

WATER/DJE:jrb**

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**WATER DIVISION
Water Advisory Branch**

**RESOLUTION W-4127
April 22, 1999**

RESOLUTION

**(RES. W-4127), SAN JOSE WATER COMPANY, INC.
(SJWC). ORDER GRANTING THE APPEAL OF THE
STAFF REJECTION OF ADVICE LETTERS (AL) 278 AND
278-A AND ORDERING A RATE DECREASE OF \$14,523.**

BY LETTER DATED DECEMBER 3, 1997.

SUMMARY

This Resolution grants an appeal by SJWC for reconsideration of its ALs 278 and 278-A filings which were rejected by the Water Advisory Branch (Branch) by letter dated November 19, 1996. These advice letters were authorized by Decision (D.) 96-07-036, July 17, 1996, and requested an allocation of the profit from SJWC's contract for Recycle Plus Program billing with the City of San Jose (City). This resolution disposes of the remaining revenues of \$44,000 (corrected to \$49,604) by allocating, after taxes, between the shareholders of San Jose and the ratepayers.

BACKGROUND

In August, 1993, SJWC entered into a contract with the City to do the billing for the City's Recycle Plus program. The revenues from this contract are approximately \$244,000 per year, and SJWC uses facilities that are in rate base and staff that are in employee labor to perform the functions of this contract. In its last general rate case (A.95-08-038, August 14, 1995), SJWC proposed to allocate \$150,000 of these revenues to ratepayers. At that time DRA (now Ratepayer Representation Branch), disagreed and proposed that SJWC allocate the entire \$244,000 to ratepayers.

D.96-07-036 allocated \$200,000 of these revenues to the ratepayers. It also ordered SJWC to file an advice letter to allocate any profit it was making as a result of the contract on a 50-50 basis between ratepayers and stockholders.

Ordering Paragraph 11 of D.96-07-036 states:

"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'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. 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 the City to be credited to ratepayers."

The Branch received AL 278 on August 2, 1996, within the prescribed 60 day time limit. In it, SJWC calculated the revenues from its contract at \$764,940, of which \$520,500 was for reimbursable expenses, leaving net revenues of \$244,440. SJWC calculated un-reimbursed costs of using facilities and staff to perform the contract of \$194,836, leaving a difference of \$49,604. The \$194,836 un-reimbursed costs are costs for staff, power and allocated carrying costs of facilities and equipment that would otherwise have to be borne by the ratepayers in the absence of the contract. Because of the contract these costs can be paid by the City, lowering ratepayer costs by \$194,836. Additionally, according to SJWC, ratepayers should get half of the remaining \$49,604. SJWC states that the correct total amount that the ratepayers should get should be \$194,836 plus one half of \$49,604 (\$24,802) or \$219,638. Since D.96-07-036 credited \$200,000 in revenues to the ratepayers pending this advice letter filing, SJWC proposed that revenues should be reduced by an additional \$19,638 by crediting its balancing account.

SJWC submitted Supplemental AL 278-A on August 6, 1996, noting that the original filing did not include the impact of income taxes on the net proceeds from the contract. SJWC stated in AL 278-A that the \$49,604 identified in AL 278 is actually the net revenue before taxes. At SJWC's composite tax rate of 41.25% the company would have to pay \$10,231 in taxes on the \$49,604, leaving only \$39,373 to be split with ratepayers. Of the \$19,687 that is the ratepayer's share, they have already received \$5,164 in the \$200,000 reduction in revenues already authorized by D.96-07-036, leaving a net \$14,523 additional revenue reduction for the ratepayers.

DISCUSSION

We note that we have an open proceeding to address many of the issues included here. That proceeding, OIR. 97-10-049 addresses Excess Capacity and Privatization. However, that rulemaking proceeding addresses costs, cost allocation, and rate-making adjustments on a going forward basis. The issue here is compliance with Ordering Paragraph 5 of D.96-07-036.

