STATE OF CALIFORNIA EDMUND G. BROWN JR., *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

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April 22, 2016

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Ratesetting

TO PARTIES OF RECORD IN APPLICATION 15-01-002:

This is the proposed decision of Administrative Law Judge S. Pat Tsen. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's May 26, 2016 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.

Parties of record may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.

The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, ex parte communications are prohibited pursuant to Rule 8.3(c)(4)(B).

/s/ KAREN V. CLOPTON
Karen V. Clopton, Chief
Administrative Law Judge

KVC:lil

Attachment

Decision **<u>PROPOSED DECISION OF ALJ TSEN</u>** (Mailed 4/22/2016)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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)

DECISION APPROVING TWO PARTIAL SETTLEMENTS, RESOLVING DISPUTED ISSUES AND ADOPTING REVENUE REQUIREMENTS FOR SAN JOSE WATER COMPANY

(See Attachment A for a list of Appearances)

Table of Contents

Title **Page**

Table of Contents
(Cont'd)

DECISION APPROVING TWO PARTIAL SETTLEMENTS, RESOLVING DISPUTED ISSUES AND ADOPTING REVENUE REQUIREMENTS FOR SAN JOSE WATER COMPANY

Summary

This decision authorizes revenue requirements for San Jose Water Company for the years 2016, 2017 and 2018. The table below lists the revenue requirement, the monthly percentage increase and dollar increase for the average customer's bill covered by this decision for the test year beginning on January 1, 2016. Based on the adopted revenue requirements, the average residential customer will see its bill increase by $7.04 each month, which represents an 8.3 percent increase.

Test Year	Adopted Revenue Requirement	Percent Increase	Monthly Bill Increase by %	Monthly Bill Increase by $
2016	$317,166,500	8.56%	8.3%	$7.04

This decision adopts two separate partial settlements between San Jose Water Company and the Office of Ratepayer Advocates on a variety of issues. This decision also resolves the remaining issues in dispute between the parties for Test Year 2016 and Escalation Years 2017 and 2018. Application 15-01-002 is closed.

1. Procedural History

On January 5, 2015, San Jose Water Company (SJWC) filed Application (A.) 15-01-002 (the "Application") requesting authority to increase its revenue requirements by $34,928,000 or 12.22 percent in 2016, $9,954,000 or 3.11 percent in 2017, and by $17,567,000 or 5.36 percent in 2018. SJWC is a Class A water company subject to the jurisdiction of this Commission and the current requirements of Decision (D.) 07-05-065, which adopted a revised Rate Case Plan for Class A water utilities (Rate Case Plan). The Office of Ratepayer Advocates (ORA) filed its protest to the Application on February 2, 2015. Six mutual water companies consisting of Big Redwood Park Mutual Water Co., Brush & Old Well Road Mutual Water Co., Mountain Summit Mutual Water Co., Oakmont Mutual Water Co., Ridge Mutual Water Co. and Ville Del Monte Mutual Water Co. taking service from SJWC in its Mountain District (The Mutuals) were authorized to late file a protest on March 5, 2015.

The assigned Administrative Law Judge (ALJ) conducted a prehearing conference on February 27, 2015, and a public participation hearing was held in San Jose on March 24, 2015.

ORA and The Mutuals served testimony on April 23, 2015, SJWC served rebuttal testimony to both ORA and The Mutuals on May 7, 2015.

On June 2, 2015, the assigned ALJ issued an email ruling requiring updated testimonies from the parties to reflect compliance with the governor's Executive Order B-29-15 and the Commission's Resolution W-5041 mandating a 25 percent water usage reductions from 2013 levels. SJWC addressed the issue in testimony responding to ORA's April 1, 2015, data request.

Evidentiary hearings on the disputed issues were held on June 15 through 17, 2015. SJWC, ORA and The Mutuals filed timely opening and reply briefs. The original Settlement Agreement was filed on July 24, 2015 and the Supplemental Settlement Agreement was filed on August 13, 2015, and the proceeding was submitted for decision.

2. Settlement Agreements

2.1. Standards of Review for Settlement Agreements

2.1.1. General Standard of Review

SJWC, as the applicant, bears the burden of proof to show that the regulatory relief it requests is just and reasonable and the related ratemaking mechanisms are fair.

2.1.2. Commission Rules on Settlements

The Commission's Rules of Practice and Procedure (Rules) specifically address the requirements for adoption of proposed settlements in Rule 12.1 *Proposal of Settlements*, and subject to certain limitations in Rule 12.5 *Adoption Binding, Not Precedential*.[1]

Rule 12.1(a) states:

> Parties may, by written motion any time after the first prehearing conference and within 30 days after the last day of hearing, propose settlements on the resolution of any material issue of law or fact or on a mutually agreeable outcome to the proceeding. Settlements need not be joined by all parties; however, settlements in applications must be signed by the applicant….
>
> When a settlement pertains to a proceeding under a Rate Case Plan or other proceeding in which a comparison exhibit would ordinarily be filed, the motion must be supported by a comparison exhibit indicating the impact of the settlement in relation to the utility's application and, if the participating staff supports the settlement, in relation to the issues staff contested, or would have contested, in a hearing.

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[1] http://docs.cpuc.ca.gov/published/RULES_PRAC_PROC_/105138-11.htm#P623_143939.

Rule 12.1(d) provides that:

> The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

Rule 12.5 limits the future applicability of a settlement:

> Commission adoption of a settlement is binding on all parties to the proceeding in which the settlement is proposed. Unless the Commission expressly provides otherwise, such adoption does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding.

2.2. Settled Issues

The majority of the revenue requirement elements requested in the General Rate Case (GRC) application of San Jose Water Company were either uncontested or presented to the Commission for adoption in two separate partial settlement agreements between SJWC and ORA. The settling parties filed the Settlement and the Supplemental Settlement on July 24, 2015 and August 13, 2015 respectively. Although The Mutuals participated in the formally noticed settlement conference held on May 26, 2015, they were not parties to the settlement. The Mutuals did not file a protest to either of the settlements as filed.

2.2.1. July 24, 2015 Settlement Agreement

The settled issues contained in the July 24, 2015, agreement are:

- Utility Plant Additions;
    - Source of Supply – Sites for Replacement Wells
    - Reservoirs and Tanks – Contingency Factor;
    - Pump Stations and Equipment;
    - Distribution System;
        - Recycled Water Mains;
        - City, County and State;

        - Meters;
        - Replacement of Services Greater than 2";
        - Pressure Monitors;
        - Hydrants;
        - Advanced Metering Infrastructure; and
    - Vehicles.
- Balancing and Memorandum Accounts:
    - Research, Development and Demonstrations Memorandum Account and Intervenor Compensation Memorandum Account; and
    - Updated Preliminary Statement for Pension Expense Balancing Account;
    - Mandatory Conservation Revenue Adjustment Memorandum Account.

2.2.1.1. Utility Plant Additions

SJWC requested $335,540,800 for capital investments for 2015-2017 in 15 categories. In its Report and Recommendations on SJWC's Results of Operations, ORA agreed to SJWC's proposal in some categories and recommended reductions and disallowances in others. ORA initially recommended that the Commission reduce SJWC's capital investments for 2015-2017 to $312,428,200, but after negotiations the parties agreed to 2015-2017 capital investment of $313,836,700.

2.2.1.1.1. Source of Supply – Sites for Replacement Wells

ORA recommended disallowance of $6,528,600 for purchase of property for replacement wells. ORA based the recommendation in part on cost overruns in past similar projects, and notes that any land purchase should be preceded by evaluation of the existing well sites to determine whether a replacement well can be installed. In the Settlement, SJWC agrees to defer this project to the next GRC but parties agree that SJWC would purchase a new well site if it becomes necessary and request to recover the cost of the land in the next rate case subject to review.

