

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**



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In the Matter of the Application of SAN JOSE WATER COMPANY (U 168 W) for an Order authorizing it to increase rates charged for water service by \$34,928,000 or 12.22% in 2016; by \$9,954,000 or 3.11% in 2017, and by \$17,567,000 or 5.36% in 2018.

Application 15-01-002  
(Filed January 5, 2015)

**REPLY BRIEF OF  
SAN JOSE WATER COMPANY**

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**SUBJECT INDEX**

	<b><u>Page</u></b>
I. REPLY TO THE OFFICE OF RATEPAYER ADVOCATES .....	1
A. ORA’s Attack on SJWC’s Payroll Expense Forecast Comes Up Short on All Counts .....	2
1. SJWC’s choice of base period and escalation factors for estimating Test Year payroll expense was reasonable and should be adopted.....	2
2. The Commission should authorize new employee positions based on evidence of the need for such positions rather than on a set of vaguely referenced “factors” .....	5
3. ORA offers no good reason for disallowing the payroll cost associated with SJWC’s temporary and part-time employees.....	6
4. SJWC’s incentive compensation programs for officers and managers are consistent with standard principles of corporate governance and efficient operations and so the cost of those programs should be allowed in rates .....	8
5. ORA failed to develop an evidentiary record sufficient to support disallowance of any portion of SJWC’s NTP&S-related labor expense .....	9
B. ORA’s Proposals to Require Memorandum Accounts to Record Prior Years’ Tax Credits Violate the Rule Against Retroactive Ratemaking .....	12
II. REPLY TO THE MUTUAL WATER COMPANIES .....	15
A. The Mutuels Fail to Justify Eliminating the Over-Use Charge and the Interruptibility Condition from Schedule 1C, Which Are Necessary for SJWC to Provide Reliable Service to the Mountain District.....	15
B. The Mutuels Fail to Justify Applying a Formulaic Allocation of Costs Among Customers and Customer Classes in Order to Equalize Rates of Return for Such Segments of Utility Service .....	18
III. CONCLUSION .....	19

**TABLE OF AUTHORITIES**

**Page**

**CALIFORNIA PUBLIC UTILITIES COMMISSION DECISIONS AND ORDERS**

*Resolution Establishing a Memorandum Account for All Cost-of Service Rate-Regulated Utilities [with exceptions] to Allow the Commission to Consider Revising Rates to Reflect the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,*  
Resolution L-411, adopted April 14, 2011 ..... 12, 14, 15  
Resolution L-411A, adopted June 23, 2011..... 14, 15

*Rulemaking re New Safety and Reliability Regulations for Natural Gas Transmission and Distribution Pipelines and Related Ratemaking Mechanisms,*  
Decision 12-12-030, 2012 Cal. PUC Lexis 600 ..... 14

*San Jose Water Co.,*  
Decision 14-08-006..... 4, 5, 6, 10, 12  
Decision 15-03-048..... 10, 11

*Southern California Water Co.,*  
Decision 92-03-094, 1992 Cal. PUC Lexis 236 \*32, 43 CPUC 2d 596..... 14

**CALIFORNIA PUBLIC UTILITIES COMMISSION REGULATIONS**

California Public Utilities Commission, Rules of Practice and Procedure,  
Rule 13.11 ..... 1

**FEDERAL STATUTES**

Tax Relief, Unemployment Insurance Reauthorization, and  
Job Creation Act of 2010, P.L. 111-312 ..... 14

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In the Matter of the Application of SAN JOSE WATER COMPANY (U 168 W) for an Order authorizing it to increase rates charged for water service by \$34,928,000 or 12.22% in 2016; by \$9,954,000 or 3.11% in 2017, and by \$17,567,000 or 5.36% in 2018.

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**REPLY BRIEF OF  
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In accordance with Rule 13.11 of the Commission’s Rules of Practice and Procedure and the schedule established by Administrative Law Judge (“ALJ”) S. Pat Tsen, San Jose Water Company (“SJWC” or “the Company”), applicant in the above-captioned proceeding, hereby submits its reply brief, responding to some of the issues addressed by the Office of Ratepayer Advocates (“ORA”) and by the six mutual water companies (the “Mutuals”) in their opening briefs filed July 14, 2015, in this general rate case (“GRC”).

SJWC’s opening brief, also filed on July 14, sufficiently addressed the positions stated by ORA and the Mutuals on a number of issues. This reply brief addresses only those issues where SJWC believes that additional claims or contentions need to be addressed or where it would be helpful to emphasize previously stated points. For issues not addressed in this reply brief, SJWC stands on its position as presented in its opening brief.

**I.**

**REPLY TO THE OFFICE OF RATEPAYER ADVOCATES**

SJWC’s opening brief anticipated ORA’s positions, as stated in ORA’s opening brief, on issues related to SJWC’s proposals to decouple revenue from sales by implementing a Water

Revenue Adjustment Mechanism (“WRAM”) and a Modified Cost Balancing Account (“MCBA”), for WRAM-related conservation programs, and for a health care cost balancing account, as well as the Test Year estimates of regulatory commission expense and corporate expense. Accordingly, of the issues contested between ORA and SJWC, this reply brief will address aspects of SJWC’s estimated payroll expense and ORA’s proposal to establish a pair of income tax memorandum accounts.

A. ORA’s Attack on SJWC’s Payroll Expense Forecast Comes Up Short on All Counts.

In its opening brief, SJWC addressed in detail the various aspects of its Test Year forecast of payroll expense that were subject to challenge by ORA. SJWC will briefly respond to the same topics as they were addressed in ORA’s opening brief. This response will show that ORA does little more than rely on the sparsely reasoned choices made in the last GRC decision for SJWC, except with respect to the choice of labor escalation factors, where ORA diverges from the past decision without explanation.

1. SJWC’s choice of base period and escalation factors for estimating Test Year payroll expense was reasonable and should be adopted.

SJWC estimated its total annual payroll expense for the beginning of year 2015 based on then-current January 1, 2015 salary levels. For 2016, SJWC applied the 3% contract agreement increase for union employees and a 5% factor for administrative employees to approximate the market average compensation levels.<sup>1</sup> ORA chose to base its adjustment on recorded 2014 costs, applying a 1.6% “CPUC ECOS Memorandum Labor Factor” to project

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<sup>1</sup> SJWC Opening Brief, at 25-26, *citing* Exhibit SJWC-1, ch. 5 (Leal), at 3.

administrative and officer payroll cost for 2015, and a further “CPUC Labor Factor” of *minus* 0.7% (-0.7%) to reach a forecast for Test Year 2016.<sup>2</sup>

ORA claims that the Commission should use its escalation method and factors “because it uses the last full year of historical data, and relies on a uniform source for non-union payroll escalation.”<sup>3</sup> According to ORA, this is “a more reliable methodology than escalating for a year that is not complete . . . and using escalation factors from varying sources. . . .”<sup>4</sup>

The specific differences between ORA’s and SJWC’s escalation method and factors are that SJWC used the known January 2015 actual salaries as a baseline for estimating Test Year 2016 payroll, while ORA started from recorded expense for the year 2014, one year prior. In escalating administrative and officer payroll to a Test Year estimate, SJWC applied a 5% escalation factor to the 2015 amount, while ORA escalated by ECOS factors of 1.6% for 2015 and *minus* 0.7% for 2016.

ORA states that “SJWC estimates its 2015 payroll,”<sup>5</sup> however, it is incorrect to state that the 2015 payroll presented by SJWC is an “estimate.” The 2015 payroll is, and was at the time of filing, the actual 2015 wages paid to SJWC employees. SJWC already noted in its opening brief the testimony of witness Leal that “2015 payroll expense should be calculated based on actual wages that are in effect for 2015” and that, by relying on 2014 wages as the base for projecting Test Year 2016 expense, “ORA neglects to fully account for the annual change in wages, personnel and promotions that occurred effective January 1, 2015.”<sup>6</sup> SJWC also noted

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<sup>2</sup> SJWC Opening Brief, at 26, *citing* Exhibit O-01 (Keowen), at 3-4, 3-6 to 3-7.

<sup>3</sup> ORA Opening Brief, at 6.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 6.

<sup>6</sup> *Id.* at 26, *citing* Exhibit SJWC-10, ch. 4 (Leal), at 4-3.

Ms. Leal's challenge to the ECOS labor cost escalation factor for 2016 of *minus* 0.7% as "unrealistic in the Silicon Valley job market."<sup>7</sup>

SJWC has demonstrated that the negative ECOS labor cost escalator for 2016 is an anomaly without relevance to the Silicon Valley labor market in which SJWC must operate. Ms. Leal's testimony in response to cross-examination confirmed that SJWC has "a very constrained and competitive labor market," with a booming construction industry that is "taking all the skilled labor."<sup>8</sup> U.S. Bureau of Labor Statistics data confirmed that increases in average weekly wages for Santa Clara County and San Mateo County have substantially outstripped the average for the United States as a whole, and ORA witness Keowen acknowledged that the rate of salary increase in the service area and employee base area for SJWC appears to have been more rapid than in the country as a whole.<sup>9</sup>

There is nothing sacrosanct about the ECOS labor escalation factors, especially for estimating Test Year payroll expense. The principal decision in SJWC's last GRC applied a 5% escalation rate for administrative employees and officers for Test Year 2013, finding that rate to be "a reasonable estimate reflecting historical trends."<sup>10</sup> That is the same escalation rate SJWC applied for Test Year 2016.