We directed SJWC to substantiate "profit" and to provide a detailed accounting of expenses related to the contract between SJWC and the City of SJ. We defined the \$44,000 as profit, which was the difference between the sunk costs of \$200,000 and the operating margin of \$244,000. After filing of Als 278 and 278-A, that "profit", before taxes actually turns out to \$49,604.

We should note that in the classical accounting sense, profit is defined as revenues minus expenses. Our review of the contract between the City and SJWC reveals that there is no profit in that accounting sense. The revenues SJWC receives from the City equal SJWC's costs. It is only because there are sunk costs already associated with operating the water company that there are net revenues accruing to SJWC and as we ordered to the ratepayers alike.

We found in D.96-07-036 that after crediting the ratepayers with \$200,000 there was still \$44,000, corrected to \$49,604 subject to allocation upon filing of the detailed cost accounting of the expense by SJWC. We should note too that during the years before the filing of SJWC's general rate case that San Jose's shareholders received all the benefits of the contract. It is the nature of our rate-making process. It is quite common for expenses to be greater between rate cases than was predicted, as well as revenues to grow faster than anticipated at the time rates were set. Such is the nature of our regulatory compact, and we will not dwell upon that at this time other than to note that SJWC's shareholders did quite well in the first two years of the contract and the ratepayers in the last year. The current contract is on a yearly renewal basis. If it is cancelled, the shareholders will lose approximately \$200,000 per year.

SJWC filed a cost analysis consisting of seven categories: Computer, Printer, Mailroom, Cash Processing, Extraction, Storage and Supervision. For each category it determined annual costs to the contract based on volumes of bills. SJWC also calculated annual cost for an Administrator, four Billing Clerks, a Mail Service Clerk, and a Computer Operator, allocating those costs, 30% to the contract.

We ordered SJWC to substantiate its claim by including a detailed accounting of expenses. We did not specify a method; we just said to do it or risk losing all the remaining \$44,000 to the ratepayers. Water Advisory Branch and SJWC differed in their interpretation of reasonable methods in which to determine costs and allocations. It appears that SJWC's and staff's view of a reasonable detailed accounting method did not reach closure in this series of advice letters.

So it is necessary for us to make that determination. While San Jose's detailed accounting was not what the staff expected, San Jose did respond to the staff's data requests to explain its derivations. We have reviewed the correspondence between staff and San Jose and the associated workpapers and come to the conclusion that San Jose's analysis is "good enough", not perfect, but for purposes of this proceeding is "good enough".

When we arrive at a decision in R.97-10-049, we should not have to revisit this issue of cost allocation and detailed accounting again.

This is how we will allocate the profit of \$49,604:

| | | |
|--|-----------------|-----------------|
| "Profit" | \$49,604 | |
| Less: Income Taxes | <u>10,231</u> | |
| Net Profit | <u>\$39,373</u> | |
| Allocation between Ratepayers and SJWC | | \$19,687 each |
| Amount previously credited to Ratepayers | | <u>\$ 5,164</u> |
| Net Credit to Ratepayers | | <u>\$14,523</u> |

The rejection of Advice Letters 278 and 278-A is rescinded. Those Advice Letters are approved. San Jose Water shall credit to the ratepayers \$14,523 to its balancing account.

NOTICE

Notice is not necessary as notice was provided as part of the original request for recovery.

FINDINGS

THE COMMISSION FINDS that:

1. After investigation by the Water Advisory Branch, San Jose Water Company has complied with Ordering Paragraph 5 of D.96-07-036.
2. The rejection by the Water Advisory Branch of Advice Letters 278 and 278-A is rescinded.

April 22, 1999

IT IS ORDERED that:

1. Advice Letters 278 and 278-A are accepted.
2. San Jose Water Company shall credit its purchased power balancing account by \$14,523, \$5,164 previously credited, the ratepayers' share of the "profit".
3. San Jose's shareholders shall receive the other half of the profit, \$19,687.
4. SJWC shall notify its customers of this order by bill insert.
5. This order is effective in 30 days.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on April 22, 1999. The following Commissioners approved it:



WESLEY M. FRANKLIN
Executive Director

RICHARD A. BILAS
President

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners