

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



FILED

5-23-16
04:59 PM

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 COMMENTS OF SAN JOSE WATER COMPANY
ON PROPOSED DECISION OF ALJ TSEN**

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May 23, 2016

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In accordance with Rule 14.3 of the Rules of Practice and Procedure (“Rules”) of the California Public Utilities Commission (the “Commission”), San Jose Water Company (U 168 W) (“SJWC”) hereby respectfully submits its reply comments on the Proposed Decision of Administrative Law Judge (“ALJ”) S. Pat Tsen, entitled, “Decision Approving Two Partial Settlements, Resolving Disputed Issues and Adopting Revenue Requirements for San Jose Water Company” (the “Proposed Decision” or “PD”), which bears a mailing date of April 22, 2016, but was made available to the parties by electronic mail on Monday, April 25, 2016. SJWC’s reply comments respond to the Comments of the Office of Ratepayer Advocates (“ORA”), filed May 16, 2016, and are timely filed.

ORA’s comments address two issues: (1) the Proposed Decision’s rejection of ORA’s proposal to require SJWC to establish two memorandum accounts to track certain income tax refunds that SJWC received in past years as a result of changes in federal income tax regulations and to pass such refunds on to ratepayers; and (2) the Proposed Decision’s use of a non-inflation-adjusted 3-year average, as proposed by SJWC, to estimate Test Year overtime labor expense, rather than the 5-year average proposed to be used by ORA. SJWC will reply to ORA’s contentions regarding both these issues.

I.

THE PROPOSED DECISION CORRECTLY REJECTS ORA’S PROPOSAL TO REQUIRE MEMORANDUM ACCOUNTS TO TRACK PREVIOUSLY ACCRUED TAX REFUNDS AS CONTRARY TO THE RULE AGAINST RETROACTIVE RATEMAKING.

As the Proposed Decision explains, in August 2013, the US Treasury Department and the Internal Revenue Service issued the final Tangible Property Regulation (“TPR”), which provides a framework to distinguish capital expenditures from supplies, repairs, maintenance, and other deductible business expenses. The TPR allows a catch-up deduction for prior years as well as annual repair deductions for future years. In filing its 2014 taxes in September 2015, SJWC included such catch-up deductions. SJWC also received in 2014 an Enterprise Zone (“EZ”) credit for sales or use tax paid or incurred in prior years in connection with the purchase of qualified property. See, PD, at 29-30.

ORA proposed to require SJWC to establish a pair of memorandum accounts to track the tax refunds and credits paid to SJWC pursuant to the TPR and the EZ credit, in order to pass the benefits on to ratepayers. SJWC objected that ORA’s proposed use of memo accounts to track and flow through past refunds would amount to unlawful retroactive ratemaking. PD, at 30-31. The Proposed Decision correctly declined to order the memo accounts proposed by ORA, noting that “to avoid retroactive ratemaking, the timeline for establishment of the memorandum account is essential.” The Proposed Decision observed that to track tax refunds and provide them to ratepayers, a memorandum account would have had to be established before SJWC filed its taxes and received the refunds but that, in the case at hand, ORA sought memorandum accounts “to track refunds that have already been received by SJWC.” PD, at 32-33.

ORA asserts that the Proposed Decision commits legal error by allowing SJWC “to retain TPR and EZ tax credits without affording its ratepayers any of the benefits.” ORA Comments, at 1. ORA claims SJWC will receive \$7.2 million in TPR refunds “instead of using those credits for depreciation for future ratepayer savings” and, with the \$880,000 EZ credit in 2014, received “a total tax windfall of approximately \$8.08 million, (excluding the impact of those deductions on future rates.)” *Id.* at 1-2.

ORA notes the Proposed Decision’s observation that utilities typically seek authority to establish memorandum accounts or raise rates when they experience or anticipate large

increases in costs, and that utilities “should be under the same obligation to notify the Commission” when they experience or anticipate a large reduction in revenue requirements due to tax changes. ORA Comments, at 3, citing PD, at 33. ORA claims “SJWC chose to ignore this obligation” and criticizes the Proposed Decision for “admonishing a utility to do something and then rewarding its non-compliance.” ORA Comments, at 3.

ORA quotes liberally from the discussion of a different set of tax expense issues and a different set of proposed remedies in D.15-11-021, a recent GRC decision for Southern California Edison Co. (“SCE”), and asks the Commission to apply the rationale of that decision to the present case. See, ORA Comments, at 3-7. In particular, ORA asserts that the Proposed Decision “shirks the Commission’s duty to use all means at its disposal to ensure that federal tax credits are passed on to ratepayers” and commits an abuse of discretion by having “considered ORA’s memorandum account solution as the only potential alternative to giving SJWC a tax windfall.” ORA Comments, at 4-5. In its comments on the PD, ORA for the first time proposes an alternative solution – requiring SJWC to normalize rather than flow through the state income tax effects of the changes in tangible property tax rules. ORA Comments, at 7-8.