ORA's reliance on an older base period, when salary adjustment and promotion data for the intervening year were readily available, and on a "uniform source" for labor escalation factors that was demonstrated to be unreliable for the most recent year, was not, as ORA claims,

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<sup>7</sup> SJWC Opening Brief, at 27, *citing* Exhibit SJWC-10, ch. 4 (Leal), at 4-6.

<sup>8</sup> Tr. 390:26-391:11 (Leal/SJWC).

<sup>9</sup> See, Exhibit SJWC-15 and Tr. 425:25-428:25 (Keowen/ORa).

<sup>10</sup> *San Jose Water Co.*, D.14-08-006, at 31.

a “more reliable methodology.”<sup>11</sup> As SJWC has argued, the Company was well justified in basing its Test Year 2016 payroll cost estimate on salaries and wages actually being paid in 2015, escalated to the Test Year by a 5% factor for administrative employees and officers.<sup>12</sup> SJWC’s choice of base period and escalation factors was reasonable and should be adopted.

2. The Commission should authorize new employee positions based on evidence of the need for such positions rather than on a set of vaguely referenced “factors.”

SJWC has requested 33 new positions while ORA would allow only two new positions, and three positions that have been filled since SJWC’s last GRC.<sup>13</sup> ORA considers five positions “a reasonable amount, accounting for the factors the Commission analyzed in SJWC’s last GRC,” while SJWC’s request for 33 positions “is simply unreasonable, and unlinked to any of the factors the Commission looked at when analyzing SJWC’s request in the previous GRC.”<sup>14</sup>

What were those “factors” that the Commission analyzed in SJWC’s last GRC? ORA does not say. But looking back at Decision 14-08-006, the principal decision in that GRC, we find that the Commission’s entire discussion of “new positions” in that decision was as follows:

The Commission adopts 4 of the 27 new positions requested by SJWC for test Year 2013 expenses. The Commission includes these 4 positions as this reflects the actual addition of employees to SJWC’s payroll in 2012, the increase in staff that might be expected given the growth in customers, currently funded but vacant positions, and the adopted estimates in this decision for capital projects.<sup>15</sup>

The problem with ORA’s reliance on the “factors” listed in the last GRC decision is that it pays no attention at all to the evidentiary record in *this* GRC. As SJWC noted in its

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<sup>11</sup> ORA Opening Brief, at 6.

<sup>12</sup> SJWC Opening Brief, at 28.

<sup>13</sup> ORA Opening Brief, at 7.

<sup>14</sup> *Id.*

<sup>15</sup> D.14-08-006, *supra*, at 31.

opening brief, ORA witness Keowen didn't request any information from SJWC regarding the need for particular positions, and "didn't consider" any of the detailed explanations provided in Chapter 5 of SJWC's Results of Operations Report about the new positions the Company was requesting.<sup>16</sup> He didn't have the time "to evaluate each and every specific aspect that requires to be addressed."<sup>17</sup> Likewise, ORA makes no effort at all in its opening brief to address specific facts about SJWC's need for the positions it requests. That evidence, however is part of the record on which the Commission *should* base its decision in this GRC.<sup>18</sup>

3. ORA offers no good reason for disallowing the payroll cost associated with SJWC's temporary and part-time employees.

The only reasons ORA offers for completely disallowing SJWC's forecast expense for temporary and part-time labor are that these labor categories were denied recovery in the previous GRC and that it "strains credulity" for SJWC to claim that 24 to 26 college students hired for the summer can replace experienced, full-time SJWC employees.<sup>19</sup> SJWC will respond to both of these points.

SJWC already has demonstrated in its opening brief, based on the testimony of SJWC witness Leal, that temporary employees enable the Company to provide continuous service to its customers, contrary to the unexplained assertion of D.14-08-006 to the contrary.<sup>20</sup> Such temporary labor provides relief during peak summer months, when most permanent employees

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<sup>16</sup> SJWC Opening Brief, at 31, *citing* Tr. 429:5-430:13 (Keowen/ORa).

<sup>17</sup> Tr. 431:15-16 (Keowen/ORa).

<sup>18</sup> See, SJWC Opening Brief, at 29-30, 32, *citing* Exhibit SJWC-1, ch. 5 (Leal), at 4-29, and Exhibit SJWC-10, ch. 4 (Leal), at 4-6 to 4-7.

<sup>19</sup> ORA Opening Brief, at 7.

