996 and 1997, respectively.

This proceeding should remain open to address the issue of treatment of IDC on CWIP.

4. Any overcollection or undercollection in the memorandum account established to track the difference of revenues collected by SJWC based on DRA's treatment and SJWC's treatment of IDC on ratebase should be subject to refund or recovery.

5. Since the rates authorized in this order are for 1996, this order should be made effective today.

INTERIM ORDER

1. The settlement in Exhibit 16 between San Jose Water Company (SJWC) and the Division of Ratepayer Advocates and California Water Service Company is approved.

The motion for approval of the settlement is granted.

SJWC is authorized to file the revised schedule 88.9 attached to this order as Appendix A. This filing shall comply with General Order (GO) 96-456. The effective date of the revised schedule shall be five (5) days after the date of filing. The

of IDC in the second phase of this proceeding.

revised schedule shall apply to service rendered on or after the effective date.

4. On or after November 5, 1996, SJWC is authorized to file an advice letter, with appropriate work papers, requesting the step-rate increase for 1997, included in Appendix B, or to file a proportionate lesser increase for those rates in Appendix B in the event that SJWC's rate of return on ratebase, adjusted to reflect rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1996, exceeds 9.28%. This filing shall comply with GO 96-A. The requested step rates shall be reviewed by the Commission Advisory and Compliance Division (CACD) to determine their conformity with this order and shall go into effect upon CACD's determination of conformity. CACD shall inform the Commission if it finds that the proposed step rates are not in accord with this decision or other Commission decisions. The effective date of the revised schedules shall be not earlier than January 1, 1997, or 30 days after filing, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

5. On or after November 6, 1997, SJWC is authorized to file an advice letter, with appropriate work papers, requesting the step-rate increase for 1998, included in Appendix B or to file a proportionate lesser increase for those rates in Appendix B in the event that SJWC's rate of return on ratebase, adjusted to reflect rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1997, exceeds 9.25%. This filing shall comply with GO 96-A. The requested step rates shall be reviewed by CACD to determine their conformity with this order and shall go into effect upon CACD's determination of conformity. CACD shall inform the Commission if it finds that the proposed step rates are not in accord with this decision or other

Commission decisions. The effective date of the revised non-construction schedules shall be not earlier than January 1, 1998, or 30 days after filing, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

6. On or after November 5, 1998, SJWC is authorized to file an advice letter, with appropriate work papers, requesting the step-rate increase for 1999, included in Appendix B or to file a proportionate lesser increase for those rates in Appendix B in the event that SJWC's rate of return on ratebase, adjusted to reflect rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1997, exceeds 9.25%. This filing shall comply with GO 96-A. The requested step rates shall be reviewed by CACD to determine their conformity with this order and shall go into effect upon CACD's determination of conformity. CACD shall inform the Commission if it finds that the proposed step rates are not in accord with this decision or other Commission decisions. The effective date of the revised non-construction schedules shall be not earlier than January 1, 1999, or 30 days after filing, whichever is later. The revised schedules shall apply to service rendered on and after their effective date.

7. This proceeding shall remain open to address the issue of treatment of interest during construction on construction work in progress.

8. SJWC is authorized to establish a memorandum account to track the difference of revenues collected by SJWC between using Division of Ratepayer Advocates' treatment of interest during construction and SJWC's treatment of interest during construction on construction work in progress in ratebase.

9. Any overcollection or undercollection in the memorandum account authorized in Ordering Paragraph 8 shall be subject to refund or recovery.

10. Rates authorized in this order are subject to recovery.

11. SJWC is authorized to file an advice letter within 60 days after the effective date of this decision to allocate the profit, if any, from the billing contract with the City of San Jose's Recycle Plus Program equally between shareholders and ratepayers. SJWC should in its advice letter adequately substantiate the profit it claims exists in the contract by including a detailed accounting of expenses related to the billing and cash collection service it provides the City of San Jose. If SJWC does not file an advice letter as described in this Order, the CACD will issue a resolution for Commission approval recommending the allocation of the remaining \$44,000 included in the contract with City of San Jose to be credited to ratepayers.