2.2.1.1.2. Reservoirs and Tanks – Contingency Factor

SJWC requested $20,245,300 for various replacement and improvement at its Almaden Valley Reservoir, Belgatos Station Basin, and Cox Station #2. ORA does not dispute the need for these projects but recommended lower estimated projects costs based on a lower contingency factor to arrive at $18,731,839. The parties agreed to ORA's position because SJWC has sufficient experience with similar projects to justify a lower contingency factor.

2.2.1.1.3. Pump Stations and Equipment

ORA agreed with SJWC on the need for improvement projects at the Franciscan Station pumps and Miguelito Station pumps totaling $3,669,700 but recommended that the projects be continued as Tier 2 Advice Letter projects with an estimated total budget cap of $3,669,700. ORA reserves the right to review the advice letter to be filed upon project completion for reasonable and prudent costs. In the event that final projects costs are greater than the advice letter budget cap, SJWC reserves the right to seek recovery of the overage in a subsequent GRC.

SJWC requested $5,336,000 to fund the replacement of a motor control center and add a second booster pump at the Harwood Court Station, replacement of line shaft pumping equipment and submersible pumping equipment in 2015-2017. ORA recommended a reduction to $4,376,200 for these projects by estimating budgets based on inflation adjusted historical spendings on these projects. The parties settled on a budget of $4,737,400. This settlement was arrived through SJWC's acknowledgement that budgets should be in line with historical levels and ORA's acknowledgement that rising material costs necessitate a higher budget level.

2.2.1.1.4. Distribution System

Recycled Water Mains

SJWC requested $17,025,400 for various recycled water pipeline installations using industry standard escalation factors. ORA did not object to the need for these projects but recommended lower estimated project costs based on the use of escalation factors as provided in the Energy Cost of Service (ECOS) and Natural Gas Branches monthly memos. The parties agreed to adopt ORA's position and the settlement requests authorization of $16,486,967 for the recycled water pipeline installations.

City, County and State

SJWC requested $1,263,100 in 2015-2017 for City, County, and State project related facility relocations. ORA recommended a reduction to $1,020,055 based on the five-year inflation adjusted average. The parties settled on $1,141,600 to account for increased governmental infrastructure investments while staying in line with historical averages.

Pressure Monitors

SJWC requested $1,097,100 for the purchase and installation of pressure monitors throughout SJWC's service area. ORA does not oppose the need for these projects but recommends the program be delayed for one year based on the current progress of the project. SJWC agreed to delay the project for one year and remove the 2015 budgeted portion of the overall project to arrive at $742,800.

Services

SJWC requested $63,100 for replacement of 2" and larger services. ORA recommended that services 2" and larger be captured within the overall service replacement budget. The parties agreed to ORA's position and this specific budget item was eliminated.

Meters

SJWC requested authorization for $1,114,200 in 2015 for the replacement of obsolete Sensus Meters. ORA did not object to the need for the project but recommends that 17 of the meters proposed for replacement be removed since these meters do not meet the replacement criterion. The parties agreed to adopt SJWC's proposed budget since the work to replace the meters has been completed and ORA has not challenged the reasonableness of the completed work's costs.

Hydrants

SJWC requested $947,400 for replacement of hydrants and ORA recommended a budget of $936,900 based on inflation adjusted historical average spending on this budget item from 2010 through 2014. The parties agreed to adopted ORA's recommendation.

2.2.1.1.5. Equipment

SJWC proposed full scale implementation of Advanced Metering Infrastructure (AMI) throughout the service area, which consisted of a capital component of $8,710,000 and an expense component of $3,511,800. ORA recommended that instead of authorizing a full scale implementation SJWC should conduct a study to quantify the net benefits of AMI. ORA recommended that SJWC should file a Tier 2 Advice Letter requesting pilot study funding. The parties agreed to a capital component of $225,000 ($100,000 is offset by grant funding from the Santa Clara Valley Water District) and $225,000 expense component to perform a pilot study. Upon completion of the pilot study and if the results of the study justify, SWJC can file a separate Application seeking approval for full AMI implementation.

2.2.1.1.6. Vehicles

SJWC requested a total three-year budget of $5,473,500 for the replacement of vehicles that meet SJWC's vehicle replacement criteria, or that will meet the criteria by end of 2017. Based on the Commission's vehicle replacement policy, ORA's recommendation used a mileage threshold of 120,000 miles or a service life of eight years to determine the number of vehicles that should be replaced. ORA recommended a three-year budget of $4,972,880. The parties agreed to a three-year replacement budget of $5,223,200 to account both for the specialized nature of water utility vehicles and the Commission's policy.

2.2.1.2. Balancing and Memorandum Accounts

In testimony, ORA recommended removal of an $878,024 Mandatory Conservation Rate Adjustment Memorandum Account (MCRAMA) balance from the 2012 balancing account that had subsequently been recovered. SJWC notes in its rebuttal testimony that the MCRAMA balance had been removed from the 2013 Balancing Account after recovery of the $878,024 balance and the parties agree in settlement that the MCRAMA balance was appropriately accounted for in SJWC's calculations.

ORA recommended in testimony that SJWC should update its preliminary statement to remove the Research, Development and Demonstration Memorandum Account and the Intervenor Compensation Memorandum Account. The parties agreed to keep the accounts open to track future expenses. The parties further agreed that the Pension Expense Balancing Account should be updated to reference the most current applicable GRC decision.

2.2.2. August 13, 2015 Supplemental Settlement Agreement

The settled issue in the August 13, 2015 Supplemental Settlement Agreement is the labor expenses related to Non-Tariffed Products and Services (NTP&S). The settlement results in a reduction to many of the values shown in Tables 1, 2, and 3 of the July 24, 2015, comparison exhibit, therefore, a revised comparison exhibit, reflecting the reductions, is included with the August 13, 2015, supplemental agreement.

Contemporaneous with the current GRC proceeding, SJWC sought rehearing of D.14-08-006, the Commission decision that resolved SJWC's Test Year 2013 GRC, A.12-01-003. On March 27, 2015, the Commission issued D.15-03-048, which granted limited rehearing on the treatment of labor expense related to NTP&S.

SJWC and ORA ultimately resolved the issue of NTP&S related labor expense in both proceedings by agreeing to ORA's proposed disallowance while not agreeing to a methodology for allocating such costs. SJWC and ORA filed the Supplemental Settlement Agreement concurrently in this GRC and the re-opened Test Year 2013 GRC. The Settling Parties agree that the annual amount of $442,400 represents a reasonable estimate of the amount of incremental NTP&S labor that should be credited to Test Year 2016 Total Payroll Expense forecasts. The settlement is not considered precedential and both SJWC and ORA maintain the right to recommend alternative estimating methodologies in future GRCs.

2.2.3. Discussion and Conclusion

Based upon the record of this proceeding we find the parties complied with Rule 12.1(a) by making the appropriate filings and noticing settlement conferences. The settlements are contained in Attachments B and C to this decision. The settlements also include as an appendix, a comparison exhibit listing the various elements of revenue requirement of the original, updated and final positions of the settling parties for the various accounting categories. The comparison exhibit specifies the status of each contested issue as having been resolved or remaining in dispute. The comparison exhibit also outlines the disposition of uncontested issues, stating that either ORA accepted SWJC's position as presented in its Report on the Result of Operations or SWJC accepted ORA's position as presented in its Report.

As reflected in their reports, testimony and briefs, SJWC and ORA began this GRC proceeding with different positions on various issues. The parties had access to reports, testimony, minimum data requirements, and data request responses, and have been in discussions on the issues involved. The Settlement Agreement and Supplemental Settlement Agreement represent a compromise between the parties after arm's length negotiations. We find that SJWC and ORA have considered the facts and law relevant to this case and reached reasonable compromises on most of the issues raised in SJWC's Application. We find the Settlement Agreement and Supplemental Settlement Agreement to balance various interests affected in this proceeding, reflects appropriate compromises of the parties' litigation positions and, as modified, is reasonable.