<sup>20</sup> SJWC Opening Brief, at 33-34.

take vacations.<sup>21</sup> As SJWC previously noted, the Commission’s sparsely reasoned disallowance of these labor costs in the last GRC was ill advised and should not be repeated.<sup>22</sup>

ORA’s assertion that it “strains credulity” to claim that college students can replace experienced, full-time SJWC employees is especially weak. As noted above, Ms. Leal’s testimony made clear that temporary labor provides relief during summer months. She also testified that such temporary employees help SJWC complete simple maintenance projects at low cost.<sup>23</sup> ORA’s “argument” to the contrary is simply an exercise in arithmetic with ambiguous implications. ORA calculates that the 24 to 26 college students receive approximately \$1,980 per person per month, and claims that if temporary laborers can replace full-time staff at such a price, “then SJWC’s payroll is dramatically inflated and ratepayer funding should be reduced.”<sup>24</sup>

This is an absurd and frivolous argument. Not only does ORA “low-ball” its estimate of monthly pay for the college students,<sup>25</sup> ORA is utterly unrealistic in claiming that a temporary summer employees can “replace” full-time staff. SJWC witness Leal testified that these temporary employees “perform useful and necessary work,” filling in “when most employees are on vacation with their children . . . [a]nd we have a hole to fill.”<sup>26</sup> It is common knowledge that college students can be hired to perform odd jobs at modest wages. That does not mean that they can or would replace experienced employees filling permanent positions to perform essential tasks. For ORA to suggest otherwise is simply ridiculous.

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<sup>21</sup> Tr. 409:11-24 (Leal/SJWC).

<sup>22</sup> SJWC Opening Brief, at 34.

<sup>23</sup> *Id.* at 34, *citing* Exhibit SJWC-10, ch. 4 (Leal), at 4-5.

<sup>24</sup> ORA Opening Brief, at 8.

<sup>25</sup> Plugging a more realistic estimate of 2.5 months’ average summer employment into ORA’s formula produces monthly average pay of \$2,376.

<sup>26</sup> Tr. 409:11-410:10 (Leal/SJWC).

SJWC has provided expert evidence that its use of temporary and part-time labor is limited, reasonable, and efficient. ORA's arithmetic only confirms that showing and ORA has presented no evidence to the contrary. The Commission should not exclude the payroll expense associated with SJWC's temporary and part-time employees from the Test Year estimate of payroll expense.

4. SJWC's incentive compensation programs for officers and managers are consistent with standard principles of corporate governance and efficient operations and so the cost of those programs should be allowed in rates.

Ms. Leal testified that SJWC maintains a Short Term Incentive ("STI") plan that awards annual cash bonuses to reward superior performance, for which about 38 managers and officers out of 358 total personnel positions are eligible. Ms. Leal testified that the STI plan motivates staff to greater effort and so provides a significant benefit to customers. Ms. Leal also explained the Long-Term Incentive ("LTI") plan for SJWC's officers, noting that LTI is not "additional" compensation, but is instead a re-allocation of payroll expense between cash compensation and long-term incentives that benefits SJWC's customers.<sup>27</sup>

ORA's witness conceded that bonuses may provide additional incentive to accomplish goals, but insisted bonuses should not be included in rates and should be funded by shareholders.<sup>28</sup> In its opening brief, ORA assumed a dichotomy between shareholder and ratepayer interests, presuming that just because "shareholder groups" are concerned to see incentive-based compensation, such plans do not serve the interests of ratepayers.<sup>29</sup>

This is a false dichotomy. Certainly, there are instances where the interests of shareholders and ratepayers are opposed, but both shareholders and ratepayers benefit from

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<sup>27</sup> Exhibit SJWC-1, ch. 5 (Leal), at 1-3; see also, SJWC Opening Brief, at 35-36.

<sup>28</sup> Exhibit O-01 (Keowen), at 3-4.

<sup>29</sup> ORA Opening Brief, at 8.

compensation plans for managers and officers that appropriately balance base salaries and incentive opportunities. ORA seems to resent the fact that “ordinary staff” are not eligible for SJWC’s “ordinary incentive programs,” other than “spot bonuses,”<sup>30</sup> but ORA ignores the fact that most of SJWC’s “ordinary staff” are compensated pursuant to a collective bargaining agreement that SJWC has negotiated with a union more concerned to achieve wages beneficial to all its members than to provide bonus opportunities for the high achievers.

In rebuttal testimony, witness Leal noted that “bonuses are often tied to key performance indicators related to customer service and operating efficiencies, thus providing direct benefits to ratepayers.”<sup>31</sup> ORA has done nothing to show that SJWC’s incentive compensation programs are unfair to employees or harmful to morale or operations. To the contrary, as the record shows and SJWC’s opening brief confirms, both the STI and the LTI programs are consistent with standard principles of good corporate governance and efficient business operations. “They are proper and necessary costs of doing business in a competitive labor world.”<sup>32</sup> No justification has been shown for disallowing recovery of those costs in rates.

5. ORA failed to develop an evidentiary record sufficient to support disallowance of any portion of SJWC’s NTP&S-related labor expense.

As SJWC noted in its opening brief, the same issue regarding payroll expense related to non-tariffed products and services (“NTP&S”) that is presently at issue on rehearing of SJWC’s last GRC decision is presented again in this case. Pursuant to applicable Commission rules, compensation for employees who participate in providing NTP&S is properly included in utility revenue requirement to the extent that the employees’ work on NTP&S does not impose

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<sup>30</sup> *Id.* at 9.

<sup>31</sup> Exhibit SJWC-10, ch. 4 (Leal), at 4-4.

<sup>32</sup> SJWC Opening Brief, at 38.

incremental costs on the utility.<sup>33</sup> ORA nominally recognizes this principle but does not proceed consistently with it.

ORA made the same adjustment to exclude labor attributed to NTP&S in this GRC as it had made in the prior one – removing “Labor cost attributed to NTP&S” in the amount of \$442,357 from the 2016 payroll forecast.<sup>34</sup> When questioned about the ORA position, ORA witness Keowen stated that labor related to NTP&S should not be allowed in rates in this proceeding, in order to be consistent with D.14-08-006.<sup>35</sup> He acknowledged that D.15-03-048 determined that whether the labor cost associated with NTP&S is incremental is a question of fact to be investigated, and that the same factual inquiry needs to be made in this case. Yet he admitted that his recommendation to disallow all NTP&S-related labor expense was based on the assumption that it is all incremental, and the issue of the incremental or non-incremental character of that labor was not the subject of his study.<sup>36</sup>

The Commission ruled in D.15-03-048 that only incremental costs should be allocated to NTP&S, and that a factual analysis is required to determine whether and in what amount NTPS-related labor cost is incremental – whether it has been incurred *due to* the provision of NTP&S.<sup>37</sup> ORA’s disallowance of all of SJWC’s NTPS-related labor cost, however, was *not* based on an assessment of the incremental or non-incremental character of the labor at issue. ORA offered no evidence that any portion of SJWC’s NTPS-related labor cost for 2016 is incremental – *i.e.*, labor cost that has been or will be incurred *due to* the provision of

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<sup>33</sup> *Id.* at 3-4.

<sup>34</sup> Exhibit O-01 (Keowen), at 3-3.

<sup>35</sup> Tr. 431:27-432:12 (Keowen/ORa).

<sup>36</sup> Tr. 433:16-434:15 (Keowen/ORa).

<sup>37</sup> D.15-03-048, *supra*, at 5-7.

NTP&S. This is why SJWC concluded the discussion of this issue in its opening brief by asserting that ORA’s challenge to SJWC’s NTP&S related labor cost fails for lack of proof.<sup>38</sup>

In its opening brief, ORA substitutes argument for evidence on this issue. ORA notes that one SJWC employee, a Distribution System Inspector, attributed 59% of his work hours to NTP&S, while SJWC requests funding for four more positions in the distribution systems department.<sup>39</sup> But ORA proposes to disallow those positions, so it is inconsistent for ORA to rely on SJWC’s request for those proposed positions as a basis for asserting that any of the payroll expense associated with distribution systems employees is “incremental” with respect to time they have spent providing NTP&S. ORA should not be allowed to have it both ways – on the one hand arguing for disallowance of new positions and on the other hand using SJWC’s request for those positions to claim that an existing employee’s NTP&S work makes his compensation “incremental” to the utility’s needs.

Despite the fact that ORA’s expert witness conducted no study of the incremental vs. non-incremental character of SJWC’s NTP&S-related labor expense, ORA argues broadly that SJWC’s “significant overtime expenses” in departments used for NTP&S, high rates of usage of four positions and one employee for NTP&S, and the Company’s request to hire more people in positions and department that are “highly used for NTP&S” indicate that SJWC appears to be using employees ostensibly paid to provide regulated services, to provide NTP&S.<sup>40</sup>

ORA’s conclusion is an obvious fact. Some SJWC employees who are paid to provide regulated services also provide NTP&S. Like the testimony of ORA witness Keowen, so ORA’s brief as well falls short of addressing the key issue identified by Decision 15-03-048,

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<sup>38</sup> SJWC Opening Brief, at 43.

<sup>39</sup> ORA Opening Brief, at 11.

<sup>40</sup> *Id.*

which granted rehearing of Decision 14-08-006 on the NTP&S-related labor costs issue. That issue is whether the time the referenced SJWC employees devote to NTP&S is excess capacity – whether they are properly employed to provide regulated services and are working on NTP&S in spare time – or, in the alternative, whether some of those employees are not needed for regulated services so that their labor cost is incremental – incurred *due to* their employment for the provision of NTP&S. ORA fails to prove its claims. There is no basis on the evidentiary record of this GRC for the disallowance of NTP&S-related labor expense sought by ORA, and there is no basis for any disallowance of NTP&S-related labor expense.

B. ORA’s Proposals to Require Memorandum Accounts to Record Prior Years’ Tax Credits Violate the Rule Against Retroactive Ratemaking.

ORA states that it proposes two tax memorandum accounts to account for changes in tax law in the Tangible Property Regulation (“TPR”) and the Enterprise Zone Sales and Use [“EZ”] tax credit. ORA describes its expectation that SJWC will file for a refund on its 2014 taxes by the extension deadline of September 30, 2015.<sup>41</sup> ORA provides no detail regarding the EZ credit, but likewise proposes that it be “tracked in a memorandum account and refunded to ratepayers,” depending on the result of a pending audit.<sup>42</sup> ORA goes to some effort to show that the subject tax changes meet the Commission’s criteria for establishing a memorandum account and cites authority indicating the Commission has used memorandum accounts in the past to track tax law changes, asserting that “the same would be appropriate here.”<sup>43</sup>

The problem with ORA’s proposals is that establishing memorandum accounts to generate refunds with respect to tax credits for past tax years, paid or credited prior to the

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<sup>41</sup> ORA Opening Brief, at 14.

<sup>42</sup> *Id.* at 17.

<sup>43</sup> *Id.* at 15, *citing* Resolution L-411 (Exhibit O-02).

establishment of the memorandum accounts, would violate the rule against retroactive ratemaking. SJWC explained why this is the case in considerable detail in its opening brief.<sup>44</sup> ORA devotes just one paragraph to the issue, implying that because SJWC has not yet filed its 2014 taxes, which will include adjustments under the new TPR, and because the TPR adjustments affect “the future income taxes that ratepayers must pay,” the rule against retroactive ratemaking does not apply.<sup>45</sup>

SJWC must first note, as its Chief Financial Officer, James Lynch, testified, the effects of the TPR on SJWC’s deferred federal income tax liability, causing a deduction from rate base, are incorporated into SJWC’s revenue requirement going forward, including Test Year 2016. So, ratepayers will benefit from SJWC’s implementation of the TPR as those regulations affect the *future* pass-through of income tax obligations.<sup>46</sup> Ratepayers also will benefit from the continued flow-through of the effects of TPR for state income tax purposes. A memorandum account is not needed to ensure these benefits to ratepayers.

While SJWC has not yet filed its 2014 taxes, it will do so within the normal extension period, which expires September 30, 2015.<sup>47</sup> ORA proposes to have the Commission require SJWC to establish a memorandum account to “claw back” the value of tax credits claimed on that tax return, but such a memorandum account cannot be established prior to the effective date of the Commission’s decision in this GRC. The same is true for a memorandum account that ORA proposes to “claw back” the EZ tax credit that SJWC received in 2014. Such memorandum

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<sup>44</sup> See, SJWC Opening Brief, at 50-55.

<sup>45</sup> ORA Opening Brief, at 16.

<sup>46</sup> See, SJWC Opening Brief, at 51, *citing* Exhibit SJWC-10, ch. 5 (Lynch), at 5-2.

<sup>47</sup> Tr. 294:5-16 (Lynch/SJWC).

accounts cannot overcome the rule against retroactive ratemaking to the extent of recovering costs incurred or credits received prior to the establishment of the account.<sup>48</sup>

The authority ORA cites for the Commission having used memorandum accounts in the past to track tax law changes is Resolution L-411, a resolution that established a one-way memorandum account for certain cost-of-service rate-regulated utilities to track certain impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (the “New Tax Law”). Under the heading, “*The details of the memorandum account,*” Resolution L-411 states as follows:

The memorandum account will be used to determine whether any future rate changes are appropriate to reflect impacts of the New Tax Law ***for the period from the date of this resolution*** until the effective date of revenue requirement changes in each Covered Utility’s next GRC (“Memo Account Period”). The memorandum account will be used by each Covered Utility to track the revenue requirement impacts of the New Tax Law during the Memo Account Period . . . .<sup>49</sup>

The emphasized phrase in the above-quoted excerpt from Resolution L-411 makes clear that the memorandum accounts established pursuant to that Resolution would achieve the Commission’s intended goal – “to preserve the opportunity to consider whether some or all of the tax impacts not otherwise reflected in rates should benefit ratepayers, without having to face

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<sup>48</sup> See, *Southern California Water Co.*, D.92-03-094, 1992 Cal. PUC Lexis 236 \*32, 43 CPUC2d 596, 600; *Rulemaking re New Safety and Reliability Regulations for Natural Gas Transmission and Distribution Pipelines and Related Ratemaking Mechanisms*, D.12-12-030, 2012 Cal. PUC Lexis 600; see generally, SJWC Opening Brief, at 53-55.