This order is effective today.

Dated July 17, 1996, at Sacramento, California.

P. GREGORY CONLON
President
DANIEL Wm. FESSLER
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

We will file a joint written partial dissent.

/s/ DANIEL Wm. FESSLER
Commissioner

/s/ JESSIE J. KNIGHT, JR.
Commissioner

APPENDIX A

Page 1 of 4

San Jose Water Company

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to general metered water service.

APPLICABILITY

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. \$1.2703 (I)

Service Charge:

Per Meter Per Month

For 5/8 x 3/4-inch meter	0.70 (I)
For 1-inch meter	1.11 (I)
For 1-1/2-inch meter	1.27 (I)
For 2-inch meter	1.44 (I)
For 3-inch meter	1.60 (I)
For 4-inch meter	1.61 (I)
For 6-inch meter	2.78 (I)
For 8-inch meter	4.45 (I)
For 10-inch meter	6.40 (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 CONDITION:

1. To amortize the Lost Revenue due to Voluntary Conservation, a surcharge of \$0.0239 (N) per Ccf is to be added to the Quantity Rates shown above for a 12 month period beginning with the effective date of this tariff.

2. All bills are subject to the reimbursement fee set forth on Schedule No. UF-1. Any service to a residential customer who requires a larger meter because of the flow requirement for the flow meter size determined based on the normal water use of the customer excluding the flow requirement, and (ii) and upsize charge, determined by the difference between the actual meter size required including the flow requirement and the appropriate meter size required without the flow requirement; and (i) the quantity charge based on the quantity of water used.

3. For the purpose of the protection under this schedule, the utility will supply only such water at such pressure as may be available from time to time as a result of its operation of the system. Section 774 of the Public Utilities Code limits the liability of the utility resulting from a claim regarding the provision or maintenance of an adequate water supply, water pressure, equipment or other the protection facility or services. Acceptance of service under this tariff is acknowledgment of notice of the provision of Section 774 of the Public Utilities Code.

4. All bills are subject to the reimbursement fee set forth on Schedule No. UF-1.

APPENDIX A
Page 2 of 4

San Jose Water Company, Inc.

Schedule No. 1B

GENERAL METERED SERVICE WITH
AUTOMATIC FIRE SPRINKLER SYSTEM

APPLICABILITY

APPLICABILITY

Applicable to all detached single family structures whose automatic fire sprinkler system is served through the meter providing residential water service.

TERRITORY

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

RATES

Quantity Rates:

Per 100 cu ft. \$1.2703 (i)

Service Charge:

For 5/8 x 3/4-inch meter \$6.70 (i)
For 1-inch meter \$6.70
For 1 1/4-inch meter \$11.40
For 1 1/2-inch meter \$27.80
For 2-inch meter \$44.50 (i)

Upsize Charge:

For 1/4-inch meter upsize \$0.88 (i)
For 1/2-inch meter upsize 1.75
For 3/4-inch meter upsize 2.63
For 1-inch meter upsize 3.50 (i)

SPECIAL CONDITION:

- To amortize the Lost Revenue due to Voluntary Conservation, a surcharge of \$0.0239 (N) per Ccf is to be added to the Quantity Rates shown above for a 12 month period (N) beginning with the effective date of this tariff. (N)
- Any service to a residential customer who requires a larger meter because of fire flow requirement to a fire sprinkler system will be billed (i) a meter service charge, for the appropriate meter size determined based on the normal water use of the customer excluding the fire flow requirement, and (ii) and upsize charge, determined by the difference between the actual meter size required including the fire flow requirement and the appropriate meter size required without the fire flow requirement; and (iii) the quantity charge based on the quantity of water used.
- For the purpose of fire protection under this schedule, the utility will supply only such water at such pressure as may be available from time to time as a result of its operation of the system. Section 774 of the Public Utilities Code limits the liability of the utility resulting from a claim regarding the provision or maintenance of an adequate water supply, water pressure, equipment or other fire protection facility or service. Acceptance of service under this tariff is acknowledgment of notice of the provision of Section 774 of the Public Utilities Code.
- All bills are subject to the reimbursement fee set forth on Schedule No. UF.