We are not aware of any statutory provisions or prior Commission decisions that would be contravened or compromised by the two partial settlements. The Settlements will result in reasonable rates for SJWC's customers that reflect the cost of providing safe and reliable water service. As such, we find the proposed settlement to be consistent with the law.

The Commission has issued numerous decisions endorsing settlements if they are fair and reasonable in light of the whole record. Adoptions of reasonable settlements serve the public interest by reducing the expense of litigation, conserving Commission resources, and allowing parties to reduce the risk that litigation will produce unacceptable results.

We conclude, pursuant to Rule 12.1(d) that the settlement is reasonable in light of the whole record, consistent with the law and in the public interest.

3. Disputed Issues between SJWC and ORA

3.1. Revenue Decoupling – Water Revenue Adjustment Mechanism (WRAM)/ Modified Cost Balancing Account (MCBA)

SJWC currently has a Monterey-Style WRAM that records the difference between the revenue generated by metered water sales via its tiered rate structure and the revenue it would have received with a single uniform rate. SJWC seeks to implement a revenue decoupling mechanism similar to the WRAM and MCBA that the Commission has approved for four other Class-A water utilities.[2] SJWC states that decoupling of revenue recovery from water sales will benefit the company, ratepayers and conservation efforts by removing the incentive to promote water sales.

SJWC's expert testified that the WRAM will ensure recovery of the portion of SJWC's fixed costs that are recovered through the quantity charge as well as certain variable costs not included in the MCBA. The MCBA will recover actual costs for purchased water, groundwater extraction fees and purchased power.

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[2] D.08-02-036 adopted WRAM/MCBA for Cal Water and Park, D.08-08-030 adopted WRAM/MCBA for Golden State Water Company, D10-12-029 adopted WRAM/MCBA for Valencia Water Company, and D.12-09-004 adopted WRAM/MCBA for Apple Valley Ranchos Water Company.

SJWC states that the two programs will accomplish revenue decoupling and replace SJWC's current incremental costs supply offset accounts.[3]

SJWC's acknowledges that the Commission has approved fully decoupled WRAMs for four other Class-A water companies as part of settlement agreements in other proceedings and they are often not considered precedential. SJWC argues that since the settlements were adopted as part of a focused investigation regarding water conservation policy, they should be considered as precedential policy.[4]

ORA objects to SJWC's request for full decoupling since the Commission-authorized WRAM pilot projects for other Class-A water companies are still under evaluation. ORA states that a permanent change in revenue accounting on the basis of a drought is not justified since the drought is not permanent.[5] ORA also asserts that full decoupling is not required to promote conservation since SJWC's conservation efforts during the drought have been effective without full decoupling and in spite of customer growth. ORA states that SJWC's effective and ongoing conservation efforts are proof that SJWC's desire for decoupling is more about revenue protection than conservation.

ORA posits that SJWC's existing Monterey-Style WRAM, Incremental Cost Balancing Account, Mandatory Conservation Revenue Adjustment Memorandum Account (MCRAMA) and Water Conservation Memorandum Account (WCMA) protect SJWC's financial interest in providing safe and reliable

[3] Ex. SJWC-1, Ch. 19 at 5-7.

[4] Ex. SJWC-1, Ch. 19 at 15-16.

[5] Ex.O-1 at 3-18:3-8.

service, while ensuring SJWC and its customers are proportionally affected.[6] ORA states that these mechanisms ensure that when conservation rates are implemented neither party suffers nor benefits from the rates.

The Commission does not adopt SJWC's requested change from a Monterey-Style WRAM to fully decoupled WRAM at this time. SJWC's current water conservation success demonstrates that full revenue decoupling is not necessary to promote water conservation and SJWC has not adequately established another basis for the change requested.

Of the companies that currently have WRAM/MCBA, one has had no review due to scant data, one review resulted in the adoption of another pilot mechanism which requires future review, one review was inconclusive on the important question of excessive undercollections and one awaits a final decision on all questions of the WRAM/MCBA effectiveness.

Finally, Decision (D.)14-10-047 ordered a Phase II in Rulemaking (R.) 11-11-008 to analyze and propose action on issues regarding affordability and rate design, including but not limited to conservation rate design such as tiered rate structures and accounting mechanisms such as the WRAM. Pursuant to the Third Amended Scoping Memo, dated April 30, 2015, Phase II is now scheduled to close by October 30, 2016. In light of this, any changes to SJWC's existing mechanisms are premature.

For these reasons, we do not alter SJWC's Monterey-style WRAM at this time.

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[6] The MCRAMA tracks the revenue impact due to mandatory conservation. The WCMA tracks the additional administrative costs and operating costs from mandatory conservation not otherwise recoverable through an existing mechanism or rates authorized by the Commission.

3.2. WRAM-Related Conservation Programs

SJWC seeks to include additional conservation programs along with the requested WRAM/MCBA programs. SJWC forecasts $1,536,100 in WRAM Related Conservation Plan expenses for 2016. SJWC's WRAM related conservation programs and their costs for 2016, 2017 and 2018 are:

- Waterfluence Landscape Budget Program ($0);
- Home Water Use Reports ($1,967,499);
- Ultra-High Efficiency Toilet, Showerhead, and Aerator Direct Install Program ($1,920,000);
- Commercial Industrial and Institutional (CII) Survey Program ($375,000);
- School Education Program ($318,000); and,
- Landscape Education Program ($27,300).

SJWC states that while its customers have achieved significant reductions in gallons per capita per day water use, meeting the 30 percent reduction SJWC has asked of its customers will require that SJWC make as many programs as possible available to its customers. SJWC also states that additional conservation programs are needed to fill gaps in its existing conservation programs. SJWC witness Pink's testimony summarized the benefit-to-cost ratios for four of the six proposed programs. The summary resulted in a positive ratio for each program, meaning that the discounted cost of water saved per acre-foot is significantly lower than for any other source of water supply.[7]

ORA recognizes the success of the current conservation programs and their results and recommends that the existing budget be continued. ORA notes that ongoing conservation programs include low-flow shower heads and faucet

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[7] Exhibit (Ex.) SJWC-1, Ch. 18 at 32-33.

aerators, public education and participation in programs offered by the Santa Clara Valley Water District (SCVWD) and that these programs are funded indirectly through pump taxes paid by SJWC ratepayers to SCVWD. However, ORA recommends against specific additional funding for the requested new programs. ORA asserts that any new conservation programs should be addressed through SJWC's existing conservation budget.[8]

ORA notes that SJWC received funding for three years of the School Water Education Program in the last GRC, but has only spent six months' worth of the funding so far. ORA claims that SJWC's statement that it will discontinue the program unless it is again funded in rates[9] is proof of SJWC's lack of commitment to the program.

Since most of the programs SJWC requests additional funding for are programs already provided through SCVWD, we decline to approve additional funding for them here. The CII program is not currently funded, but as this is similar to a program SCVWD discontinued in 2012, we decline to adopt funding for it here.

Although SJWC used only six months' worth of the School Water Education Program funding, the late release of the decision in that GRC may have more to do with it than SJWC's lack of commitment to the program,[10] as asserted by ORA. We find that programs educating the next generation of ratepayers about the importance of water conservation useful and therefore

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[8] ORA does recommend expanding SJWC's recycled water program which amounts to a 1887 percent increase in total conservation spending.

[9] Reporter's Transcript (RT) at 311:6-11.