<sup>49</sup> *Resolution Establishing a Memorandum Account for All Cost-of Service Rate-Regulated Utilities [with exceptions] to Allow the Commission to Consider Revising Rates to Reflect the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, Resolution L-411, adopted April 14, 2011 (Exhibit O-02), at 8 (emphasis added). Resolution L-411 was superseded by a revised Resolution, Resolution L-411A, adopted June 23, 2011, which removed inconsistencies, corrected errors, and clarified the ordering paragraphs of the original Resolution. Resolution L-411A preserved the passage quoted above without change. *Id.* at 1, 8.

issues of retroactive ratemaking.”<sup>50</sup> This is because the mandated memorandum accounts were intended to apply only to New Tax Law impacts occurring “from the date of this resolution” and the Resolution specifically ordered that the memorandum accounts so established would be effective “as of the date of this resolution.”<sup>51</sup>

Resolutions L-411 and L-411A provide no support for ORA’s proposal to require establishment of memorandum accounts for the specific purpose of “clawing back” tax credits received prior to the Test Year and prior to the effective date of the Commission’s decision in this GRC. Resolutions L-411 and L-411A recognized and worked within the limits of the rule against retroactive ratemaking. ORA’s proposal fails to do so, and so would produce an unlawful result.

## V.

### REPLY TO THE MUTUAL WATER COMPANIES

#### A. The Mutuals Fail to Justify Eliminating the Over-Use Charge and the Interruptibility Condition from Schedule 1C, Which Are Necessary for SJWC to Provide Reliable Service to the Mountain District.

The Mutuals have proposed to eliminate Schedule 1C that applies to service in SJWC’s Mountain District in the Los Gatos area of the Santa Cruz Mountains. SJWC has proven that there continues to be a constraint on its ability to serve customers in the Mountain District, justifying continued maintenance of a \$7.00 per ccf over-use charge and an interruptible service condition.

A separate tariff for the Mountain District is necessary mainly because of a limitation to the capacity that can be served to the Mountain District. As Mr. Jensen testified, [“i]t will be

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<sup>50</sup> *Id.* at 4.

<sup>51</sup> *Id.* at 18 (Ordering Paragraph 7).

necessary for SJWC to maintain Schedule No. 1C as long as there is a capacity limitation for the Mountain District. Thus, the Commission should reject the Mutual Water Companies' proposal to eliminate Schedule No. 1C."<sup>52</sup>

The Mutuals' arguments to the contrary are unconvincing, and are replete with errors and irrelevancies. For example, the Mutuals contrast the 500 gallons per customer per day service allowance (above which the Over-Use rate applies) with Mr. Gere's calculation, as directed by Mr. Burke, of monthly usage of 329.6 gallons per customer per day based on water production in the Mountain District in the month of July 2013.<sup>53</sup> But Mr. Gere explained that the daily average does not demonstrate sufficiency of capacity except "with the caveat that it's an interruptible supply." This is because average flow for a day or a month does not account for the peaking factor that applies "when everyone is using water sort of all at once." He emphasized that the system is designed to meet demand calculated by applying peaking factor (the standard is 1.5) to an average flow, to protect a water system from depressurizing during maximum day demand conditions.<sup>54</sup> Applying the standard peaking factor of 1.5 to the 329.6 gallons monthly use per customer, as calculated by Mr. Gere at Mr. Burke's direction, produces a peak demand of 494.4 gallons per customer – which clearly supports the 500 gallons per customer per day usage allowance on which SJWC's over-use charge for the Mountain District is based.

The Mutuals also mischaracterize Mr. Gere's testimony in several respects. They assert that he "failed to answer many questions about SJWCs knowledge of its ability to take advantage of the MWCs Storage."<sup>55</sup> Instead, the referenced passages from Mr. Burke's cross-

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<sup>52</sup> Exhibit SJW-11, ch. 1 (Jensen), at 1-10.

<sup>53</sup> Mutuals' Opening Brief, at 11.

<sup>54</sup> Tr. 139:17-142:7 (Gere/SJWC).