APPENDIX A

Page 3 of 4

San Jose Water Company

Schedule No: 4

PRIVATE FIRE SERVICE

(T)

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	RATES
	Per Month	Quantity Rate
For 2-inch meter	\$7.00	(1)
For 3-inch meter	\$10.50	(1)
For 4-inch meter	\$14.00	(1)
For 6-inch meter	\$21.00	(1)
For 8-inch meter	\$28.00	(1)
For 10-inch meter	\$35.00	(1)
For 12-inch meter	\$42.00	(1)

SPECIAL CONDITIONS:

- 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.
- 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.
- 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.

(continued)

(END OF APPENDIX A)

APPENDIX A
Page 4 of 4

San Jose Water Company

Schedule No. 6

(1) 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 Meter Per Month
Per 100 cu. ft.	\$1.0473 (1)
Service Charge:	
For 5/8 x 3/4-inch meter	6.70 (1)
For 3/4-inch meter	6.70
For 1-inch meter	11.40
For 1-1/2-inch meter	27.80
For 2-inch meter	44.50
For 3-inch meter	83.00
For 4-inch meter	139.00
For 6-inch meter	278.00
For 8-inch meter	445.00
For 10-inch meter	640.00 (1)

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 CONDITION:

- To amortize the Lost Revenue due to Voluntary Conservation, a surcharge of \$0.0239 per Ccf is to be added to the Quantity Rates shown above for a 12 month period beginning with the effective date of this tariff.
- All bills are subject to the reimbursement fee set forth on Schedule No. UF.

(continued)

(END OF APPENDIX A)

APPENDIX B

Page 1 of 1

San José 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 to the rate which would otherwise be in effect on that date.

	1997	1998	1999
SCHEDULE No. 1, No. 6			
Service Charges:			
For 5/8x3/4-inch meter	0.10	0.20	0.20
For 3/4-inch meter	0.10	0.20	0.20
For 1-inch meter	0.30	0.40	0.40
For 1-1/2-inch meter	0.70	1.00	1.00
For 2-inch meter	1.50	1.50	1.50
For 3-inch meter	4.00	4.00	4.00
For 4-inch meter	6.00	6.00	6.00
For 6-inch meter	6.00	7.00	7.00
For 8-inch meter	15.00	20.00	20.00
For 10-inch meter	50.00	50.00	50.00
Quantity Rates:			
For all water delivered, per 100 cu. ft.	0.0086	0.0119	0.0119
Quantity Rates: (Sch. 6)			
For all water delivered, per 100 cu. ft.	0.0086	0.0119	0.0119
SCHEDULE No. 1B			
Service Charges:			
For 5/8x3/4-inch meter	0.10		
For 3/4-inch meter	0.10	0.20	0.20
For 1-inch meter	0.30	0.40	0.40
For 1-1/2-inch meter	0.70	1.00	1.00
For 2-inch meter	1.50	1.50	1.50
Upsize Charge:			
For 1/4-inch meter upsize	1.00	1.13	1.13
For 1/2-inch meter upsize	2.00	2.25	2.25
For 3/4-inch meter upsize	3.00	3.38	3.38
For 1-inch meter upsize	4.00	4.50	4.50
Quantity Rates:			
For all water delivered, per 100 cu. ft.	0.0086	0.0119	0.0119
SCHEDULE No. 4			
For each 2-inch service	1.00	1.50	1.50
For each 3-inch service	1.50	1.50	1.50
For each 4-inch service	2.00	2.00	2.00
For each 6-inch service	3.00	3.00	3.00
For each 8-inch service	4.00	4.00	4.00
For each 10-inch service	5.00	5.00	5.00
For each 12-inch service	6.00	6.00	6.00