[10] Ex. SJWC-10, Chapter (Ch.) 6 at 3-4.

reasonably included in rates. Since SJWC was granted three years funding for the program in the last GRC and had spent only six months' worth by the time the current application was filed, we will continue to fund the program, but for only an additional 18 months. Since SJWC still has funding left over from the last GRC, eighteen more months of funding should take it to the next GRC. Therefore, we approve additional conservation spending of $159,300 for the School Water Education Program To ensure timely utilization of both the past unspent dollars and the prospective authorized dollars, we order both the past unspent funds and the additional authorized spendings be booked to a one-way balancing account.

3.3. Payroll Expenses

3.3.1. Escalation Factors and Methodology

SJWC requested $42,504,336 in payroll expenses, decreased to $42,495,890 in its 45-day update. SJWC asserts that its payroll expense forecast is based on the existing number of positions at the time of filing this application (358 which includes 3 positions not currently included in rates) and their known salaries at the time. For the 2016 calculation, SJWC used an estimate of the 2015 payroll expense and applied the 3 percent contract agreement increase for union members and a 5 percent increase for administrative employees to bring them closer to the market average.[11] The 5 percent figure for administrative employees and officer compensation is based on SJWC's calculated 2.8 percent inflationary factor, plus a market adjustment of 2.2 percent. SJWC then used the Commission-published ECOS labor factors for escalation years 2017 and 2018.

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[11] Ex. SJWC-1, Ch. 5 at 3.

ORA calculated 2015 payroll expense using 2014 actual data escalated by 3 percent for union employees (as per contract) and the most recent ECOS labor factor of 1.6% for administrative employees and officers. For the 2016, 2017 and 2018 payroll expense, ORA escalates the union employees' salaries by the union contract amount of 3 percent and the administrative employees and officers by the ECOS escalators.[12] ORA argues that its methodology uses actual payroll expense data as the baseline and then applies the union contract increases and the ECOS escalation factors for administrative employees and officers for 2015 and each year thereafter for the three-year GRC cycle.

ORA points out that SJWC used the ECOS figures to escalate years 2017 and 2018, but for Test Year 2016 opted to use 5 percent, the SJWC-calculated combination of inflation factor and market adjustment rather than the ECOS figure of -0.7 percent. SJWC's rationale for not using the 2016 ECOS escalation factor is that it is an anomaly. ORA argues that a uniform source for the escalation factors is preferable to picking and choosing among various sources.

We adopt a combination of the SJWC and ORA positions on methodology. We believe that ORA's method of using the 2014 actual payroll expense data is a preferable starting point than estimating 2015 payroll and escalating from there. We agree with SJWC and ORA that the union contract figures be adopted as the escalation factors for union employees' payroll. However, for the administrative employees' and officers' payroll escalation factors, we impute an escalation factor of 2.2 percent for 2016 and use the current ECOS escalation factors for

[12] Ex. O-1, at 3-4 and 3-5.

2015, 2017 and 2018 respectively.[13] We agree with SJWC that the 2016 ECOS figure of -0.7 percent is an anomaly, but decline to adopt SJWC's 2016 escalation factor of 5 percent. Although it is a nice round figure, we find that imputing an escalation factor based on the average of non-anomalous ECOS years 2015, 2017 and 2018 is a more reasonable basis for determining the escalation factor for 2016. The average of 2015 (1.6 percent), 2017 (2.3 percent) and 2018 (2.7 percent), ECOS escalation factors is 2.2 percent. Therefore, the escalation factors used to determine administrative employees' and officers' salaries are 1.6 percent for 2015 and 2.2 percent for 2016. For escalation years 2017 and 2018, the actual ECOS escalations factors in effect at the time of the filings will be used.

3.3.2. New Positions

SJWC seeks approval and funding for 33 new positions for a total cost of $3,218,300. SJWC provided explanations of the need for the additional positions including but not limited to three in the Customer Service Department, four in the Distributions Systems Department, seven in the Engineering Department, four in Operations, and six in the Water Quality Department. SJWC asserts that the need for the additional employees is based on increased regulatory obligations, improved customer service and increasing infrastructure replacement.

ORA states that SJWC's request for 33 new positions represents a 9.21 percent increase in staffing when the customer growth rate is only 0.29 percent. ORA asserts that SJWC's request results in an increase of 30 times

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[13] The ECOS factors are derived from the IHS Global Insight U.S. Economic Outlook, which is updated monthly. Parties' testimony was inconsistent as they used various escalation factors based on different publication dates, but the numbers used here are based on the parties' agreed upon use of the February 2015 ECOS inflation factors.

the average historical customer growth rate at a time when customers are facing increased rates due to mandatory water conservation.[14] ORA also points out that as of March 31, 2015, SJWC had 15 vacant positions and that several of the vacant positions are very similar to the new positions requested by SJWC. For instance, vacant positions include a Distribution Systems Laborer, and Assistant Civil Engineer and a Water Treatment Plant Operator, yet SJWC requests approval for a Distributions Systems Worker, and Assistant Civil Engineer and a Water Treatment Supervisor. On this basis, ORA recommends the Commission approve five new positions, one for the customer growth rate, three positions that were filled during the last GRC and one for the Information Governance Initiative capital project.[15]

We find SJWC's request for 33 new positions unreasonable in light of the fact that new positions are being sought for classifications currently included in payroll expense, but vacant. Based on SJWC's testimony, there has been an abnormal number of retirements, and as vacancies come up and are filled, other positions open lower in the "food chain" and the ultimate openings for external hires are likely to be at entry level positions.[16] With the number of fully funded vacancies, retirements at the higher pay rates, and the probability of positions being filled at entry-level salaries, SJWC has the discretion to reallocate resources and make personnel changes within the current payroll expense.

For these reasons, the Commission approves six new positions of the 33 requested by SJWC. We approve one position on the basis of customer

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[14] Ex, O-1, at 3-7 and 3-8.

[15] Ex. O-1, at 3-8.

[16] RT 318:22-387:8, 393:11-394:21, 408:4-409:10.

growth rate. We approve the three positions SJWC has already filled, although SJWC should not take this as a sign that if they fill positions not included in payroll expense they will automatically be approved in the next GRC. We find that three new positions are within reason. We approve one position to improve technology in Customer Service as it will enhance customer access to information and communication with the company. Finally, we approve a Records Manager for the Information Governance Initiative, a capital project supported by ORA.

3.3.3. Temporary and Part Time Positions

SJWC includes $288,870 in its payroll expense for part-time and temporary labor. SJWC claims that temporary labor is included in union contracts, provides needed additional help during peak summer months, is cheaper to employ and helps when regular employees are on extended absences. SJWC employs 24 to 26 college students each summer and 2 part-time Customer Service Representatives to maintain service levels to customers.[17] SJWC states that the use of temporary and part time employees is so crucial to the continued efficient operations of the company that is has continued to employ this labor even though recovery of the cost was disallowed in the last GRC.

ORA argues that recovery for the use of temporary and part time employees was disallowed in the previous rate case because they do not provide continuous benefit to ratepayers and therefore should also be denied recovery here. ORA states that the costs are speculative and if SJWC does not use the labor, it results in a windfall to the company at ratepayer expense.[18]

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[17] Ex. SJWC-10 at 4-6.

[18] Ex. O-1 at 3-5.

We disallow recovery for temporary and part time positions because the need is uncertain and therefore does not provide a continuous benefit to ratepayers. We acknowledge that there may be times when temporary or part time employees are necessary and to the extent that they provide cover for vacant, fully funded positions, additional ratepayer funding is unnecessary. SJWC also has the discretion to allocate existing payroll to cover the expense of temporary or part time coverage for vacations or extended absences.