ORA’s argument is outrageous, substituting rhetoric for analysis and ignoring the profound discrepancies between two very different fact situations. First of all, there is no evidence that the tax provisions and regulations at issue in the two cases are identical or even similar in their effects, nor is there evidence to support a comparison of the conduct of SCE and SJWC with respect to the relevant tax provisions in the context of their differently timed GRCs.¹ Most importantly, the recent SCE case considered a proposal on the record, submitted by The Utility Reform Network (“TURN”), which was the object of detailed examination of witnesses and detailed briefing, for a prospective rate base offset and a prospective adjustment to the utility’s allowance for income taxes. The Commission adopted a variant of that proposal and also required SCE to establish a prospective “two-way Tax Accounting memorandum Account to track all tax changes during this GRC period.” D.15-11-021, at 438, 453-55, 459-62, 532 (Finding of Fact 551), 549 (Conclusion of Law 142). In considering the TURN proposal and adopting its own variations on that proposal, the Commission carefully reviewed the same

¹ Even ORA, in an innuendo-laced phrase, acknowledges that “SCE appears to have adopted a slightly more nefarious strategy than SJWC.” ORA Comments, at 3.

California Supreme Court decisions establishing the rule against retroactive ratemaking that SJWC addressed in briefing the present issue in this GRC, and the Commission was careful to avoid any action that would retroactively disallow previously adopted allowances for income tax expense. D.15-11-021, at 438-45. The Commission expressly concluded that “[u]nlike [the] Pacific Telephone [case], the change has been discussed directly in the record of this proceeding to set prospective rates to be in force only after a hearing.” *Id.* at 549 (Conclusion of Law 136).

The present case is a very different one. SJWC has proposed normalization of the relevant tax benefits for federal income tax purposes and flow-through of those benefits for state income tax purposes. This has been standard practice for more than 30 years. In testimony and briefs, ORA proposed to require establishment of memo accounts to record the tax benefits accrued with respect to prior years and recognized on SJWC’s 2014 tax returns – a proposal that the Proposed Decision recognizes as crossing the line of illegality as retroactive ratemaking.

Now, despite the lack of any evidentiary support or any demonstration of its ratemaking effects, ORA opportunistically proposes to reverse a generation’s practice of flowing through depreciation-related tax benefits in calculating state income tax for ratemaking purposes. This last-minute proposal, lacking any foundation in the evidentiary record, must be rejected.

Likewise, it is only now, for the first time, that ORA accuses SJWC of ignoring an “obligation” to notify the Commission of tax changes, as noted in the Proposed Decision. ORA Comments, at 3. ORA never suggested, in its prepared testimony, at hearing, or on brief, that SJWC had violated any duty to notify the Commission of changes in IRS tax regulations. There is no record evidence to support such a claim, but only evidence that SJWC calculated state and federal income tax expenses consistently with established procedures. The Proposed Decision does not purport to impose such an “obligation,” but only to propose a concept for future application. That, unlike ORA’s approach, comports with the requirements of due process.

II.

ORA SUGGESTS NO LEGAL OR FACTUAL ERROR IN THE PROPOSED DECISION’S CHOICE OF AN UNADJUSTED 3-YEAR AVERAGE TO FORECAST OVERTIME EXPENSE.

ORA criticizes the Proposed Decision’s reliance on a 3-year non-inflation-adjusted base period to project overtime expense, while applying 5-year or 6-year averages for other

expense categories. ORA's assertion that the Proposed Decision does not explain why it adopts base periods of varying duration is incorrect. In fact, the Proposed Decision provides reasons for its choices in each instance to which ORA refers. See, PD, at 25-27.

There is no good reason to require a uniform base period for all expense categories. Contrary to ORA's claim, the Rate Case Plan *does not* so require. See, D.04-06-018, App. A, at 7. It is worth recalling the time-honored phrase: "A foolish consistency is the hobgoblin of little minds." R.W. Emerson, "Self-Reliance," in ESSAYS (1841).

III.

CONCLUSION

For the reasons stated above and in SJWC's opening comments, SJWC respectfully urges ALJ Tsen and the Commission to reject ORA's proposals for changes to the Proposed Decision as without merit, but instead to make changes and additions to the Proposed Decision in line with SJWC's opening comments and Appendix A thereto.

Respectfully submitted,

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Dated: May 23, 2016

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