(END OF APPENDIX B)

APPENDIX C
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San Jose Water Company

Adopted Quantities
(Dollars in thousands)

	1997	1996	1996	1997
Water Production: MG	135,418	131,858		
Well Supply	43,747	43,888	23,028	23,049
Surface Water	50,813	50,882	3,200	3,200
Purchased Water	3,204	3,885	19,801	19,801
Total MG	4,505	4,134	46,029	46,050
Total KCCF	1,022	1,038	61,532	61,560
Purchased Water Rates	148	148		
Santa Clara Valley Water District (7.93)	28	28		
Purchased Water Cost Per MG	0	0	\$951.36	\$951.36
Pump Tax Cost Per MG	507.20	507.20	\$736.54	\$736.54
Purchased Water Costs				
SCVWD	18,374.8	18,374.8	\$18,837,879	\$18,837,879
Pump Tax Cost			\$16,961,043	\$16,976,510
Total Purchased Water Costs			\$35,798,922	\$35,814,390
Purchased Power	21,224.7	20,734		
Pacific Gas & Electric Co. (1.93) \$/kWh	0.070	0.07	0.099291	0.099291
Power Ratio	0.00	0	0.9363	0.9363
Total Power Usage (kWh)	0	0	57,613,254	57,638,628
Total Power Costs (\$)	0.00	180	5,720,478	5,723,034
Water Quality Expenses (\$)				
Chemicals	141,355	141,358	86,000	88,000
Labor	405.1	405.5	328,000	337,000
Other	61,330	61,330	359,000	369,000
Total Water Quality Expenses	202,690	202,691	773,000	794,000

APPENDIX C
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San Jose Water Company

Adopted Quantities
Schedule 1

1997	Number of Services by meter size	Schedule 1		Schedule 6	
		1996	1997	1996	1997
	5/8 x 3/4-inch	131,928	132,418	0	0
	3/4	43,586	43,747	1	1
23,043	1	20,535	20,613	5	5
2,500	1-1/2	2,982	2,994	3	3
10,801	2	4,184	4,202	6	16
20,020	3	1,089	1,095	3	3
21,000	4	313	313	2	2
	6	148	149	0	0
	8	28	28	1	1
22,122	10	0	0	0	0
23,222	12	0	0	0	0
		204,794	205,560	31	31
	Metered Sales (KCcf)	56,349.9	56,374.9	260	260
218,237,812					
218,237,812					
222,818,222					
	No. of Service	1996	1997	Usage - KCcf	Avg Usage - ccf
	Residential	202,994	203,744	51,966.5	256.0
	Industrial	82	82	697.0	8,500.0
103,000.0	Pub. Authority	1,568	1,584	3,606.4	2,300.0
0,000.0	Irrigation	0	0	0.0	0.0
850,220.0	Resale	31	31	260.0	8,387.0
2,532,000.0	Other	150	150	80.0	533.0
	Private Fire	2,356	2,416	56,609.8	56,634.9
000.88		207,181	208,007	56,609.8	56,634.9
000,722	Water Loss (8.0%)			4922.2	4925.1
000,000	Total Water Produced			61,532.0	61,560.0
107,000	Water Production (AF)			141,258	141,322
	Purchased Water (AF)			60,767	60,767
	Well (AF)			70,670	70,735
	Surface (AF)			9,821	9,821

APPENDIX C

San Jose Water Company

Income Tax Calculation
(Dollars in Thousands)