3.3.4. Bonuses for Officers and Managers

SJWC maintains a short-term incentive (SIT) plan and a long-term incentive (LTI) plan that provides annual cash awards to reward officers' and managers' superior performance and to reinforce SJWC's short and long-term strategic goals and objectives. Approximately 38 managers and officers out of a total of 358 employees are eligible for the STI and a limited number of field supervisors and administrative employees are given the opportunity to earn modest bonuses. SJWC asserts that the STI brings total compensation for administrative staff to 92 percent of comparable companies and agencies and provides an incentive to greater effort and benefit to customers.[19]

SJWC described the purpose of the LTI as designed to improve the Company's long-term performance and to address concerns of shareholder advocacy groups that a significant portion of officer compensation for publicly traded companies should be based on incentives and aligned with shareholder interests. SJWC described the LTI as part of total compensation that is compared to the compensation of officers of other companies. The LTI requires that certain

[19] Ex. SJWC-1, Ch. 5 at 1-2.

conditions are met by the officers, including service time period requirements, and that they are critical to retaining valuable personnel.[20]

SJWC explained the importance of the LTI as a reallocation of payroll expense between cash compensation and long-term incentives. SJWC asserts that it benefits ratepayers because without it, cash compensation would need to be increased by 10 percent -30 percent to be at market.[21]

ORA asserts that SJWC's witness admitted that the company's LTI plan is designed to address concerns of shareholders and that a large portion of officer compensation is based on incentives that align with shareholder interests.[22] ORA states that because the incentives align with shareholder interests, ratepayers should not be asked to fund the bonus program.

ORA also asserts that unused bonuses would be a ratepayer-funded windfall to the company. In response, SJWC claims that it has typically paid more than 100 percent of its STI targets and so there should be no concern over a potential windfall.[23]

The Commission does not adopt SJWC's proposed officer bonus amounts in payroll expenses. We agree with ORA that ratepayers should not be required to fund additional payroll expenses for incentives that align with shareholder interests. We declined to adopt the ECOS escalation figure of -0.7 percent for 2015 and have instead increased payroll expense by 2.2 percent with additional increases in the escalation years. These increases afford SJWC the option to

[20] *Id*. at 2.

[21] *Id*. at 3.

[22] RT 397:14-28.

[23] Ex. SJWC-10 at 4-3 to 4-4.

determine the size of salary increases and bonuses for individual employees based on their performance.

3.3.5. Overtime Expense

SJWC calculated overtime expense based on a non-inflation adjusted three-year average using years 2012 - 2014. ORA recommends using a non-inflation adjusted five-year average that will reduce the abnormally high overtime years such as 2013.

We adopt SJWC's three-year non-inflation adjusted average using 2012 - 2014. The three-year average provides a sufficiently normalizing effect on the high overtime in 2013.

3.4. Regulatory Expense

SJWC seeks regulatory expense of $1 million for the current GRC cycle using a three-year cycle to estimate, resulting in $341,000 for Test Year 2016 and including one Cost of Capital proceeding, at least one formal application coming out of this GRC and miscellaneous other activities not related to a formal proceeding. SJWC states that the regulatory landscape has become more complicated, contentious and costly with GRCs and other proceedings taking longer than outlined in the scoping memo and requiring additional outside services such as legal, consulting, noticing and printing. SJWC cited safety and security issues, drought response and increased participation by intervenors as other reasons for increased regulatory expenses.

ORA objects to SJWC's estimate on the grounds that it is based on the assumption of a fully litigated rate case. ORA cites SJWC's last GRC which was fully litigated, yet the total regulatory expense for the last three-year rate case cycle was only $570,000, which does not justify the requested regulatory expense of $1 million.

ORA states that using an average based on a five-year cycle is more reasonable as it evens out variations. Based on a five-year inflation adjusted average, ORA recommends Test Year 2016 expenses of $185,000. SJWC states that a five-year cycle eliminates one GRC year, the most expensive year in a three-year cycle. SJWC demonstrated that using ORA's forecast method, applied to a six-year cycle that captures the expenses of two general rates cases, and with the same inflation factors resulted in Test Year 2016 expenses of $216,000.

We find neither SJWC's nor ORA's estimates reasonable. SJWC's estimate, using a three-year cycle that included the cost of a fully litigated GRC and estimating upward from that point, overestimates expenses.

ORA's estimate is based on a five-year average that included only one GRC and therefore underestimates expenses. We agree with SJWC that there may be some increased regulatory expense due to safety concerns, however, drought response should be adequately addressed in the existing memorandum accounts. We see no added expense due to increased intervenor involvement. The same parties are involved in this proceeding as were involved in the previous GRC. We also agree that SJWC will likely have a Cost of Capital proceeding in the next three-year cycle and expenses for that should be anticipated and included. With these considerations in mind we adopt Test Year 2016 regulatory expense of $216,000 based on ORA's method as modified using a six-year base period.

3.5. Corporate Expense

SJWC based its $908,000 estimate of corporate expenses for Test Year 2016, on the actual 2014 costs, adjusted for weighted composite and customer growth factors. SJWC explains that corporate expenses encompass SEC filings, investor relations, shareholder meetings, fees related to stocks and bonds and director's fees and expenses.[24]

ORA objects to SJWC's calculations because 2014 is the highest corporate expense period over the last five years. SJWC states that using the most recent and highest recorded amount most accurately reflects the current level of these expenditures and the upward trend in these expenses.[25] ORA recommends using a five-year inflation adjusted average which results in $790,000 of corporate expense for Test Year 2016. ORA's rationale is that because corporate expense is an expense category where costs fluctuate from year to year, it is more reasonable to use the five-year average.

We agree that there may be fluctuations in this expense category and therefore it is more reasonable to use a five-year average. On that basis we adopt the ORA figure of $790,000 for Test Year 2016 corporate expenses.

3.6. Payroll Taxes

The largest expense for payroll taxes is the Federal Insurance Contributions Act (FICA) taxes. There are two components of FICA taxes; FICA Social Security (6.2 percent of gross earnings with maximum taxable earnings of $106,800) and FICA Medicare Tax (1.4 percent of gross earnings without a cap). The FICA tax rates have been steady since 2003, with the FICA Social Security maximum taxable earnings increasing gradually every year. The combined FICA tax rates for Social Security (6.2 percent) and Medicare (1.45 percent) have remained constant at 7.65 percent.

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[24] Ex. SJWC-10 at 2-5.

[25] Ex. SJWC-10 at 2-6.

SJWC estimated its FICA taxes for 2016 as $3,000,300 using a three-year historical average of 7 percent and applying it to the total payroll expense. The result was 9.6 percent, and it was applied to SJWC's payroll, which had capitalized labor deducted.[26]

ORA objects to SJWC's calculations, stating that the 9.60 percent ratio is much higher than the maximum FICA rate of 7.65 percent. ORA believes the cause of this discrepancy is that SJWC did not reduce its estimate by the amount of capitalized FICA, which is supposed to be 24.17 percent. ORA states that SJWC capitalizes 24.17 percent of its State Unemployment Insurance and Federal Unemployment Insurance taxes and should reduce its FICA estimate by the same at amount.[27]

SJWC responded by stating that the capitalized portion of FICA was already accounted for in SJWC's workpapers and so ORA's recommendation would amount to removing the capitalized portion twice. ORA stated that if SJWC agreed that 24.17 percent of FICA tax should be capitalized, ORA would be willing to add $589,000 to plant additions to compensate for the loss of overhead.[28]

SJWC recommends that the Commission adopt its forecasting methodology. However, if the Commission adopts ORA's methodology, the capitalized portion of payroll removed from total payroll taxes should be added back into Administrative Expenses Transferred, to avoid double removal and thereby should be included in Plant Additions.

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[26] Ex. SJWC-2, Workpapers at 10-2 and 10-7.

[27] EX. O-1 at 6-2 and 6-3.

[28] RT 416:24-417:8.

SJWC's original methodology resulted in ratepayers paying FICA taxes in excess of the 7.65 percent cap and is unreasonable. We adopt ORA's methodology since it complies with the maximum total FICA tax rates. Therefore, 24.17 percent of the FICA tax should be capitalized and the capitalized portion should be added to plant additions.