<sup>55</sup> Mutuals' Opening Brief, at 13 (*sic*).

examination of Mr. Gere demonstrate that Mr. Gere answered Mr. Burke's questions to the full extent of his personal knowledge, as Mr. Burke repeatedly claimed to have "understood."<sup>56</sup> The Mutuels next assert that Mr. Gere failed to answer how the Peaking Factor is computed for the Mountain District, but in the referenced passage Mr. Burke did not ask that question and Mr. Gere responded fully to the more general questions about peaking factors that Mr. Burke did ask.<sup>57</sup> The Mutuels then falsely claim that Mr. Gere gave contradictory answers to questions that he answered in a fully consistent fashion.<sup>58</sup> In particular, the Mutuels claim to see a contradiction between Mr. Gere's statement that with the interruptibility provision and the per residence usage limitation in the Mountain District tariff, "the capacity we have is adequate" and his statement that SJWC has not had to interrupt anybody's service to date,<sup>59</sup> but those statements are not contradictory at all. In fact, as both the 2010 engineering study and Mr. Gere's testimony confirmed, the limiting features of Schedule 1C have enabled SJWC to provide reliable service to Mountain District customers that SJWC would not otherwise be able to provide without multi-million dollar investments in enhanced pumping facilities.<sup>60</sup>

These and other inaccuracies and irrelevancies in the Mutuels' Opening Brief make it difficult for SJWC to do more than emphasize the conclusions expressed in its own opening brief. As Mr. Gere testified, elimination of the usage limit is not feasible. The capacity of the four primary pump stations is adequate to serve customer demand while maintaining an appropriate peaking factor, but an equipment malfunction or significantly increased usage by

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<sup>56</sup> *Id.*; see, Tr. 147:27-150:21 (Gere/SJWC).

<sup>57</sup> Mutuels' Opening Brief, at 13; see, Tr. 140:26-142:7 (Gere/SJWC).

<sup>58</sup> Mutuels' Opening Brief, at 13-14; see, Tr. 142:8-147:4, 155:17-27; 161:20-162:16 (Gere/SJWC); Exhibit M-1, Att. 4 (2010 engineering study), at 13 (conclusion).

<sup>59</sup> Mutuels' Opening Brief, at 14, referencing Tr. 160:16-19 and 161:8-19 (Gere/SJWC).

<sup>60</sup> See, Exhibit M-1, Att. 4, at 11-13.

most Mountain District customers on a particular day could interrupt service. Usage limits also provide incentive for the Mutuels to properly maintain their systems and to repair leaks promptly. For all these reasons, SJWC must retain the current 500 gpd/residence usage allowance with an over-use charge and an interruptibility condition in place.<sup>61</sup>

B. The Mutuels Fail to Justify Applying a Formulaic Allocation of Costs Among Customers and Customer Classes in Order to Equalize Rates of Return for Such Segments of Utility Service.

The Mutuels' Opening Brief indicates considerable effort to explain the model or formula by which the Mutuels propose to assign variable and fixed costs to particular customers classes of service and then to calculate rates of return (positive or negative) generated by the rates applicable to such customers and service classes, and then draws various conclusions from that exercise. The Mutuels, however, fail to make a convincing showing that this complex exercise is worth the effort – or will produce any result that is in the public interest.

SJWC strongly opposes further consideration of the Mutuels' cost allocation model. As witness Jensen testified, water service is “different from a competitive industry. There are public policy goals that are pursued by regulators that . . . often times supersede competitive market decisions.”<sup>62</sup> SJWC endorses Mr. Jensen's assessment of cost allocation among customer classes as “a judgment call,”

because there's a public policy associated with the Commission's determination of what is just and reasonable. Utility ratemaking is fraught with subsidies going across customer classes, [with] individual customers within classes. And there may be overriding public policy goals why allocations should be made in a certain fashion.<sup>63</sup>

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<sup>61</sup> See, SJWC Opening Brief, at 60-63, *citing* Exhibit SJWC-11, ch. 1 (Jensen/SJWC), at 1-3, and ch. 2 (Gere), at 2-2 to 2-3.

<sup>62</sup> Tr. 219:4-20 (Jensen/SJWC).

<sup>63</sup> Tr. 219:22-220:17 (Jensen/SJWC).

The Commission should not embark on an effort to develop or seek to develop analysis of customer-specific or customer class-specific rates of return, and should not consider itself compelled or required to achieve identical or similar rates of return for differing classes or groups of customers. SJWC's rates should be cost based on a total company basis and should enable SJWC to earn a reasonable rate of return on that basis. That is all that the law requires.

VI.

CONCLUSION

For all the reasons stated in the testimony of its witnesses and in its opening and reply briefs, San Jose Water Company respectfully asks that the Commission authorize increases in rates for Test Year 2016 and Escalation Years 2017 and 2018 sufficient to enable the Company to meet and carry out the many and varied challenges and obligations discussed herein.

Respectfully submitted,

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