	1996	1997
Metered Revenue	94,994.0	96,184.9
Deferred Revenue	397.0	418.0
Purchased Water	18,837.0	18,838.5
Purchased Power	5,720.4	5,723.0
Pump Tax, Main Basin	16,961.0	16,976.5
Water Quality Expense	773.0	794.0
OM & AG	22,078.6	22,590.6
Billing Contract	(200.0)	(200.0)
Payroll Taxes	863.0	891.0
Ad.Val.Taxes	1,967.7	2,041.8
Uncollectible .0008	214.2	216.1
Local Franchise .0125	274.7	277.1
Business Licenses	31.8	31.8
subtotal	67,521.4	68,180.4
Transportation Depr.	339.2	304.1
50% meals disallowed	(21.0)	(21.0)
Interest	6,548.0	6,807.0
Capitalized Interest	0.0	0.0
Total Deductions	74,387.6	75,270.5
Taxable Income	20,606.4	20,914.4
State Tax Depreciation	9,618.9	10,069.5
Deferred Rev. Net of tax	245.3	255.2
State Taxable income inc. Deff.Rev.	11,232.8	11,100.1
State Corp.Franch.Tax @ 9.3%	1,052.9	1,040.4
Federal Tax Depreciation	8,093.9	8,535.1
State Franchise tax	988.7	1,052.9
Federal Taxable Income exc. Deff.rev.	11,523.8	11,326.4
Fed. Income Tax @ 35.12%	4,047.2	3,977.8
Def.Tax It	(3.5)	(13.2)
ITC	(0.5)	0.0
Total Federal Income Tax	4,078.4	3,995.3
Total Taxes	5,131.2	5,035.8
Net to Gross Multiplier	1.8885	

* Capitalized interest to be determined in future hearing on this issue.

San Jose Water Company
Income Tax Calculation
(Dollars in Thousands)

Utility Plant, Depreciation Reserve, and Rate Base
(Dollars in Thousands)

	1996	1997
Utility Plant		
Plant BOY.	323,095.4	339,149.1
CWIP	0.0	0.0
Utility add.	14,753.7	13,778.1
Co. Budget Plant sub.	14,753.7	13,778.1
Advances	3,000.0	3,000.0
Contribution	0.0	0.0
total add.	17,753.7	16,778.1
Retirement	1,700.0	1,700.0
Plant EOY.	339,149.1	354,227.2
Wgt. Plant Add.	8,062.2	7,572.2
Avg. Plant, wgt.	331,157.6	346,721.3
Depreciation Reserve		
Reserve BOY.	101,535.4	109,268.3
Contribution	873.5	914.3
Depr. expense	8,418.7	8,602.2
Transp. Equip.	340.7	305.4
total accrual	9,632.9	9,821.9
Retirement	1,900.0	1,900.0
Reserve EOY.	109,268.3	117,190.2
Wgt. Accr. Add.	4,186.6	4,288.9
Avg. Depr. Res. wgt.	105,722.0	113,557.2
RATE BASE		
Utility Plant	331,157.6	346,721.3
Material & Supplies	480.0	480.0
Work. Cash - Gross	30.5	30.5
Work. Cash Lead/Lag	2,737.3	2,636.8
Work. Cash W/H Employees	(71.0)	(71.0)
Depreciation Reserve	(105,722.0)	(113,557.2)
Advances. Construction	(30,040.8)	(30,278.5)
Contribution	(30,693.2)	(31,688.0)
Amort of Intang.	(159.8)	(170.9)
Deferred Taxes	(17,851.7)	(19,212.9)
Def. Tax on Sale	(412.9)	(412.9)
Taxes on - Advances	2,699.9	2,948.1
Taxes on - CIAC	2,938.8	3,218.7
Avg. RATE BASE	155,692.7	160,644.0

APPENDIX C
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San Jose Water Company

Comparison of typical bills for residential metered customers of various usage level and average level at present and authorized rates for the year 1996.

General Metered Service
(3/4-inch meters)

Monthly Usage (Ccf)	Present Rates	Authorized Rates	Percent Increase
5	12.87	13.05	1.40 %
10	19.20	19.40	1.04
20	31.86	32.11	0.78
21.33 (Avg)	33.55	33.80	0.75
30	44.52	44.81	0.65
50	69.84	70.22	0.54
100	133.14	133.73	0.44

(END OF APPENDIX C)

KNIGHT, Commissioner) with whom Commissioner FESSLER joins, dissenting in part:

By deciding that shareholders should participate in profits from non-operating revenue derived from the billing service contract between San Jose Water Company (SJWC) and the City of San Jose (City), the Commission demonstrates its willingness to encourage maximum use of the regulated assets which are paid for by the customers. We believe a management incentive to productively employ idle utility assets is most appropriate. For the reasons explained below, we join our colleagues in this part of the decision; however, we dissent from the return on equity (ROE) authorized by the majority.