3.7. Memorandum Accounts to Record Prior Years' Tax Credits

On August 14, 2013, the Treasury Department (Treasury) and the Internal Revenue Service issued the final Tangible Property Regulation (TPR), T.D.9689. The final regulation considers the dichotomy between the Internal Revenue Code Sec 263(a) which requires capitalization of amounts paid to acquire, produce or improve tangible property and Internal Revenue Code Sec 162 which allows deductions for all ordinary and necessary expenses paid or incurred during a taxable year in carrying on any trade or business, including costs of certain supplies, repairs, and maintenance. The final TPR regulations attempt to provide a framework for distinguishing capital expenditure from supplies, repairs, maintenance, and other deductible business expenses.

The TPR allows a catch-up deduction referred to as the Section 481(a) adjustment resulting from the retroactive application of the regulation to prior years as well as annual repair deductions for future years. Based on witness testimony, SJWC will have filed its 2014 taxes in September of 2015 which includes catch-up deductions going back to 2006.[29]

A taxpayer engaged in a trade or business within a designated Enterprise Zone (EZ) can take an Enterprise Zone Sales and Use EZ credit for sales or use

[29] RT 291:11- 296:16.

tax paid or incurred in connection with the purchase of qualified property. The existing credit was repealed on January 1, 2014. SJWC filed refund claims for years 2008 – 2012 to claim the EZ credit and received $880,000 in credit in 2014.

ORA asserts that the savings impact of the TPR for 2013 and prior years ($4.8 million), 2014 ($1.1 million) and 2015 ($1.3 million),[30] were not reflected in SJWC's last GRC. ORA also claims that SJWC's EZ credit refund of $880,000 was not reflected in the last rate case and should be passed on to ratepayers depending on the result of SJWC's pending audit.

ORA proposes two tax memorandum accounts to account for changes in tax law in the TPR and the EZ credit to track refunds and return them to ratepayers. ORA claims that in this GRC, where revisions in tax law have significantly changed the situation between the utility and the ratepayers, a memorandum account is not only permitted but should be established to ensure ratepayers benefit from the changes. ORA argues that the memorandum account treatment is appropriate here because the change in the tax rules were of an exceptional nature that:

- Are not under the utilities control;
- Could not have been reasonably foreseen in the utility's last GRC;
- Will occur before the utility's next GRC;
- Are of a substantial nature such that the amount of money involved is worth the effort of processing a memo account; and
- Have ratepayer benefits.[31]

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30 Ex, O-1 at 5-5.

31 Standard Practice U-27-W at 6, paragraph 27.

ORA argues that all of the elements of memorandum account treatment are present here. The tax laws are not under the control of the utility and could not have been foreseen in SJWC's last rate case. SJWC will file its taxes before its next rate case and the amount of the money is substantial; a $14.4 million change in federal taxes due and a $4.8 million change in state taxes due. The memorandum accounts would benefit ratepayers by allowing the benefits of tax refunds to flow through to ratepayers. ORA further asserts that the TPR adjustments for earlier years affects not only present income taxes, but also the future income taxes that ratepayers must pay.

SJWC claims that the TPR was released in August 2013, after the record was closed in the last GRC and that is why the refunds were not included in that case. SJWC claims that the memorandum accounts to track refunds requested by ORA amount to retroactive ratemaking and should be rejected by the Commission. SJWC also claims that the appropriate tax treatment according to the TPR is included in this rate case filing. SJWC claims that the use of a memorandum accounts permits the Commission to preserve expenses or revenues for future consideration of their impact on rates, but only to the extent that those expenses or revenues are incurred or accrued after the memorandum account has been authorized and established.

SJWC cites multiple cases in which it was decided that memorandum accounts can serve the interests of a public utility in recovering costs not previously recognized in rates, but only to the extent that those costs or revenues are incurred or accrued after the memorandum account has been authorized and established.[32]

We decline to adopt the memorandum accounts based on the changes in the TPR and EZ credit due to timing issues related to the establishment of the memorandum accounts. On the surface the memorandum account criteria appears to fit for the tax revisions that took place in August 2013;

- The costs, or in this case refunds, based on new tax regulations were not under SJWC's control;
- The refunds could not have been reasonably foreseen in the utility's last GRC;
- The refunds occurred before the utility's next GRC;
- The costs are of a substantial nature such that the amount of money involved is worth the effort of processing a memo account; and
- The refunds have ratepayer benefits.

Memorandum accounts are typically established through the GRC process, to track for recovery or refund unforeseen costs occurring during the subsequent three-year rate case cycle. This rule is not absolute, the Commission may order utilities to set up memorandum accounts during the three-year cycle if we become aware of circumstances necessitating its establishment. In order to avoid retroactive ratemaking, the timeline for establishment of the memorandum account is essential.

In the case at hand, the establishment of memorandum accounts is sought to track refunds that have already been received by SJWC.

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[32] RT 301:21 – 302:20.

The past years' tax expenses were based on reasonable estimates of costs approved in the GRCs at that time. In order to track refunds of those taxes and provide them to ratepayers, a memorandum account would have had to be established before SJWC files its taxes and receives refunds.. For these reason, we do not approve the establishment of memorandum accounts to track tax refunds of the TPR and EZ credits. We note here that changes in tax law that occur between a utility's GRCs should receive appropriate regulatory treatment. When utilities experience or anticipate large and unexpected increases in costs, they will typically request authority from the Commission to establish a memorandum account or raise rates. Utilities should be under the same obligation to notify the Commission when it experiences or anticipate a large reduction in its revenue requirements due to tax changes.

3.8. Health Care Cost Balancing Account

SJWC requests authorization for a Health Care Cost Balancing Account to recover or refund premium changes for both medical and dental plans based on the uncertainty of the impacts of the Affordable Care Act (ACA). SJWC cites the similar memorandum or balancing accounts authorized by the Commission for other companies based on the same rationale it is using.[33]

SJWC states that it has experienced dramatic year-to-year fluctuations in medical and dental premiums and expects the fluctuations to continue in light of the passage of the ACA.[34] SJWC also states that the balancing account is

[33] Ex. SJWC-1, Ch.5 at 29-30.

[34] Ex. SJWC-10 at 8.

necessary because in the future the Internal Revenue Service may tax these benefits, increasing the employer and employee payroll tax liability.

ORA asks the Commission to reject SJWC's request for a Health Care Balancing Account. ORA states that the ACA was enacted in 2010 and is currently 91 percent implemented and therefore, the program and its impacts are known and SJWC can make adjustments to lessen any further impacts. ORA's suggested adjustments are reducing the high cost plans known as "Cadillac Plans" to avoid the Tax on High-Cost Insurance Plans. ORA also suggests that SJWC pass excess medical costs through to its employees or compensate employees in lieu of health care coverage.[35]

ORA uses information provided by SJWC in its application to illustrate that medical premium rates have been trending lower since the initial increases that occurred in the early years of the ACA. And except for 2015, dental premium rates have been low with the average premium increase for the last six years being 0.92 percent.[36]

ORA also states that the Commission-authorized memorandum or balancing accounts for the other Class-A water companies were enacted based on a different set of circumstances than currently exists for SJWC. ORA points out that the existing balancing or memo accounts were approved when only half of the provisions of the ACA were implemented and therefore some uncertainty regarding costs existed, or were part of a settlement and limited to one rate case cycle, with review in the next GRC.[37]

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[35] Ex. O-1 at 12-3.

[36] *Id* at 12-4 to 12-6.

[37] Ex. O-1 at 12-7 to 12-8.

We do not approve SJWC's request for a Health Care Cost Balancing Account. SJWC's own information illustrates that the wild fluctuations in premiums are over. We also believe that approving the establishment of a balancing account removes the incentive for SJWC to control health care benefit costs. The circumstances under which we approved health care cost balancing accounts in the past do not exist for SJWC. Therefore, approving a Health Care Cost Balancing Account in this proceeding is not reasonable.

4. Disputed Issues between SJWC and The Mutuals

In 2006, SJWC acquired the Redwood Estates Mutual Water Company which became SJWC's Mountain District. The Mountain District is located in the Santa Cruz Mountains south of SJWC's service territory and at the time of acquisition was supplied by SJWC's Montevina pipeline which had a pumping capacity of 320 gallons per minute. This supplied the Mountain District customers with 250 gallons per day. SJWC filed Tariff 1C for the Mountain District which had certain differences in rates and terms of service than Schedule 1, which was applicable to other service areas. Initially Schedule 1C applied to 374 residential customers formerly served by Redwood Estates Mutual Water Company as well as eight mutual water companies which in turn served 456 other residential customers. By 2010, all six of The Mutuals involved here had been added and SJWC was serving 386 residential customers and nine total mutual water companies in the Mountain District.

4.1. Elimination of the Mountain District and the Tariff Schedule 1C

The Mutuals propose to eliminate Tariff Schedule 1C and the Mountain district, claiming it is merely a pressure zone of SJWC, that there is no difference in cost to provide service, therefore, no justification for the rate differences and that the Mountain District provides excess revenue to SJWC.[38]

SJWC responds that the distinctive use-limiting characteristics of the Mountain District's Tariff Schedule 1C have enabled SJWC to provide reliable service to the Mountain District customers without multi-million dollar investments in enhanced pumping facilities. SJWC explains that there is a limitation to the amount of water that can be supplied to the Mountain District. That amount is currently 500 gallons per day per customer. SJWC claims that 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 safety margin or peaking factor, but an equipment malfunction or significantly increased usage by most Mountain District customers on a particular day could cause an unavoidable interruption. Similarly, unrepaired leaks in The Mutuals' distribution systems could lead to unavoidable service interruptions if usage limits were not in place. The limits also provide an incentive for The Mutuals to properly maintain their systems and to repair leaks promptly.[39] The Schedule 1C $7 per hundred cubic foot over-use charge coupled with the service interruptibility condition serve as an incentive to customers to be mindful of usage and are necessary to ensure adequate water supply.

[38] Ex. M-1 at 15.

[39] Ex. SJWC-11 at 2-2 to 2-3.

The Mutuals claim that SJWC's statements are inconsistent. SJWC's witness stated that the "capacity is adequate" and "we have not had to interrupt anybody's service to date."[40] The Mutuals assert that those statements are proof that the usage limitation and the interruptibility provision are unnecessary. SJWC responds that those statements actually prove that the usage limitation and the interruptibility provision are doing what they are supposed to do and should be maintained. SJWC believes that absent the current usage limits, over-use fee and service interruptibility, demand in the Mountain District would exceed capacity.

We do not adopt the Mutuals' recommendation to eliminate the Mountain District or Tariff Schedule 1C. The current tariff provisions were part of a Commission-approved settlement agreement between SJWC and seven mutual water companies in its 2009 GRC. The Mutuals have not provided sufficient support for their position that Tariff Schedule 1C, with its 500 gallon per day per customer usage limit, over-use fee, and interruptibility provision is not required to maintain adequate supply to the Mountain District customers. Conversely, SJWC has proved that the usage limits included in Tariff Schedule 1C are operating as intended and are necessary for SJWC to continue to provide adequate supply to the Mountain District without requiring a large capital investment to enhance pumping facilities.

4.2. Equalizing Rates of Return

The Mutuals propose significant adjustments to equalize the rate of return from all service and customer classes so that all classes deliver similar if not

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[40] RT 160:16-19 and 161:8-19.

identical rates of return to SJWC.[41] This would be accomplished by recovering fixed costs via service charges and variable charges by quantity charges and then allocating rate of return to each based on their ratio to total costs.

The Mutuals claim that SJWC has a -6.48 percent rate of return on service to the 90 percent of its customers in the residential class.[42] Under cross-examination by ORA's counsel, the Mutuals witness calculated that residential customers use about 58 percent of SJWC's water production but provide about 62 percent of SJWC's revenues.[43]

SJWC concedes that some customer classes pay more than others, but states that it is because they use more water on a per connection basis and have a higher capacity requirement as evidenced by the larger meter sizes.[44] SJWC explained that it uses just one calculation of rate of return and it is based on the rate base for the entire system, cost of service for the entire system and revenues for the entire system, applying a methodology that has been reviewed and approved by the Commission in numerous GRC proceedings.[45] SJWC contends that there is no added benefit, but substantial costs associated with determining rate base, cost of service and revenues as applied to individual customer classes.

We decline to adopt the Mutuals' rate design for equalizing rates of return among customer classes. We are not convinced it is necessary and even if we were, the Mutuals' proposal assumes that equalized rates of return are the single

[41] Ex. M-1 at 16 and 28.

[42] *Id* at 32-33.

[43] RT 282:2 – 283:22.

[44] Ex. SJWC-11 at 1-11.

[45] *Id* at 1-12.

most important factor involved in rate design. The Mutuals' proposal ignores the myriad other considerations that go into developing rate design.

4.3. Expanded Water Conservation

SJWC's requested Water Conservation programs were discussed and resolved in Section 3.2.

4.4. Water Ratepayer Assistance Program (WRAP) Discounts

The Mutuals recommend that WRAP discounts be changed to qualify beneficiaries based on living status – specifically by giving higher residential discounts to households of three or more.

SJWC agrees with this proposal as WRAP eligibility is based in part on living status, with income qualification guidelines tied to the number of people in the household. SWJC also noted that the WRAP discount is based on the total bill, which is in part based on the number of people in the household, thus providing larger discounts to households with more people.

5. Pending Motions

On August 4, 2015, SJWC filed a motion to strike portions of the Reply Brief filed by The Mutuals. The motion sought to strike portions of pages 3 through 7 and page 12 of the Mutuals' reply brief on schedule 1C and the The Mutuals' proposed rate design. The Mutuals did not file a response.

SJWC states that portions of The Mutuals reply brief presents assertions of fact based on information outside the evidentiary record, accuses one SJWC witness of misleading the Commission without foundation, breaches the confidentiality of prior settlement negotiations, and presents a new argument that is not responsive to claims in SJWC or ORA's opening briefs.

We deny SJWC's motion to strike portions of The Mutuals' reply brief as moot. Our decision today considers only information within the evidentiary record and accords appropriate weight to the parties' assertions.

6. Comments on Proposed Decision

The proposed decision of Judge S. Pat Tsen in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on _____ by _____.

7. Assignment of Proceeding

Liane M. Randolph is the assigned Commissioner and S. Pat Tsen is the assigned judge in this proceeding.

Findings of Fact

1. SJWC filed A.15-01-002 on January 5, 2015, requesting an increase of $34,928,000 or 12.22 percent in 2016, $9,954,000 or 3.11 percent in 2017, and $17,567,000 or 5.36 percent in 2018, over currently authorized rates.

2. On February 2, 2015, ORA filed a protest to SJWC's application.

3. On March 5, 2015, The Mutuals filed a protest to SJWC's application.

4. On July 24, 2015, SJWC and ORA filed a motion to adopt a partial settlement agreement on various issues.

5. On August 13, 2015, SJWC and ORA filed a motion to adopt a supplemental partial settlement agreement on NTP&S.

6. The July 24, 2015 and August 13, 2015 partial settlement agreements resolve most of the contested issues between SJWC and ORA.

7. The Mutuals is not a party to the July 24, 2015 and August 13, 2015 partial settlement agreements but it participated in the settlement negotiations and did not file a protest to the proposed settlements.

8. The July 24, 2015 and August 13, 2015 partial settlement agreements represent a reasonable compromise of SJWC and ORA's litigation positions and are supported by the record of the proceeding.