The Contract With The City Of San Jose

In general rate cases, this Commission regularly authorizes the expenses associated with San Jose Water Company's billing system. Apparently, that system meets the needs of water customers efficiently and promptly when the times to disburse invoices and to process remittances arrive. Because the billing process is intermittent, at times the related equipment and manpower operate below peak capacity. The SJWC management chose to maximize the use of these assets by contracting to provide billing services to the City. We agree with our colleagues that such a novel employment of idle regulated resources should be encouraged.

We also agree with the decision's allocation of the revenues generated by the City contract whereby costs already borne by captive customers are reimbursed and any profit is divided evenly between them and shareholders. Accord Re Suburban Water Systems, (1994) 53 Cal.P.U.C.2d 45, 56-57 - partial dissent, Commsrs. Fessler and Knight (D.94-01-028)). This profit sharing should guarantee that captive customers are reimbursed fully for any unidentified buried costs and are provided a fair share of the profit. As important, this profit sharing gives management an

appropriate incentive to seek the most efficient use of the resources under their control.

However, we are troubled by SJWC's failure to develop a proper record on this issue. Commission policy dictates that it was the company's burden to present clear and convincing evidence in support of its proposal that shareholders participate in the revenue from the City contract (See Re Pacific Bell (1987), 27 Cal.P.U.C.2d 1, 17-22 (D.87-12-067); Pacific Telephone and Telegraph Co. (1979), 2 Cal.P.U.C.2d 89, 98-99 (D.90647); Suburban Water Co. (1962), 60 Cal.P.U.C. 183, 200 (D.64256); Southern Counties Gas Co. (1960), 58 Cal.P.U.C. 27, 34 (D.60614)). As the majority's decision suggests, evidentiary documentation of this issue is decidedly weak. For example, the City contract is not in the record, nor is there an adequate accounting of the revenues and expenses associated with the contract. Pursuant to Commission Decision 50185 [decision not published but result noted at 53 Cal.P.U.C. 258 (1954)], SJWC is required to comply with the Uniform System of Accounts (USOA). The USOA provides for the accounting of "other income" such as revenues from non-utility related contracts (See USOA, pp. 74-76.). The majority decision establishes an advice letter procedure to obtain validation of the City contract profits. This procedure provides SJWC with the opportunity to demonstrate its compliance with the USOA and, in effect, gives the company a second chance to meet its burden of proving the profits which it claims are produced by this contract.

We have reservations about giving parties a second opportunity to do that which they should have done prior to submission of a case. Yet we concur with the majority in this portion of the decision for three reasons. First, this decision is our first opportunity in a water case to give management an incentive message regarding the use of excess utility capacity for the benefit of customers and shareholders. Second, the monies involved are relatively small. Third, the advice letter

procedure established requires SJWC to develop a record which passes the scrutiny of the Water Branch, Commission Advisory and Compliance Division and of the Division of Ratepayer Advocates (DRA). Because there will be a second phase of this proceeding (DR) disagreements, if any, over the advice letters showing may be tested in those hearings.

The Return on Common Equity

We dissent from the majority's decision to increase from 10.00% to 10.20% the return on equity (ROE) for SJWC utility shareholders are entitled to a just and reasonable return on their investment. However that determination is not a precise science. (Re Sierra Pacific Power Co (1993) 52 Cal P.U.C. 2d 390 406 (D.93-12-022)). It is an educated judgment based, in part on quantitative financial models which provide a range of reasonable returns.