9. The July 24, 2015 and August 13, 2015 partial settlement agreements do not contravene any statutory provisions or prior Commission Decisions.

10. The July 24, 2015 and August 13, 2015 partial settlement agreements, if adopted, will reduce litigation expenses, conserve Commission resources, and provide SJWC customers with safe and clean water at reasonable rates.

11. SJWC seeks Commission approval to implement a WRAM and MCBA decoupling mechanism that would decouple revenue recovery from water sales, similar to what the Commission has approved for other Class-A water utilities.

12. SJWC operates with a Monterey Style WRAM, and its water conservation programs have met or exceeded the state's conservation mandates.

13. The Santa Clara Valley Water District provides funding to SJWC for the Waterfluence Landscape Budget program, Home Water Use Reports, Ultra-high Efficiency Toilet, Showerhead and Aerator Direct Install Program, Commercial Industrial and Institutional Survey Program and the Landscape Education Program.

14. Of the three-year funding it received in the last GRC, SJWC has spent only six months' worth of funding on the School Education Program.

15. $159,000, along with the unspent funds authorized in the last GRC, should be sufficient to continue the School Education Program in this rate cycle. A

School Education Conservation Program one-way balancing account protects ratepayers and ensures refund of unspent funds.

16. Union contracts dictate annual pay increases for union employees.

17. ECOS labor factor is a reasonable figure to be used in determining non-union employee payroll expense escalations.

18. SJWC has provided sufficient justification for six new positions, including one reflecting customer growth, three filled during the last rate case cycle, one in the Customer Service Department for improved technology, and one Records Manager for the Information Governance Initiative, a capital project, is reasonable.

19. Temporary and part time employees, to the extent they are filling in for vacant and authorized positions, can be funded through Commission authorized payroll spending.

20. Granting bonuses for officers and managers for their activities that align with shareholder interests do not provide a continuous benefit to ratepayers.

21. Overtime expenses should be normalized by using a three-year average.

22. Regulatory expenses should be determined using a six-year average to account for all types of regulatory filings.

23. Test Year 2016 Corporate Expenses should be determined using an average of the last five years.

24. SJWC estimated its FICA tax at 9.6 percent ratio to SJWC's total payroll expense for 2016.

25. FICA tax rates have not exceeded 7.65 percent since 2003.

26. SJWC reduced its State Unemployment Insurance and Federal Uninsured Insurance estimate by 24.17 percent to account for capitalization. The same reduction should be made to SJWC's FICA estimates.

27. Establishing memorandum accounts to track future refunds of taxes paid in past GRCs is retroactive ratemaking.

28. The wild fluctuations in premiums due to implementation of the Affordable Care Act have subsided.

29. A Health Care Cost Balancing Account removes the incentive for companies to control health care benefit costs.

30. The circumstances under which we approved Health Care Cost Balancing Accounts in the past do not exist here.

31. The Mountain District is appropriately placed under Tariff Schedule 1C to accommodate capacity and pumping limitations to customers in that district.

32. Rate design considers many variables in addition to rate of return from classes of customers.

Conclusions of Law

1. Rule 12.1(d) provides that the Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

2. The July 23, 2015 Settlement Agreement and August 13, 2015 Supplemental Settlement are reasonable in light of the whole record, consistent with the law, and in the public interest.

3. SJWC's application should be granted to the extent provided in the following order.

4. SJWC should be authorized to file, by Tier 1 Advice Letter revised tariff schedules, and concurrently cancel its present schedule for such service. This filing should be subject to approval by the Commission's Division of Water and Audits. The effective date of the revised schedules should be five days after filing.

5. The surcharge to true-up the interim rates should comply with Standard Practice U-27-W.

6. SJWC should be granted an additional $159,300 for the School Water Education Program, to be booked into a one way balancing account with the unspent funds authorized in the last GRC.

7. Payroll expense for union employees should be increased 3 percent annually based on union contracts.

8. The 2015 payroll expense for non-union employees should be estimated using 2014 payroll expense data and increasing it by the ECOS labor factor of 1.6 percent.

9. The 2016 payroll expense for non-union employees should be estimated using 2.2 percent as an escalation factor.

10. The 2017 and 2018 payroll expense for non-union employees should be escalated using ECOS labor factor for those years.

11. SJWC should be authorized to add six new employees.

12. Overtime expense should be calculated using a three-year average to normalize high overtime years.

13. Regulatory expense should be $216,000 for Test Year 2016 and $600,000 for the three-year rate case cycle.

14. Corporate Expenses of $790,000 should be authorized for Test Year 2016.

15. SJWC's FICA tax estimate should be reduced by 24.17 percent and $589,000 should be added to utility plant additions to compensate for the loss of overhead.

O R D E R

IT IS ORDERED that:

1. San Jose Water Company is authorized to increase rates by amounts designed to increase revenue by $25,021,500 or 8.56 percent in Test Year 2016.

2. The joint motion of San Jose Water Company and the Office of Ratepayer Advocates to approve the July 24, 2015, Settlement Agreement is granted.

3. The joint motion of San Jose Water Company and the Office of Ratepayer Advocates to approve the August 13, 2015, Supplemental Settlement Agreement is granted.

4. San Jose Water Company is shall file a Tier 1 Advice Letter for a surcharge to true-up the difference between interim rates for the period January 1, 2016 to the implementation date of the tariffs included in this order. The surcharge must comply with Standard Practice U-27-W. This calculation will be based on the 2016 tariff schedules attached to this decision that would have been implemented under the present rate design. The difference between the interim and final rates based on the revenue requirement shall be recovered over the balance of the rate case cycle.

5. San Jose Water Company shall file by Tier 1 Advice Letter the revised tariff schedules for 2016 attached to this decision and to concurrently cancel its present schedules for such service. This filing shall be subject to approval by the Commission's Division of Water and Audits. The effective date of the revised schedule shall be no earlier than five days after the effective date of this decision, and shall apply only to service rendered on or after the effective date.

6. For escalation years 2017 and 2018, San Jose Water Company shall file Tier 2 Advice Letters in conformance with General Order 96-B proposing new revenue requirements and corresponding revised tariff schedules. The filing

shall include rate procedures set forth in the Commission's Rate Case Plan (Decision 07-05-062) for Class-A Water Utilities and shall include appropriate supporting workpapers. The revised tariff schedules shall take effect no earlier than January 1, 2017 and January 1, 2018, respectively and shall apply to service rendered on and after their effective dates. The proposed revisions to revenue requirements and rates shall be reviewed by the Commission's Division of Water and Audits. The Division of Water and Audits shall inform the Commission if it finds that the revised rates do not conform to the Rate Case Plan, this order, or other Commission decisions, and if so, reject the filing.

7. San Jose Water Company will compute its payroll expenses for union employees by using 2014 figures and escalating by 3 percent annually.

8. San Jose Water Company will use Energy Cost of Service escalation factors to compute payroll expenses for its non-union employees.

9. San Jose Water Company is authorized $159,300 for its School Education Program to be booked to a one way balancing account along with unspent funds authorized in the last General Rate Case.

10. San Jose Water Company is authorized to fund six new positions as specified in Section 4.3.2 of this decision.

11. San Jose Water Company is authorized an aggregate regulatory expense budget of $600,000, with $216,000 authorized for Test Year 2016.

12. San Jose Water Company is authorized a Test Year 2016 corporate expense budget of $790,000.

13. San Jose Water Company must reduce its Federal Insurance Contributions Act taxes estimate by 24.17 percent. San Jose Water Company is authorized to add $589,000 to its utility plant additions to compensate for the loss of overhead.

14. Application 15-01-002 is closed.

This order is effective today.

Dated ______________________________, at San Francisco, California.

ATTACHMENT A

LIST OF APPEARANCES

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(END OF ATTACHMENT A)