(It is the application of judgment, not the precision of these models, which is the key to selecting a specific return on common equity estimate within the range predicted by analysis." [Re Pacific Gas and Electric (1991) 42 Cal P.U.C. 2d 105, 112 (D.91-11-059)])

In this case, the proposed decision of the Administrative Law Judge (ALJ) evaluates the financial model evidence and the business risks peculiar to SJWC, including its status as a single district company. We see no reason to deviate from the ALJ's judgment that 10.00% is a just and reasonable ROE. It is prudent to presume that on issues that require decision of inexact determinations such as establishing return on equity, the Commission should rely on the persons most familiar with the evidentiary records. In this instance it was the ALJ. The majority offers no rationale for their rejection of the ALJ's proposal.

Both the ALJ and the majority correctly reject SJWC's ROE arguments and rely instead on the range of reasonable returns presented in DRA's Discounted Cash Flow (DCF) and Risk Premium (RP) analyses. The analyses produced a spread of 9.15% to 10.33%; DRA proposed an ROE of 9.9%, 10 basis points above the midpoint of 9.8%. The ALJ determined that an additional 10 basis points increase (to 10.00%) would better account for the risk inherent in SJWC's single district status. For virtually the same reasons as those expressed by the ALJ, the majority decision increases the proposed ROE by 20 basis points raising it to 10.20%. In the absence of an explanation, the majority's heightened perception of SJWC's risks is unwarranted. This inference appears especially true when the record shows that since the last rate case SJWC consistently earned in excess of the authorized return.

The majority notes that the adopted ROE of 10.20% falls well within the range of returns authorized in recent water cases. Their decision illustrates this point with a ROE table listing six recent water rate cases wherein authorized ROEs range from 10.00% to 11.10% [See majority decision, mimeo at p.19, n.2]. However, the table does not reveal that all of those returns except the August, 1995 California Water Service (CalWater) case were reached by settlement. Both 1996 cases, Suburban Water Systems (Suburban) and CalWater, were settled at 10.00% and 10.30% respectively.

The return for SJWC adopted by the majority in this contested proceeding is 20 basis points above the Suburban settlement, adopted in April, 1996 and it is 10 points below the CalWater settlement, adopted in June, 1996. Certainly, these facts will not be missed by the water industry and by granting the increase may produce a chilling effect on future proceedings. Despite this Commission's express encouragement of all party settlements and desire that ALJs promote such settlements, the majority decision may inadvertently promote

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D.96-07-036

regulatory uncertainty relative to parties' perceptions of our preference. It is our belief that this Commission is firm in its long term resolve to promote its preference for alternate dispute resolution. It would be a mistake for others to misinterpret the majority decision as a commentary on potential deviations from this express preference for settlements.

Finally, it is important to note the true impact of the majority's decision - a higher bill for captive consumers. The ALJ's proposed ROE is just and reasonable. The majority's modification of the ALJ's assessment favors shareholders and inexplicably adds \$233,000 to the cost of service for captive consumers. We see no compelling reason to burden the customers of San Jose Water Company with this additional sum.

Dated this 17th day of July, 1996, at San Francisco, California

/s/ Jessie J. Knight, Jr.
Jessie J. Knight, Jr.
Commissioner

/s/ Daniel Wm. Fessler
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D.96-07-036

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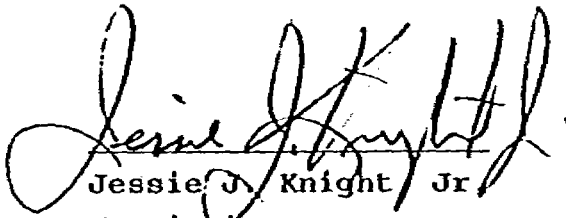
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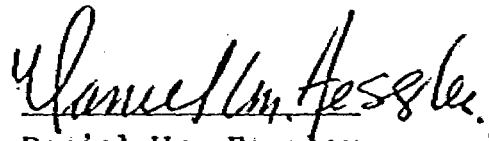
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Daniel Wm. Fessler
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